Item No: 3.2	Classification: Open	Date: 26 February 2014	Meeting Name: Council Assembly
Report title:		Treasury Management Strategy 2014/15 Including: Annual Investment Strategy, Prudential Indicators, and Minimum Revenue Provision Statement	
Wards or Groups affected:		All	
From:		Strategic Director of Finance and Corporate Services	

RECOMMENDATIONS

That council assembly:

1. Notes the treasury management strategy 2014/15 to be managed by the strategic director of finance and corporate services under financial delegation.

2. Notes the treasury management policy set out in paragraph 9 of this report

3. Agrees the annual investment strategy 2014/15 set out in paragraphs 13 to 23 of this report, with capital preservation a key objective, in line with government guidance on investments.

4. Agrees prudential indicators covering capital finance and treasury management for the years 2014/15 to 2016/17 referred to in paragraph 34 of this report and set out in Appendix B.

5. Agrees the minimum revenue provision statement, setting aside prudent sums to reduce debt, referred to in paragraphs 35 and 36 of this report and set out in Appendix C.

BACKGROUND INFORMATION

6. Each year the council assembly should agree a treasury management strategy to manage investments and debt. The strategy is supported by a series of prudential indicators and a policy on the minimum revenue provision (MRP) to repay debt arising from past capital expenditure. The requirement for these arise from the Local Government Act 2003, government guidance on investments and MRP, and supporting codes (Prudential Code for Capital Finance in Local Authorities, Treasury Management in the Public Services Code of Practice and Guidance) issued by the Chartered Institute of Public Finance and Accountancy (CIPFA).

7. Under financial delegation, the strategic director of finance and corporate services is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that he can carry out his responsibilities effectively.

8. As well as this annual strategy report, council assembly also receives a mid-year report and an annual outturn report. Quarterly updates are presented to

cabinet, and the audit and governance committee reviews and scrutinises treasury policies and strategy.

KEY ISSUES FOR CONSIDERATION

Treasury management policy

9. The council's treasury management policy, which was adopted by council assembly in 2010 is as follows:

> Treasury management is the management of the council'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.
>
> The council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities shall be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation and recognise that effective treasury management shall provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

10. The policy has been prepared in accordance with CIPFA's Treasury Management Code. Officers have reviewed the statement and are satisfied that it remains relevant and appropriate and that no amendments are required.

