Item No: 2.2	Classification: Open	Date: 22 February 2017	Meeting Name: Council Assembly
Report title:		Treasury Management Strategy 2017-18 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. Agrees the 2017-18 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 2017-18 referred to in paragraphs 22 to 23 of this report and set out at Appendix A.

4. Agrees the prudential indicators covering capital finance and treasury management for the years 2017-18 to 2019-20 referred to in paragraph 36 of this report and set out at Appendix B.

5. Agrees the minimum revenue provision statement, setting aside prudent sums to reduce debt and long term liabilities referred to in paragraphs 37 to 41 of this report and set out at Appendix C.

BACKGROUND INFORMATION

6. Each year the council assembly is asked to 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 constitution and in compliance with the CIPFA codes, three reports are presented to council assembly: this annual strategy report, a mid-year report and an annual outturn report. Regular updates are presented to

cabinet, and the audit, governance and standards 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 proposed.

Investment position and strategy

Investment position

11. The council holds its cash in money market instruments diversified across major banks, building societies, and bonds issued by the UK government and supranational entities. Cash funds represent income received in advance of expenditure plus balances and reserves. The investment priorities are capital preservation and liquidity. These investments are managed by an in-house operation and two investment firms: Aberdeen Asset Managers and AllianceBernstein. Investments are rated in the following way by Fitch, Moody's and Standard and Poor's:

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 (+donates exceptionally strong credit feature)

12. The sum invested between 1 April 2016 and 30 November 2016 averaged £191m (£238m average 2015-16) and the balance at 30 November 2016 was £175m. The reducing cash balances reflects a number of factors, in particular the use of reserves to support both capital and revenue spending and reduced government funding.

13. The average return over the quarter was 0.60%. At its meeting in August, the Monetary Policy Committee cut the Bank Rate to 0.25% from 0.5% and introduced a Term Funding Scheme. Prior to this rates had been held at 0.50% since 2009. Reducing cash balances and 'lower for longer' interest rates mean that investment returns will be lower than that earned in recent years.

14. The council's investment maturity profile as at 30 November 2016 is shown below:

INVESTMENT MATURITY PROFILE AND RATING - 30 NOVEMBER 2016				
Yr Band	**A**	**AA**	**AAA**	**Total**
Up to 1 Year	33%	28%	26%	**86%**
1 - 2 years	1%	5%	1%	**7%**
2 - 5 years	0%	2%	5%	**7%**
Total	**34%**	**35%**	**32%**	**100%**

15. As at the end of November 2016, the sum managed by the fund managers was £71.8m each with in house funds held of £31.0m; the investment position is set out in the table below.

