| Item No: 3.2 | Classification: Open | Date: 24 February 2016 | Meeting Name: Council Assembly |
|---|---|---|---|
| **Report title:** | | Treasury Management Strategy 2016/17 Including: Annual Investment Strategy, Prudential Indicators, and Minimum Revenue Provision Statement | |
| **Wards or Groups affected:** | | All | |
| **From:** | | Strategic Director of Finance and Governance | |

**RECOMMENDATIONS**

That council assembly:

1. Notes the 2016/17 treasury management strategy which is to be managed by the strategic director of finance and governance under financial delegation.

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

3. Agrees the annual investment strategy 2016/17 referred to in paragraphs 15 to 16 of this report and set out at Appendix A.

4. Agrees the prudential indicators covering capital finance and treasury management for the years 2016/17 to 2018/19 referred to in paragraph 27 of this report and set out at Appendix B.

5. Agrees the updated minimum revenue provision statement, setting aside prudent sums to reduce debt and long term liabilities referred to in paragraphs 28 to 30 of this report and set out at 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 capital expenditure. This requirement arises 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 governance 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. Under the council's constitution and in compliance with the CIPFA codes, three reports are received by council assembly each year: this annual strategy report, a mid-year report and an annual outturn report. Regular

updates are presented to cabinet, and the audit and governance committee reviews and scrutinises treasury policies and strategy annually.

## 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 in the Public Services Code. It remains appropriate and no amendments are required.

### Investment Position and Strategy

Investment position

11. As at 31 December 2015, the cash held in investments was £198m and over the year to December 2015 averaged £248m. The cash is invested prudently until it is needed.

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 money market instruments and high rated bonds within a risk controlled framework.

13. In December 2015 the sum managed by the fund managers was reduced by £10m to meet normal cash demands in the final quarter of the financial year. Further cash will be withdrawn if necessary. The investment position at 31 December 2015 is set out in the table below.