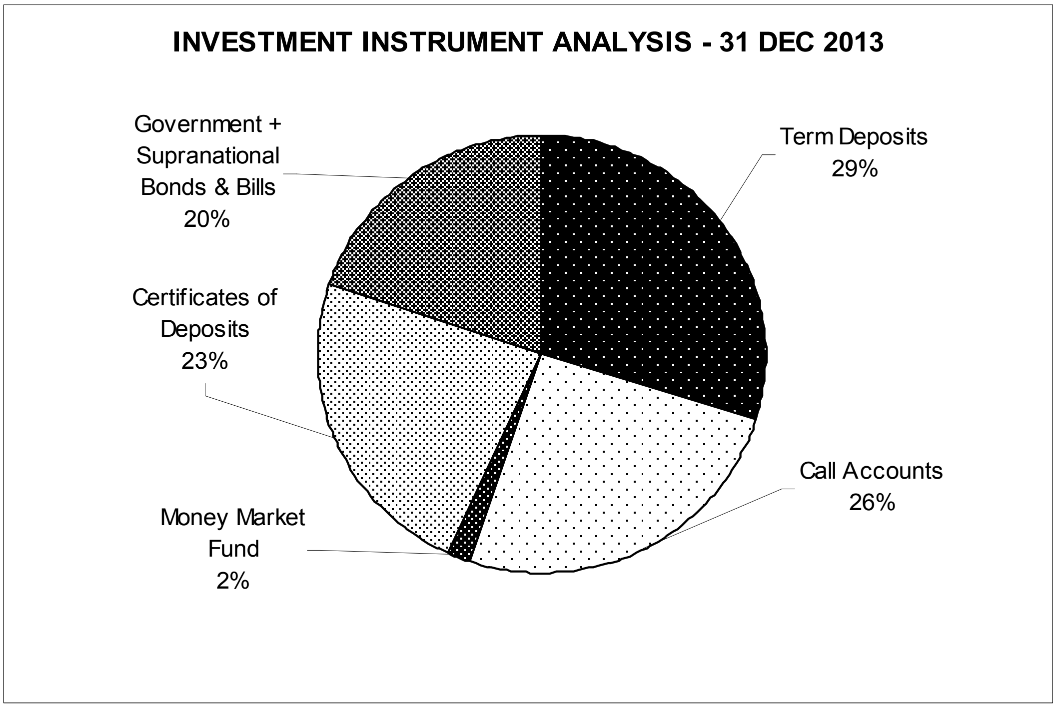
Investment Position and Strategy

Investment position

11. As at 31 December 2013, the cash balance held in investments was £233m and over the course of the nine months to December 2013 averaged £242m. The cash is invested prudently until it is needed in spending and the investment objectives are to preserve principal, provide liquidity and secure a reasonable return.

12. Investments are managed by an in-house operation and two fund managers (AllianceBernstein and Aberdeen Investment Managers). The in-house operation focuses on meeting day to day cash demands, while the fund managers invest in marketable short term money market instruments and high rated bonds within a risk controlled framework in accordance with the investment objectives. The investment position at 31 December 2013 is set out in the tables below.

INVESTMENT COUNTERPARTY AND RATINGS - 31 DEC 2013									
EXPOSURE	**FUND**				**Fitch Ratings**				
COUNTERPARTY	Aberdeen	Alliance Bernstein	In-House	Total	Long	Short	Sup-port	Sovereign	Sovereign Rating
	£m	£m	£m	£m					
Nordea Bank Finland	3.5	-	-	3.5	AA-	F1+	1	Finland	AAA
Credit Indust Et Comrcl	3.5	-	-	3.5	A+	F1	1	France	AA+
Socgen	-	1.0	-	1.0	A	F1	1	France	AA+
BNP Paribas	3.5	2.0	-	5.5	A+	F1	1	France	AA+
Deutsche Bank	-	3.0	-	3.0	A+	F1+	1	Germany	AAA
Global Treas Funds-Mmf	-	-	4.0	4.0		AAA		Global	
Rabobank	-	2.0	-	2.0	AA-	F1+	1	Netherlands	AAA
Ing Bank	3.4	2.0	10.0	15.4	A+	F1+	1	Netherlands	AAA
Abn Amro Bank	3.5	2.0	-	5.5	A+	F1+	1	Netherlands	AAA
Dnb Bank	3.5	-	-	3.5	A+	F1	1	Norway	AAA
European Inv Bank	7.0	6.5	-	13.5	AAA	F1+		Supranational	AAA
Int Bank Reconst Devt	3.5	6.3	-	9.8	AAA	F1+		Supranational	AAA
Svenska	3.3	-	15.1	18.4	AA-	F1+	1	Sweden	AAA
Skandinaviska	3.5	1.0	-	4.5	A+	F1	1	Sweden	AAA
Credit Suisse	3.5	2.1	-	5.6	A	F1	1	Switzerland	AAA
Nationwide Bsoc	3.3	-	10.0	13.3	A	F1	1	UK	AA+
Rbs/Natwest	-	-	62.9	62.9	A	F1	1	UK	AA+
Uk Treasury	-	22.4	-	22.4	AA+	F1+		UK	AA+
Barclays Bank	5.0	-	15.1	20.1	A	F1	1	UK	AA+
Lloyds Bank	-	-	15.1	15.1	A	F1	1	UK	AA+
Bny Mellon	0.5	0.1	-	0.6	AA-	F1+	1	US	AAA
Total £M	50.5	50.4	132.2	233.1					



Investment maturity profile and long term rating - 31 December 2013				
Year Band	A+ to A	AA+ to AA-	AAA	Total
	£m	£m	£m	£m
Up to 1 year	159.0	39.7	9.9	208.6
1-2 years			8.6	8.6
2-5 years		7.1	8.8	15.9
Total	159.0	46.8	27.3	233.1

Investment strategy

13. The council's investment objectives are to preserve principal, provide liquidity and secure a reasonable return. The current low risk approach will continue into 2014/15 and the investment strategy reflecting this draws on investment guidelines produced by the Department of Communities and Local Government (DCLG), which require security and liquidity to have priority. Technical details supporting the strategy are set out in Appendix A to this report.