INVESTMENT COUNTERPARTY AND RATING AT 30 NOVEMBER 2016								
		CREDIT RATING			FUND			
Couterparty	Country Of Origin	Sovereign Rating	Long-term	Short term	Aberdeen £m	Alliance £m	In house £m	Grand Total £m
AUSTRALIA & NEW ZEALAND BANKING GROUP LT	AUSTRALIA	AAA	AA-	F1+		1.4	-	1.4
ABN AMRO BANK	NETHERLANDS	AAA	A	F1	3.3	1.1	-	4.4
BANK NEDERLANDSE GEMEENTEN NV	NETHERLANDS	AAA	AAA			0.7	-	0.7
BANK OF AMERICA	UNITED STATES	AAA	A+	F1+			-	-
BANK OF MONTREAL	CANADA	AAA	AA-	F1+	4.0	2.2	-	6.2
BANK OF NOVA SCOTIA	CANADA	AAA	AA-	F1+	2.0	2.2	-	4.2
BARCLAYS BANK PLC	GREAT BRITAIN	AA+	A	F1	1.5	2.2	-	3.7
BNP PARIBAS	FRANCE	AA	A	F1			-	-
CAISSE D'AMORTISSEMENT DE LA D	FRANCE	AA	A			1.4	-	1.4
CANADIAN IMPERIAL BANK	CANADA	AAA	AA-	F1+	2.0	2.2	-	4.2
COMMONWEALTH BANK OF AUSTRALIA	AUSTRALIA	AAA	AA-	F1+	3.0	2.1	-	5.1
CREDIT AGRICOLE CORP & INVST BANK	FRANCE	AA	A	F1	5.0	2.3	-	7.3
CREDIT SUISSE AG/LONDON	SWITZERLAND	AAA	A	F1	4.0		-	4.0
DANSKE BANK A/S	DENMARK	AAA	A	F1	3.0	2.2	-	5.2
EUROPEAN INVESTMENT BANK	SUPRANATIONAL	AAA	AAA	F1+	4.8	2.9	-	7.7
EXPORT DEVELOPMENT CANADA	CANADA	AAA	AAA			1.4	-	1.4
FMS WERTMANAGEMENT AOER	GERMANY	AAA	AAA	F1+		2.9	-	2.9
GLOBAL TREAS FUNDS - MMF	GLOBAL	AAA	AAA				15.6	15.6
ING BANK NV	NETHERLANDS	AAA	A+	F1		2.1	-	2.1
INTERNATIONAL BANK FOR RECON & DEV	SUPRANATIONAL	AAA	AAA	F1+		2.9	-	2.9
INTERNATIONAL SECURITY FUND - MMF	GLOBAL	AAA	AAA				15.4	15.4
JPMORGAN CHASE & CO	UNITED STATES	AAA	AA-	F1+		2.1	-	2.1
KBC Bank	BELGIUM	AA	A-	F1	5.0			5.0
KFW	GERMANY	AAA	AA+	F1+		2.8	-	2.8
LLOYDS TSB BANK PLC	GREAT BRITAIN	AA	A+	F1	4.0	2.1	-	6.1
NATIONAL AUSTRALIA BANK LTD	AUSTRALIA	AAA	AA-	F1+	1.0		-	1.0
NATIONWIDE BUILDING SOCIETY	GREAT BRITAIN	AA	A	F1		2.1	-	2.1
NETWORK RAIL INFRASTRUCTURE	GREAT BRITAIN	AA	AA+	F1+		1.0		1.0
NORDEA EIENDOMSKREDITT AS	NORWAY	AAA	AA-	F1+		2.2	-	2.2
RABOBANK LONDON	GREAT BRITAIN	AA	AAA			1.8	-	1.8
ROYAL BANK OF CANADA	CANADA	AAA	AA	F1+	5.3	2.1	-	7.4
SANTANDER UK PLC	GREAT BRITAIN	AA	A	F1	2.3	2.1	-	4.4
SKANDINAVISKA ENSKILDA BANKEN AB	SWEDEN	AAA	AAA		2.3	2.2	-	4.5
SOCIETE GENERALE	FRANCE	AA	A	F1	4.5	2.3	-	6.8
STANDARD CHARTERED BANK	GREAT BRITAIN	AA	A+	F1	3.0		-	3.0
SWEDBANK HYPOTEK AB	SWEDEN	AAA	AAA			2.1	-	2.1
SVENSKA HANDELSBANKEN	SWEDEN	AAA	AA	F1+	5.0		-	5.0
TORONTO-DOMINION BANK	CANADA	AAA	AA-	F1+		2.2	-	2.2
UBS LONDON	SWITZERLAND	AAA	A	F1	3.5		-	3.5
UNITED KINGDOM I/L	GREAT BRITAIN	AA	AA+	F1+		4.0	-	4.0
UNITED KINGDOM TBILLS	GREAT BRITAIN	AA	AA+	F1+	2.3	8.5	-	10.8
WELLS FARGO BANK	UNITED STATES	AAA	AA	F1+			-	-
WESTPAC BANKING CORP	AUSTRALIA	AAA	AA-	F1+	1.0		-	1.0
Grand Total					**71.8**	**71.8**	**31.0**	**174.6**

16. 2016-17 year to date £5m in Public Works Loan Board (PWLB) loans matured and were paid off. No new loans were taken and the debt balance outstanding at 30 November 2016 was £458m. Affordability and the "cost of carry" remain important influences on the council's borrowing strategy.

17. The ratings are as follows:

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

18. In the lead up to, and following the result of the EU referendum there has been reassurance that the Bank of England was ready to support money market liquidity. Various indicators of credit risk reacted negatively to the result of the referendum on the UK's membership of the European Union. UK bank credit default swaps saw a modest rise but bank share prices fell sharply, on average by 20%, with UK-focused banks experiencing the largest falls.

19. Fitch downgraded the UK's sovereign rating by one notch to AA from AA+, and Standard & Poor's downgraded its corresponding rating by two notches to AA from AAA. Fitch, S&P and Moody's have a negative outlook on the UK.

20. Following the UK vote to leave the EU, Moody's changed the outlook on 12 UK banks and building societies. At the same time, the rating agency has changed the outlook on the UK banking system to negative from stable. The actions follow the recent change in the outlook of the UK's Aa1 government bond rating to negative from stable.

21. There has been no change to Arlingclose's credit advice on UK banks and building societies since the referendum result.

Annual investment management strategy 2017-18

22. 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.

23. The annual investment management strategy 2017-18 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. Fund managers will help execute the strategy as much as is needed.

