

Item No: 3.2	Classification: Open	Date: 25 February 2015	Meeting Name: Council Assembly
Report title:		Treasury Management Strategy 2015/16 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 2015/16 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 2015/16 referred to in paragraphs 14 to 17 of this report and set out at Appendix A.
4. Agrees prudential indicators covering capital finance and treasury management for the years 2015/16 to 2017/18 referred to in paragraph 25 of this report and set out in Appendix B.
5. Agrees the minimum revenue provision statement, setting aside prudent sums to reduce debt and long term liabilities, referred to in paragraphs 26 to 27 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. This 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 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

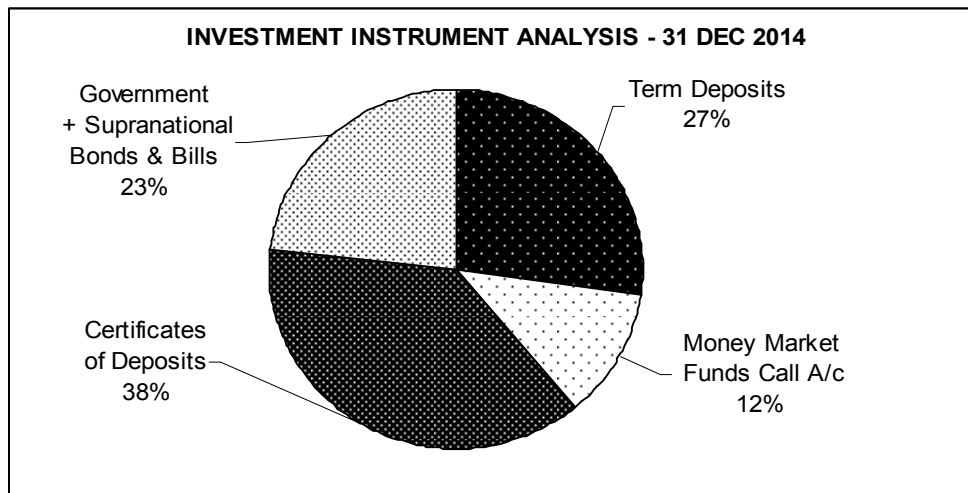
11. As at 31 December 2014, the cash held as investments was £166m and over the year to December 2014 averaged £216m. The cash is invested prudently until it is needed in spending.
12. Investments are managed by an in-house operation and two fund managers (AllianceBernstein and Aberdeen Investment Managers). 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. The investment position at 31 December 2014 is set out in the table below.

INVESTMENT COUNTERPARTY AND RATINGS - 31 DEC 2014									
EXPOSURE £m	FUND				Ratings				
	Aberdeen	Alliance Bernstein	In-House	£m	Long	Short	Support	Sovereign	Sovereign Rating
NORDEA BANK FINLAND	6.50	-	-	6.50	AA-	F1+	1	FINLAND	AAA
CREDIT AGRIC CIB	3.50	-	-	3.50	A	F1	1	FRANCE	AA
CREDIT INDUST ET COMRCL	3.50	-	-	3.50	A+	F1	1	FRANCE	AA
SOCGEN	-	1.20	-	1.20	A	F1	1	FRANCE	AA
BANQUE NATIONAL DE PARIS	3.50	2.00	5.00	10.50	A+	F1	1	FRANCE	AA
DEUTSCHE BANK	-	2.00	-	2.00	A+	F1+	1	GERMANY	AAA
GOLDMAN SACHS MMF	-	-	10.90	10.90	Money	AAA		GLOBAL	Money Fund
BLACKROCK MMF	-	-	8.30	8.30	Money	AAA		GLOBAL	Money Fund
RABOBANK	1.10	2.00	-	3.10	AA-	F1+	1	NETHERLANDS	AAA
ING BANK	3.50	2.00	-	5.50	A+	F1+	1	NETHERLANDS	AAA
ABN AMRO BANK	-	1.00	-	1.00	A+	F1+	1	NETHERLANDS	AAA
EUROPEAN INV BANK	7.00	3.10	-	10.10	AAA	F1+	0	SUPRANATIONAL	AAA
INT BANK RECONST DEVT	-	4.80	-	4.80	AAA	F1+	0	SUPRANATIONAL	AAA
SVENSKA	3.30	-	15.00	18.30	AA-	F1+	1	SWEDEN	AAA
SKANDINAVISKA	-	2.00	-	2.00	A+	F1	1	SWEDEN	AAA
CREDIT SUISSE	3.50	1.00	-	4.50	A	F1	1	SWITZERLAND	AAA
UBS	3.50	2.00	15.00	20.50	A	F1	1	SWITZERLAND	AAA
NATIONWIDE BSOC	3.30	2.00	-	5.30	A	F1	1	UK	AA+
SANTANDER UK	1.50	-	-	1.50	A	F1	1	UK	AA+
UK TREASURY	-	23.80	-	23.80	AA+	F1+	0	UK	AA+
BARCLAYS BANK	-	2.00	-	2.00	A	F1	1	UK	AA+
LLOYDS BANK	3.50	-	10.10	13.60	A	F1	1	UK	AA+
BNY MELLON	0.20	0.10	-	0.30	AA-	F1+	1	US	AAA
BANK OF AMERICA	3.5	-	-	3.50	A	F1	1	US	AAA
Total £m	50.90	51.00	64.30	166.20					