14. The council holds cash in the normal course of its business and any cash not immediately used in spend should be invested until needed. Investments should be managed prudently and fall within two categories: specified investments and non-specified investments, as set out in government guidance. Specified investments are investments up to one year, as detailed below, with high liquidity and credit quality. Non-specified investments, as set out below, are investments that exceed one year and so potentially more responsive to liquidity, credit and market factors.

15. Prudent exposure to non-specified investments can help raise the level and sources of investment returns over the long term and may be considered, having regard to prevailing credit and market conditions. Investment exposure shall be diversified and be managed with due care and attention.

16. All investments should be denominated in GBP sterling, comply with credit standards and investment limits. Exposure to share capital that is treated as capital expenditure is outside the scope of this strategy.

17. The strategic director of finance and corporate services is responsible for this strategy and its management. Fund managers may be appointed to assist in advising or executing elements of the strategy. As at February 2014 the council's fund managers are: AllianceBernstein Ltd and Aberdeen Asset Managers Ltd.

18. Investment returns remain low, reflecting a prolonged period of very low policy rates (base rates) and ultra-loose monetary policies still in place to support the financial markets and stimulate growth both in the UK and abroad. Base rates in the UK have been at 0.50% since 2009 and the part year investment return for the first three quarters of 2013/14 was 0.40%.

19. In the interest of capital preservation, deposits are placed in large high rated banks or building societies, highly likely to be supported, in the unlikely event it were needed. Cash is also placed in short term money market instruments and bonds issued by the UK government or supranational banks supported by UK and other sovereigns.

20. Limits are placed on investment term in the interest of prudence. Exposure to longer investments remains low in view of continued market volatility and liquidity is assured by holding funds in call accounts, short term money market instruments and marketable bonds.

21. Following consideration by the audit and governance committee at its meeting on 12 November 2013, the credit characteristics of the strategy have been strengthened further with the inclusion of high rated covered bonds and quasi-sovereigns.

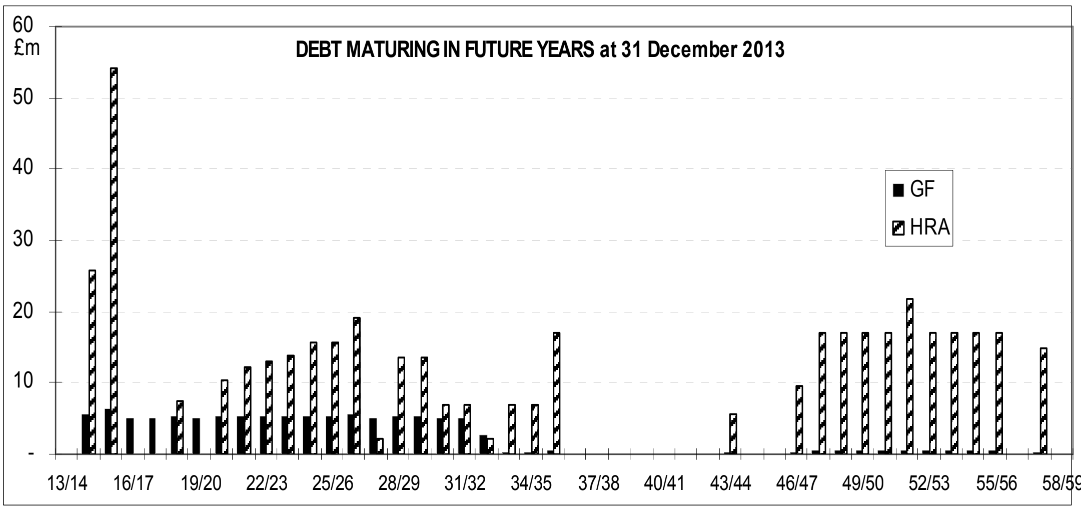
22. A covered bond is a form of secured lending, with dual recourse and in the unlikely event that a major high rated bank failed to meets its obligation, the covered bond holder (the council) has a priority claim over a regulated pool of assets (often in the form of mortgages) for added security. Unlike mortgage backed securities which were at the centre of the financial crisis and issued by stand alone special purpose vehicles, covered bonds are obligations of the issuing bank, which has a high rating in its own right and likely to be supported if needed. The inclusion of high rated covered bonds would raise credit quality, diversify exposure further, and help improve yield over the long term.