| INVESTMENT COUNTERPARTY AND RATING AT 31 DECEMBER 2015 | | | | | | |
|---|---|---|---|---|---|---|
| TYPE/ COUNTRY | COUNTERPARTY | RATING | ABERDEEN | ALLIANCE BERNSTEIN | IN-HOUSE | TOTAL £m |
| ***GOVERNMENT & SUPRANATIONAL BONDS*** | | | | | | |
| CANADA | EXPORT DEVT CANADA | AAA | - | 1.5 | - | 1.5 |
| NETHERLANDS | BNG-BANK NEDERLAND GEMENT | AA+ | - | 0.4 | - | 0.4 |
| | NWB-NEDERLAND WATERBK | AAA | - | 1.5 | - | 1.5 |
| SUPRANATIONAL | EUROPEAN INV BANK | AAA | 7.0 | 3.4 | - | 10.4 |
| | INT BANK RECONST DEVT | AAA | - | 6.8 | - | 6.8 |
| UK | UK TREASURY | AA+ | - | 8.8 | - | 8.8 |
| ***Subtotal Government & Supranational Bonds*** | | | ***7.0*** | ***22.4*** | ***-*** | ***29.4*** |
| ***BANK COVERED BONDS*** | | | | | | |
| AUSTRALIA | ANZ BANKING CORP | AAA | - | 2.3 | - | 2.3 |
| | COMMONW BANK AUSTRALIA | AAA | - | 2.3 | - | 2.3 |
| | NATIONAL AUSTRALIA | AAA | 3.5 | 1.5 | - | 5.0 |
| CANADA | BANK OF MONTREAL | AAA | - | 1.5 | - | 1.5 |
| | BANK OF NOVA SCOTIA | AAA | - | 2.3 | - | 2.3 |
| | CANADIAN IMP BK | AAA | - | 1.9 | - | 1.9 |
| | ROYAL BANK CANADA | AAA | 3.5 | 2.3 | - | 5.8 |
| | TORONTO DOMINION | AAA | - | 2.3 | - | 2.3 |
| DENMARK | DANSKE BANK | AAA | - | 1.5 | - | 1.5 |
| FINLAND | NORDEA EIENDOMSKREDIT | AAA | - | 2.3 | - | 2.3 |
| SWEDEN | SKANDINAVISKA | AAA | - | 2.3 | - | 2.3 |
| | SVENSKA STADSHYPOTEK | AAA | - | 2.3 | - | 2.3 |
| | SWEDBANK | AAA | - | 2.3 | - | 2.3 |
| UK | BARCLAYS BANK | AAA | - | 0.8 | - | 0.8 |
| | LLOYDS BANK | AAA | - | 2.3 | - | 2.3 |
| | NATIONWIDE BSOC | AAA | - | 0.8 | - | 0.8 |
| | SANTANDER UK | AAA | - | 2.3 | - | 2.3 |
| ***Subtotal Bank Covered Bonds*** | | | ***7.0*** | ***33.3*** | ***-*** | ***40.3*** |
| ***BANK SENIOR MONEY MARKET SECURITIES*** | | | | | | |
| AUSTRALIA | COMMONW BANK AUSTRALIA | AA- | 5.0 | - | - | 5.0 |
| CANADA | CANADIAN IMP BK | AA- | 3.5 | - | - | 3.5 |
| | TORONTO DOMINION | AA- | 5.0 | - | - | 5.0 |
| FINLAND | NORDEA BANK FINLAND | AA- | 6.5 | - | - | 6.5 |
| FRANCE | BANQUE NATIONAL DE PARIS | A+ | 0.4 | 3.5 | 10.0 | 13.9 |
| | SOCGEN | A | 5.0 | - | - | 5.0 |
| GLOBAL | BLACKROCK MMF | Money Fund | - | - | 12.1 | 12.1 |
| | GOLDMAN SACHS MMF | Money Fund | - | - | 12.8 | 12.8 |
| NETHERLANDS | ABN AMRO BANK | A | 5.0 | - | - | 5.0 |
| | ING BANK | A | - | 1.1 | - | 1.1 |
| | RABOBANK | AA- | 1.0 | - | - | 1.0 |
| SWEDEN | SVENSKA | AA- | 3.5 | - | - | 3.5 |
| SWITZERLAND | CREDIT SUISSE | A | 2.7 | 1.0 | - | 3.7 |
| UK | HSBC | AA- | - | 1.3 | - | 1.3 |
| | LLOYDS BANK | A+ | 7.0 | - | 10.0 | 17.0 |
| | NATIONWIDE BSOC | A | - | 1.5 | 10.0 | 11.5 |
| | STANDARD CHARTERED | AA- | 6.0 | - | - | 6.0 |
| US | BNY MELLON | AA | 4.6 | 2.4 | - | 7.0 |
| | CITIBANK | A+ | 7.0 | - | - | 7.0 |
| ***Subtotal Bank Senior Money Market Securities*** | | | ***62.2*** | ***10.8*** | ***54.9*** | ***127.9*** |
| **GRAND TOTAL £m** | | | **76.20** | **66.50** | **54.90** | **197.60** |
| Fitch long term ratings or equivalent; Money Funds rated AAA short term | | | | | | |

| Rating | Definition |
|---|---|
| AAA | Highest credit quality |
| AA+/AA/AA- | Very high credit quality |
| A+/A/A- | High credit quality |
| F1+/F1 | Highest short term credit quality; strongest capacity for timely payment |

14. 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 here in the UK and abroad. Base rates in the UK have been at 0.50% since 2009 and no rise is expected until well into 2016. The part year investment return for the nine months to December 2015 was 0.70%.

Investment strategy

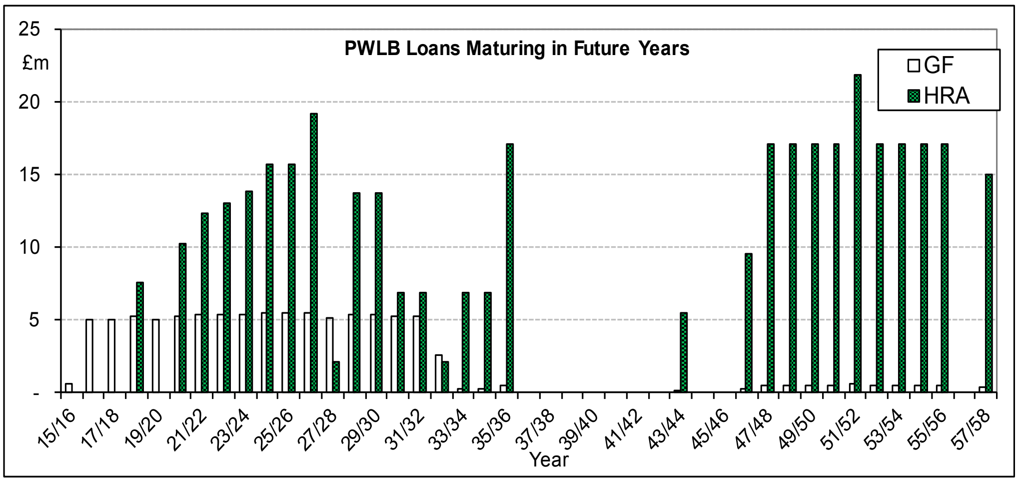
15. The council's investment objectives are to preserve principal, provide liquidity and secure a reasonable return. This is in line with investment guidance produced by the Department of Communities and Local Government (DCLG), which also requires that the council assembly approve investment strategy annually.