Fitch Ratings or equivalent

INVESTMENT MATURITY PROFILE AND LONG TERM RATING - 31 DEC 2014				
Yr Band	A	AA	AAA	Grand Total
Up to 1 Yr	60%	27%	2%	89%
1-2 Yrs			5%	5%
2-5 Yrs		4%	2%	6%
Grand Total £m	60%	31%	9%	100%

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)
1	Extremely high probability of support, if it were needed



13. 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 nine months to December 2014 was 0.57%.

Investment strategy

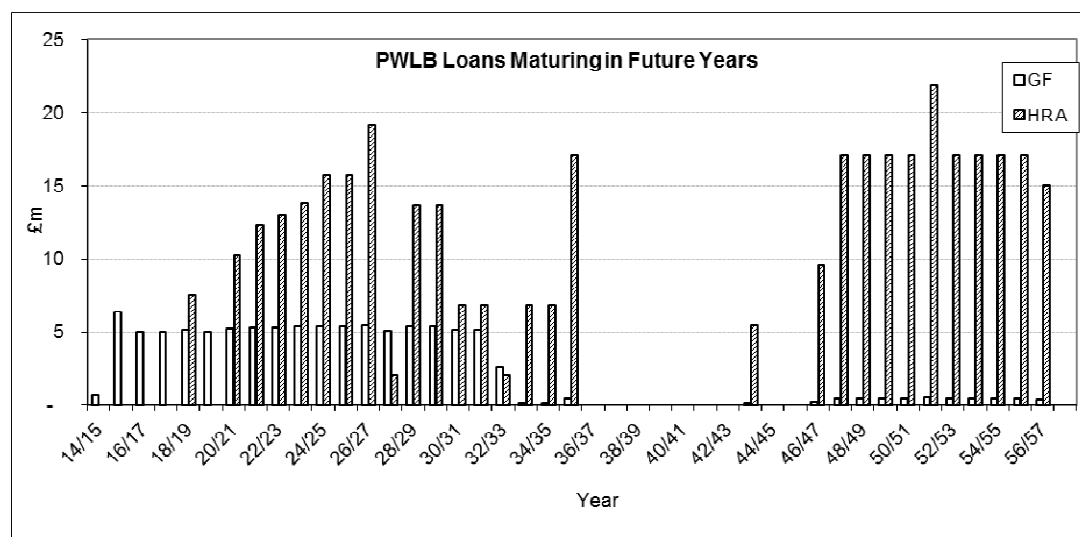
14. The council's investment objectives are to preserve principal, provide liquidity and secure a reasonable return. This is in line with investment guidelines produced by the Department of Communities and Local Government (DCLG).
15. To ensure that the investment strategy remains up to date under current financial conditions, KPMG's specialist investment advisory unit were asked to carry out an independent review. Their findings confirm that the council's current investment strategy remains prudent and fit for purpose. They suggest a number of updates to raise diversification, liquidity and potential returns at the margin whilst recognising that the scope for targeting higher returns safely under current low credit spreads and low yields across various durations is limited.
16. The updated investment strategy, which requires council assembly approval, is attached at Appendix A. The updates include:
 - the inclusion of percentage limits to supplement amount limits,
 - the addition of short duration low volatility enhanced cash funds,
 - the reduction in the maximum term on any one investment from 10 years to 5.5 years,
 - the reduction in the overall average life of investments from 3 years to 2 years,
 - the reduction in the maximum exposure to any one bank,
 - the reduction in the minimum rating for banks by one notch (long term rating from A/A2/A to A-/A3/A- and short term from F1/P-1/A-1 to F2/P-2/A-2, subject to a minimum sovereign rating AA-/Aa3/AA-Fitch/Moody's/S&P), to help reduce exposure to any single counterparty against a background of improved bank capital and funding,
 - the reduction in the minimum rating on foreign government, supranational and quasi sovereign bonds from AAA/Aaa/AAA to AA-/Aa3/AA- (Fitch/Moody's/S&P), and
 - the deletion of reference to support rating, which following banking reforms regulating state support will no longer be a reliable indicator of the likelihood of support for creditors in the event it were needed.
17. The lower foreign sovereign rating recognises rating actions which have seen UK, France, Finland, the Netherlands and the United States being rated below AAA/Aaa/AAA by one or more rating firms. The one notch