23. Quasi-sovereigns support a range of public policies and investments and include bodies in the UK and abroad. The entities are rated the same as or close to the rating of the sovereign in which they operate, reflecting the interest the state has in the entity and the high likely hood of support if it were needed. Network rail is an example of a quasi-UK sovereign. It owns UK rail infrastructure and its debt is guaranteed by the government. Exposure to quasi-sovereigns will strengthen credit quality, diversify exposure further and help improve yield.

Debt management position and strategy

Debt management position

24. The balance of loans outstanding at the end of December 2013 to fund past capital spend was £555m. All debt is from the Public Works Loans Board (PWLB) at fixed rates and following housing revenue account (HRA) self-financing reforms in 2012 was disaggregated between the HRA and the general fund. At 31 December 2013, the HRA loan balance stands £451m, unchanged since the introduction of self-financing. The remaining balance £104m falls on the general fund. So far this year £5m in general fund debt has been paid off from the minimum revenue provision set aside to repay debt. Sums due to mature in the future are set out in the chart below.



25. The average rate of interest on outstanding HRA debt is currently 6.56% reflecting the high historical rates when the loans were taken to finance spend. The general fund's average rate is lower at 3.57%, following refinancing carried out in 2012.

Debt management strategy

26. Despite the rates, debts remain affordable and risks arising contained. The level of historical debt is being pared down annually by the minimum revenue provisions in the case of the general fund and the HRA, under self financing, is also able to make provisions towards debt repayment. Furthermore, as re-financing rates are well below historical levels, maturing loans can be replaced with lower coupon loans, reducing financing costs further.

27. Debt management is also supported by prudential indicators, which include two statutory debt caps; the authorised limit on debt (determined by the council each year) and the limit on HRA indebtedness (determined by the government). The council is within both limits.

28. No new loans in 2014/15 are envisaged to fund the current programme. However, the general fund has some £5.7m due for repayment in 2014/15 and, as with 2013/14, can be met from the minimum revenue provision.

29. The HRA also has some £25.8m maturing in 2014/15 and capacity to set aside sums for debt repayment. The £25.8m maturing debt is being paid off in the final quarter of 2013/14 and will give flexibility to apply HRA set aside from 2013/14 onwards. A further £54.3m in HRA loans are due to mature in 2015/16 and these will be replaced with new loans repayable in instalments or paid off, depending on HRA requirements and financing conditions. The repayments may be funded out of existing HRA set aside capacity out of revenues, balances or reserves.

30. The principal source of long term funding is the PWLB where loans can be at fixed or variable rates that fluctuate with short term rates. Short term funds may also be available from wholesale markets. There is also a push by the Local Government Association (LGA) to develop a municipal bond agency as an alternative to the PWLB but an operational agency is still some way off, and is discussed further at paragraph 31.

31. As well as funding from loans, capital spend has also been funded from internal borrowing, as it is cheaper than external loans. The balance funded internally stands at £190m at December 2013 and, as with external loans, it too is paid off by setting aside a minimum revenue provision. The internal borrowing was raised following the acquisition of the council headquarters at 160 Tooley Street and can be replaced with external loans should it prove attractive to do so in the future.