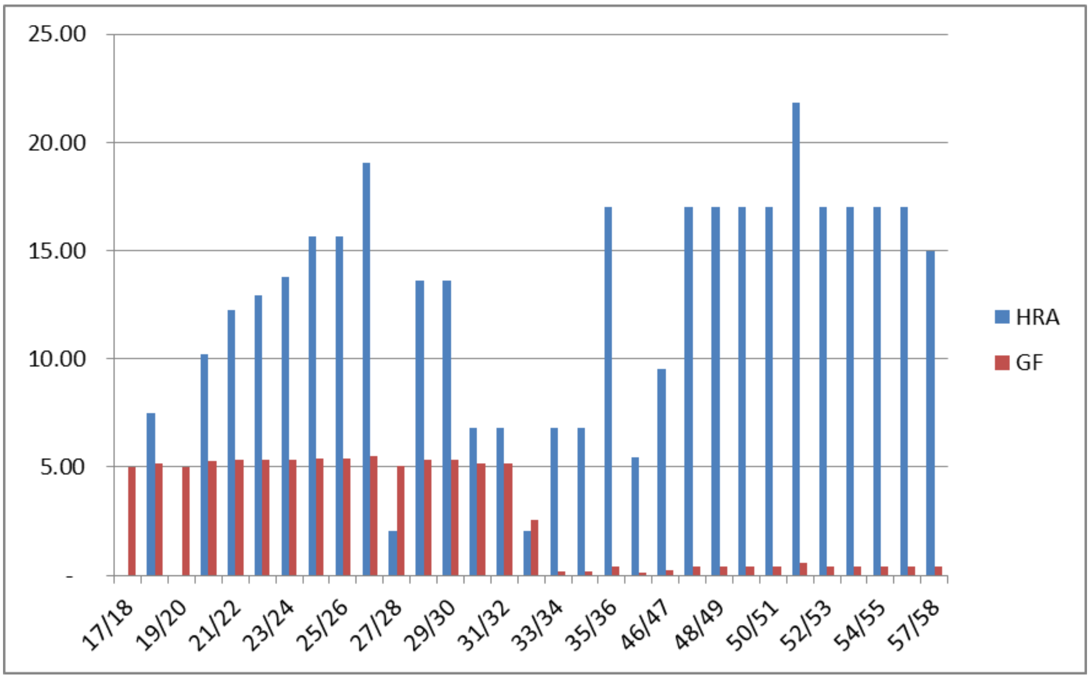
Debt management position and strategy

Debt management position

24. 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 2016 was £463m (£371m housing revenue account (HRA) and £92m general fund). In the year to December 2016, £5m

general fund loans matured and were repaid. The years in which the remaining loans fall for repayment is set out in the chart below.

PWLB Loans maturing in future years (£m)



25. All loans are at fixed rates. Many loans were taken on in the 1980s and 1990s 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)

26. 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 2016 was £205m (£18m HRA and £187m 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 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

27. The council's capital programme continues to expand and in 2016-17 the general fund and HRA capital programme as reported at month 8 infers a potential need to draw on internal debt finance. However, as capital expenditure forecasts are becoming more certain it is expected that this need is less likely as we draw to the end of the current financial year. Previously, this report presented the potential to secure the investment in the HRA capital programme through a transfer of debt once the use of HRA reserves, capital receipts, grants and contributions has been maximised. This option may be utilised in 2017-18, subject to the agreed capital programme and funding available. This option 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.

28. 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. Should this debt transferred the HRA indebtedness would still remain well within the indebtedness cap.

29. In 2017-18, £5m general fund debt matures and as in the current year 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 HRA too is continuing to set-aside sums to reduce its own financing liabilities and at the same time raise headroom for further capital investment as it becomes affordable.

30. 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. New loans may also be taken to fund capital expenditure where affordable or prudentially manage re-financing risks.

31. 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 in Appendix B.

32. In November 2016 the government confirmed plans to abolish PWLB and transfer its functions for lending to local authorities to commissioners of the Treasury, under powers in the 2011 Public Bodies Act.

33. The reform is directed at central governance arrangements and no change to policy on lending to local authorities is expected.

34. As reported previously, the Local Government Association (LGA) has established a municipal bond agency (Local Capital Finance Company) as an alternative to the PWLB.

35. The agency 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

36. 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 2017-18 to 2019-20 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.

Minimum revenue provision (MRP)

37. Government guidance on the 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 produces a statement on its MRP policy. MRP costs falls on revenue budgets and runs on 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.

38. Under the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, a local authority is required to charge a minimum revenue provision (MRP) annually to its revenue account in respect of capital financing obligations that arise in that year or arose in any prior year. Capital financing obligations represent debt or long term liabilities taken to fund capital expenditure.

39. 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.

40. Southwark updated its MRP statement for 2015-16. Amendments to section 21(1(A)) of the Local Government Act 2003 and the statutory guidance on the minimum revenue provision made thereunder, recommend that councils produce a policy on making prudent MRP each year.

41. The MRP statement recommended for approval by council assembly is set out at Appendix C.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Law and Democracy

42. 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.

43. 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.

44. 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.

45. 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.

46. 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 2017-18
Appendix B	Prudential Indicators - Recommended for Approval
Appendix C	Annual Minimum Revenue Provision Statement

AUDIT TRAIL

Lead Officer	Jennifer Seeley, Director of Finance	
Report Author	Fay Hammond, Departmental Finance Manager, Corporate and Central Services	
Version	Final	
Version Date	9 February 2017	
Key Decision	Yes	
CONSULTATION WITH OTHER OFFICERS / DIRECTORATES / CABINET MEMBER		
Officer Title	**Comments sought**	**Comments included**
Director of Law and Democracy	Yes	Yes
Strategic Director of Finance and Governance	N/A	N/A
Cabinet Member	Yes	Yes
Date report sent to Constitutional Team		9 February 2017