Cabinet
10 March 2016

Treasury Management Strategy Statement and Annual Investment Strategy 2016/17

Cabinet Member: Councillor Peter Hare-Scott
Responsible Officer: Head of Finance, Andrew Jarrett

Reason for Report: To agree the proposed Treasury Management Strategy and Annual Investment Strategy for 2016/17.

RECOMMENDATION(S):

1. **That the proposed Treasury Management Strategy and the Annual Investment Strategy for 2016/17, including the prudential indicators for the next 3 years and the Minimum Revenue Provision Statement (Appendix 4), be approved;**

2. **That Members agree to making an increased investment in the CCLA see 15.5.**

Relationship to the Corporate Plan: Maximising our return from all associated treasury activities enables the Council to support current levels of spending in accordance with our Corporate Plan.

Financial Implications: Good financial management and administration underpins the entire strategy.

Legal Implications: Compliance with the Local Government Finance Act 1992 and the Local Government Act 2003 is a legal requirement.

Risk Assessment: The S151 Officer is responsible for the administration of the financial affairs of the Council. Implementing this strategy and the CIPFA Code of Practice on Treasury Management manages the risk associated with the Council's treasury management activity.

1.0 Introduction

1.1 This report updates Members on our overall Treasury performance during 2015/16 and then recommends a strategy for 2016/17. Clearly this strategy will place investment protection above the level of return.

2.0 Background

2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the

Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing needs of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion, any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 CIPFA defines treasury management as:

"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.0 Reporting requirements

3.1 The Council is required to receive and approve, as a minimum, three main reports each year which incorporate a variety of policies, estimates and actuals.

3.2 Prudential and treasury indicators and treasury strategy (this report)

The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

3.3 A mid-year treasury management report

This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury performance is meeting the strategy or whether any policies require revision.

3.4 An annual treasury report

This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3.5 Review

The above reports are required to be adequately challenged by the Cabinet.

4.0 Treasury Management Strategy for 2016/17

4.1 The strategy for 2016/17 covers two main areas:

Capital issues
- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management issues
- the current treasury position
- treasury indicators which limit the treasury risk and activities of the Council
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling
- the investment strategy
- policy on use of external service providers

Treasury management consultants

4.2 The Council uses Capita Asset Services (formerly Sector) as its external treasury management advisors.

4.3 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

4.4 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5.0 Treasury Limits for 2016/17 to 2018/19

The operational boundary

5.1 This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR (Capital Financing Requirement), but may be lower or higher depending on the levels of actual debt.

The authorised limit for external debt

5.2 A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the Cabinet. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

5.3 This is the statutory duty under Section 3 (1) of the Local Government Act 2003. The government retains an option to control either the total of all Council's plans, or those of a specific council, although this power has not yet been exercised.

5.4 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax levels and housing rent levels is "acceptable".

6.0 Current portfolio position

6.1 The Council's treasury portfolio position as at 23 Feb 2016 included short-term investments/bank deposits of £24.29m and property funds (see 6.2) to the value of £ 2.5m. The investments/bank deposits comprised:

	(£m)	
Bank Deposits		
Natwest	4.29	
	4.29	**17.66%**
Building Society Investments		
Coventry	3.00	
Nationwide	3.50	
	6.50	**26.76%**
External Bank Investments		
Lloyds	4.00	
Barclays	5.00	
Standard Chartered	1.50	
Sumitomo Mitsui*	1.00	
Santander	2.00	
	13.50	**55.58%**
Total	**24.29**	

* Sumitomo Mitsui Banking Corporation Europe Limited, founded in 2003 and based in London is a subsidiary of Sumitomo Mitsui Banking Corporation

6.2 At the Cabinet on 30 July 2015 it was agreed that the Council's investment strategy could be adjusted to include deposits with the CCLA (Churches, Charities and Local Authorities) commercial property fund, up to a value of £2.5m. As a result of this, an investment of £2.5m commenced from 1 September 2015. Dividends will be paid quarterly. It is estimated, given recent Fund performance, that returns of approximately 4.5% can be achieved.

6.3 Members should note that the £24.29m is not made up of fully available cash balances and relates to various aspects of the Council's operation:

	£m
General Fund Balance	2.4
Precept payments (DCC, Fire & Police Authorities)	3.9
General Fund Earmarked Reserve (s106s, New Homes Bonus, vehicle sinking funds, etc.)	7.0
Housing Revenue Account	2.0
Housing Revenue Account Earmarked reserves	6.7
Capital Reserves	1.0
Capital Grants Unapplied	1.4
	24.40

Notes:

1. Due to working capital and timing differences, the totals will not agree exactly.
2. We no longer have an overdraft facility with Natwest as we are asked for a fee of £2.5k for a £250k facility.

6.4 The £4.29m balance held with Natwest is our clearing account where any excess balances are held. At present, a return of 0.50% is gained on this account.

6.5 During 2015/16, an average rate of investment return of 0.74 % is estimated on short term investments, generating a sum of circa £140k for the Council. In addition we estimate to receive £18k on current account balances for the year, which will broadly be on budget, additionally dividends of £56k are estimated on our CCLA property fund investments.

6.6 No direct benchmarking against other Authorities is made, however our average return is assessed against the 7 day LIBID rate which is 0.36 % at the end of January.

6.7 The Council's forecast borrowing position, based on current loans, at year end, will include £41.2m HRA and £4.4m General Fund borrowing. All external borrowing has been undertaken with the Public Works Loans Board (PWLB) at fixed rates of interest.