16. The 2016/17 investment strategy requiring approval is attached at Appendix A. The strategy prudently diversifies exposure across major high rated banks, provides access to high rated sovereigns, quasi-sovereigns, covered bonds and contains exposure to market volatility. Updates were added to the 2015/16 strategy in February 2015 following an independent review, which also confirmed that with credit spreads tight and term premium low, the scope for enhancing yield safely is limited. As now, fund managers will help execute the strategy as much as is needed.

**Debt Management Position and Strategy**

Debt management position

17. The council has loans to pay for capital expenditure in previous years. The loans are from the Public Works Loans Board (PWLB, part of HM Treasury) and the balance in loans at 1 April 2015 was £469m (£371m HRA and £98m general fund). In the year to December 2015, £6m general fund loans matured and were repaid. The years in which the remaining loans fall for repayment is set out in the chart below.




18. All loans are at fixed rates. Many loans were taken on in the 1980's and 1990's when high capital financing requirement coincided with inflation and interest rates much higher than now. The average rate of interest on PWLB loans is currently running at 5.5% (6.0% HRA and 3.5% GF).

19. As well as PWLB loans, the council also has internal borrowing to support previous years' capital expenditure. The sum outstanding in internal

borrowing at 1 April 2015 was £209m (£25m HRA and £184m GF). Internal borrowing is temporary drawing of internal balances pending replacement with loans. Both PWLB loans and internal borrowing are being paid off. The general fund debt is being paid off as it matures by way of the minimum revenue provision (MRP) in accordance with the council's MRP policy as required by government guidance. The MRP policy itself is discussed further below. The HRA is also prudently paying off debt, lowering the interest draw and raising the headroom for new investment.

Debt management strategy

20. The council's capital programme is expanding and this year the HRA capital programme is expecting to draw on debt finance to secure investment in new housing, making existing properties warm dry and safe, and provide quality kitchens and bathrooms. Initially, up to £98m debt finance has been available for the programme. The amount actually required will be determined once the use of HRA reserves, capital receipts and grants and contributions is maximised. However, it would not involve the council taking any new loans, but instead be advanced to the HRA by drawing on existing PWLB debt held by the general fund at an average rate of 3.5%, close to historical lows and well below the 6.0% rate on existing HRA loans. This ensures the council, as a whole, does not suffer a significant financial loss by borrowing money before it is actually needed.

21. The degree to which HRA can rely on debt finance to support its capital programme is constrained by its indebtedness cap. The cap was introduced by the government in 2012 as part of HRA self-financing and for Southwark was fixed at £577m, a level judged serviceable from council rents. The government at the time wanted housing authorities to support its priority of bringing public spending down and contain growth in public borrowing from rent income. Should the HRA draw on the whole £98m debt finance, its indebtedness would rise but still remain well within the £577m indebtedness cap.

22. In 2016/17, £5m general fund debt matures and as in the current year the council is setting aside prudent sums to reduce financing liabilities by way of the minimum revenue provision and would not need to take on new funds to settle the maturing obligation. The council is also continuing to set-aside sums to reduce the HRA's financing liabilities and at the same time raise headroom for further capital investment as it becomes affordable.

23. Internal borrowing remains cheaper than loans from outside bodies (such as the PWLB or capital markets) and improves affordability of capital finance costs. The council expects to continue making use of such borrowing as resources permit but at the same time remains open to taking on loans to replace internal borrowing and manage exposure to interest rate volatility including that which may arise from uncertainty in the run-up to UK's referendum on EU membership promised by the Prime Minister David Cameron by the end of 2017. New loans may also be taken to fund capital expenditure where affordable or to prudently manage re-financing risks.

24. The council's debt is 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). These are discussed further at Appendix B.