Municipal Bond Agency

32. The Local Government Association's (LGA) case for a municipal bond agency was first proposed

33. in 2012 and at the time its was envisaged that the agency would be able to lend to councils at rates below those offered by the PWLB. However since then, the PWLB has lowered the margin that it requires over gilts from 1.00% to 0.80% for all councils under its certainty rate tier and to 0.60% for councils outside London borrowing for certain capital schemes developed with their Local Enterprise Partnerships. The LGA has recognised that PWLB changes raised competitive challenges to the original business case and is now working to draw up a new business case.

Prudential indicators

34. Local authority borrowing, investment and capital finance activity is supported by the Prudential Code for Capital Finance and the Treasury Management in the Public Services Code of Practice and Guidance published by the Chartered institute of Public Finance and Accountancy and backed by the Local Government Act 2003. The codes introduced a series of indicators and limits, which the council assembly should determine annually. The indicators needing approval relate to 2014/15 to 2016/17 and are set out at appendix B. The indicators are of a technical nature and include a self imposed authorised limit on debt which the council assembly must determine each year. Approval will ensure that the council meets its obligations under the 2003 Act and that the strategic director of finance and corporate services can carry out his financial responsibilities in this area. The indicators do not affect existing budgets. The indicators will be updated over the course of 2014/15 to reflect activity.

Minimum revenue provision statement

35. The council is required under statutory guidance to produce an annual statement on minimum sums to be set aside from revenue to reduce debt and long term liabilities taken to fund capital spend.

36. The minimum revenue provision statement recommended for approval by council assembly is set out at Appendix C. The statement will apply from 2013/14 and updates the existing statement for sums set aside in respect of capital spend anticipated to be funded from capital receipts, but which is temporarily funded from borrowing, and set aside in respect of HRA financing liabilities, which for the first time under self-financing is now affordable within HRA's own resources.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Legal Services

37. The constitution determines that agreeing the treasury management strategy is a function of the council assembly and that review and scrutiny of strategies and policies is the responsibility of the audit and governance committee.

38. Financial standing orders require the strategic director of finance and corporate services to set out the treasury management strategy for consideration and decision by council assembly, and report on activity on a quarterly basis to cabinet and at mid and year-end to council assembly. Furthermore all executive and operational decisions are delegated to the strategic director of finance and corporate services.

39. The Local Government Act 2003 and supporting regulations require local authorities to determine annual borrowing limits and have regard to the Prudential Code for Capital Finance, and the Treasury Management in the Public Services Code of Practice and Guidance, published by the Chartered Institute of Public Finance and Accountancy, when considering borrowing and investment strategies, determining or changing borrowing limits or prudential indicators.

40. Section 15(1) of the 2003 Act requires a local authority "to have regard (a) to such guidance as the Secretary of State may issue". This guidance is

found in the Department of Communities and Local Government Guidance on Local Authority Investments updated March 2010 and there is statutory guidance on the Minimum Revenue Provision (MRP) produced under amendments made to section 21(1A) of the 2003 Act by section 238(2) of the Local Government and the Public Involvement in Health Act 2007.

41. Members are advised to give approval to the recommendations contained in paragraphs 1 to 5 of this report, ensuring continuing compliance with Government guidance and CIPFA's codes.

BACKGROUND DOCUMENTS

Background Papers	Held at	Contact
None		

APPENDICES

No.	Title
Appendix A	Technical details in respect of the annual investment management strategy 2014/15
Appendix B	Prudential indicators - recommended for approval
Appendix C	Annual minimum revenue provision statement

AUDIT TRAIL

Lead Officer	Jennifer Seeley, Deputy Finance Director	
Report Author	Carl Rushbridge, Departmental Finance Manager, Central and Corporate Services	
Version	Final	
Version Date	11 February 2014	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Legal Services	Yes	Yes
Strategic Director of Finance and Corporate Services	N/a	N/a
Cabinet Member	Yes	Yes
Final Report Sent to Constitutional Team		13 February 2014