	Loan Ref	Purpose	Amount Outstanding £k
GF	502059	Refuse Vehicles	175
	502905	Scarab Sweeper	74
	503319	Recycling Baler	134
	503849	Market Walk/Fore Street	4,053
		GF Total	**4,436**
HRA			
	500248	HRA Self Financing	41,220
		GRAND TOTAL	**45,656**

7.0 Borrowing Requirement

7.1 For 201/17 the Council will assess each capital project on a cost/benefit basis and should there be a borrowing requirement these proposals would be brought to Cabinet. Please see Appendix 2 for future years borrowing requirements.

7.2 As detailed in the 2012/13 Treasury Strategy, the Council accepted £46.59m in terms of its mortgage debt to purchase its existing housing stock. This debt was paid from a PWLB loan, which the authority has arranged to pay back over a 25 year period at a rate of 2.94% interest.

8.0 Prudential and Treasury Indicators for 2016/17 to 2018/19

8.1 The prudential indicators, attached at Appendix 2 to this report, are relevant for the purposes of setting an integrated Treasury Management Strategy.

8.2 The Council is also required to indicate if it has adopted and continues to comply with the CIPFA Code of Practice on Treasury Management. This was adopted on 7 January 2004 by Full Council and the revised code was adopted at the 11 March 2011 Cabinet.

9.0 Prospects for Interest Rates

9.1 The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

9.2 Capita Asset Services Bank Rate forecast remains unchanged at 0.50% until the end of Q3 2016/17 (see Appendix 3 for detailed forecasts).

10.0 Borrowing Strategy

10.1 The 2016/17 budget has been compiled on the basis that there may be some capital investment in 2016/17, principally concerning HRA house building.

10.2 The HRA mortgage debt of £46.59m was confirmed in early 2012. The Council took advice on counterparty options and optimal debt structuring. Central Government instructed the PWLB to offer a discounted borrowing rate (0.85% below its standard lending rate) which was clearly the best option for the Authority. The Council has undertaken a 25 year annuity. Interest rates will be monitored and will have consideration to the 30 year property maintenance requirements included in the HRA business plan.

11.0 Policy on borrowing in advance of need

11.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

12.0 Debt rescheduling

12.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

12.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

12.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

12.4 All rescheduling will be reported to the Cabinet at the earliest meeting following its action.

13.0 Municipal Bond Agency

13.1 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

14.0 Annual Investment Strategy

Investment Policy - changes to credit rating methodology

14.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

14.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

14.3 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

14.4 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

14.5 The borrowing of monies purely to invest or on-lend to make a return is unlawful and this Council will not engage in such activity.

14.6 At present the Council does not invest sums for periods longer than one year with the majority of deposits being made at fixed rates of interest, with the option to enter into variable interest rate deposits. This will include Certificates of Deposit (not exceeding 20% of our investment portfolio).

14.7 See Appendix 1 for the listing of current applicable counterparties.

15.0 Lending Criteria and Counterparty Limits

15.1 The Council's lending policy has evolved from investing with the Debt Management Office exclusively in 2009, to using most major UK Banks and Building Societies, subject to strict credit criteria for an investment duration no longer than one year, in 2012.

15.2 **Banks**: UK based and assessed on high level applicable short term Fitch ratings (F1,F1+) with consideration to negative reviews from Moody's and Standard & Poor's. A maximum of £5m funds held with any group, this includes the use of Certificates of Deposit which are more liquid than fixed term deposits.

15.3 **Building Societies**: UK based and assessed on Fitch short credit ratings of F1 and the organisation to have an asset base minimum of £1bn. The £5m counterparty limit also applies.

15.4 **Property Funds**: Investments with CCLA to a limit of £2.5m.

15.5 **Investment options:** This report recommends that the Council amends the available funds to invest with CCLA from £2.5m to £4m. At present the forecast return on our current property fund investments is 4.5% against an average return of 0.74% on our short term investments. On the basis of these rates, the additional revenue for the Council would equate to approximately £56k.

15.6 Other areas which will be explored are the following:

- Investment grade Corporate Bonds (these are bonds which have a relatively low risk of default, hence have high credit ratings).

15.7 There is no strong case to radically change the policy, however, going forward, a consideration of the option at 15.5, would augment the returns we get on our current policy.

15.8 In addition to these fixed term deposits, the Council also uses an instant access liquidity account with the National Westminster Bank (the Council's own banker) to sweep any small surplus funds which cannot be placed by our brokers. Again, this account is subject to the same £5m maximum deposit level.

15.9 The Council will also continue to lend to:

- Local Authorities, Police and Fire & Rescue Authorities
- DMOADF

15.10 None of the investments made to organisations stated in paragraph 15.9 will be constrained to a maximum deposit of £5m or term deposit limit due to the low level of attached risk.

15.11 In addition to these standard arrangements it should be noted that the Council currently has a slightly reduced lending portfolio based on circa £2.5m being lent between the GF and HRA. This will significantly reduce the counterparty failure risk which the GF is exposed to and increase the rate of return to the GF and reduce the interest rate cost to the HRA.

15.12 It should be noted that the Cabinet will receive a half yearly review of treasury performance which will include an update on where any surplus monies are invested and the rate of return generated on them. This could also include an amendment to the overall strategy if additional information or a change in the level of risk attached to any of the counterparties is forthcoming.

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Background Papers: Capita Briefing Papers – February 2016

Circulation of the Report: Cllr Peter Hare-Scott, Management Team