25. Following the announcement of plans to transfer the lending functions carried out by the PWLB to another agency, the government has introduced provisions in the Infrastructure Act to enable it to abolish the PWLB. However, existing arrangements remain in place and any change would be subject to a consultation document yet to be published. The reform is directed at governance arrangements (i.e. the machinery of government) and no change to policy on lending to local authorities is expected. The PWLB is the dominant source of local authority borrowing and the council is watching developments with interest.

26. The municipal bond agency (Local Capital Finance Company) is an alternative to the PWLB. Some 60 councils have joined the Local Government Association (LGA) as investors in the agency. Southwark's own contribution is £200,000. The agency has been formally assessed by two ratings agencies and is ready to issue its first bond. It aims to lend at a lower rate than the PWLB by requiring borrowers to provide a joint and several guarantee, issuing in marketable size, and sourcing funds at low rates, such as from the European Investment Bank. However the agency also faces competitive pressure from other capital market participants who are interested in lending long term funds to local authorities. The council can consider loans from any source and any it takes will be from the cheapest source, bearing in mind loan covenants and flexibility.

**Prudential Indicators**

27. 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, backed by the Local Government Act 2003. The codes introduced a series of indicators and limits, which the council assembly should agree annually. The indicators needing approval relate to 2016/17 to 2018/19 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 governance can carry out his financial responsibilities in this area. The indicators do not affect existing budgets and will be updated over the course of 2016/17 to reflect activity.

**Minimum Revenue Provision Statement**

28. Government guidance on the minimum revenue provision (MRP) requires that the general fund set aside prudent sums to reduce debt and long term liabilities (such as PFI schemes) arising from capital spend and that the council produce a statement on its MRP policy. MRP costs fall on revenue budgets and run for many years into the future, usually over the period over which the expenditure provides benefit or the period over which the revenue grant supporting the expenditure runs for.

29. As government spending cuts continue to bear down on local authority finances and challenge the sector's capacity to meets its MRP obligations, councils are looking at how they may continue to make prudent MRP payments and at the same time improve affordability. A council may not change the total MRP it is liable for but may prudently modify the timing of payments to improve affordability and take account of individual spend and financing characteristics.

30. Southwark too is looking to improve MRP affordability amid funding cuts and updating its minimum revenue provision statement. The updated statement recommended for approval is set out at Appendix C. It replaces the existing MRP statement and will apply from 2015/16 and onwards. The updates improve the council's capacity to continue making prudent MRP provisions in the future as government funding losses become even more acute and demands on revenue and capital finance become more challenging. The council's auditors usually review MRP as part of their annual audit and the strategic director of finance and governance will consider comments they may wish to make.

**SUPPLEMENTAL ADVICE FROM OTHER OFFICERS**

**Director of Law and Democracy**

31. 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.

32. Financial standing orders require the strategic director of finance and governance 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 governance.

33. 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.

34. 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.

35. Members are advised to give approval to the recommendations, ensuring continuing compliance with Government guidance and CIPFA's codes.

**BACKGROUND DOCUMENTS**

| Background Papers | Held at | Contact |
|---|---|---|
| None | | |

**APPENDICES**

| No. | Title |
|---|---|
| Appendix A | Annual Investment Management Strategy 2016/17 |
| Appendix B | Prudential Indicators - Recommended for Approval |
| Appendix C | Annual Minimum Revenue Provision Statement |

**AUDIT TRAIL**

<table>
<tr><th>Lead Officer</th><td colspan="2">Jennifer Seeley, Finance Director</td></tr>
<tr><th>Report Author</th><td colspan="2">Fay Hammond, Departmental Finance Manager, Corporate and Central Services</td></tr>
<tr><th>Version</th><td colspan="2">Final</td></tr>
<tr><th>Version Date</th><td colspan="2">25 January 2016</td></tr>
<tr><th>Key Decision</th><td colspan="2">Yes</td></tr>
<tr><th colspan="3">CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER</th></tr>
<tr><th>Officer Title</th><th>Comments Sought</th><th>Comments Included</th></tr>
<tr><td>Director of Law and Democracy</td><td>Yes</td><td>Yes</td></tr>
<tr><td>Strategic Director of Finance and Governance</td><td>N/A</td><td>N/A</td></tr>
<tr><td>Cabinet Member</td><td>Yes</td><td>Yes</td></tr>
<tr><th colspan="2">Final Report Sent to Constitutional Team</th><td>11 February 2016</td></tr>
</table>