reduction in bank rating will mean RBS (NatWest), a globally significant bank and the council's bank, meets the minimum long and short term rating under two rating agencies rather than just one at the moment. The changes will raise access to government and quasi-sovereign issues, while confining bank exposure to major banks. As now, developments in financial and credit markets will be assessed in managing actual exposure and the strategic director of finance and corporate services will continue to manage the strategy with the help of external fund managers.

Debt Management Position and Strategy

Debt management position

18. The council holds debt to fund past capital spend and the balance outstanding on the debt at 31 March 2014 was £475m, divided between the HRA (£371m) and the general fund (£104m). Each year the general fund is required to set aside sums to repay its borrowing by way of the minimum revenue provision. For 2014/15 this is £9.1m. The HRA is also reducing its debts and raising the borrowing headroom for new investment.
19. All borrowing is from the Public Works Loans Board (PWLB, a local authority lending arm of the Government) at fixed rates and matures at different dates in the future (the chart below shows maturities at 31 December 2014).



Debt management strategy

20. In 2015/16, £6.4m general fund debt matures and as in 2014/15 the council is setting aside prudent sums to reduce financing liabilities by way of the minimum revenue provision. The HRA too is continuing to set-aside sums to reduce its financing liabilities and raise headroom for further capital investment.
21. The level of cash used in place of loans, known as internal borrowing, stood at £232m at 31/03/2014. Internal borrowing is cheaper than external borrowing and in the future can be replaced with loans if needed. Loans may be repayable at the end of the loan term, in equal instalments over loan life, or by way of annuity, depending on future financing requirements. Rates on new loans depend on prevailing market conditions and are currently low on account of global economic weakness. As it is still cheaper

to use council cash than loans, borrowing is being deferred for the time being. However, new borrowing will be taken if it is needed for spend or where prudent.

22. The Government has announced that it plans to transfer the lending functions carried out by the PWLB to another agency in a consultation document to be published in due course. Current indications are that the change is about 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.
23. The Local Government Association (LGA) is proceeding with plans for a municipal bond agency as an alternative to the PWLB. To date, 37 local authorities have expressed an interest in providing around £4m capital to help launch the agency's first bond issue in 2015. The LGA itself is contributing £500,000. The council's own contribution is £200,000 and of this £60,000 has so far been drawn. The agency may carry out further fund raising ahead of its bond issue, but the council's contribution will remain capped at £200,000. Any borrowing the council needs will be from whichever source is the cheapest.
24. 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.

Prudential Indicators

25. 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 2015/16 to 2017/18 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 2015/16 to reflect activity.

Minimum Revenue Provision Statement

26. 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 (e.g. PFI) arising from capital spend.
27. The minimum revenue provision statement recommended for approval is set out at Appendix C. The statement updates the one approved by council assembly in February 2014 and now includes provisions permitting MRP on any one asset or expenditure to be considered on its own merits in the interest of financial flexibility. It will cover 2015/16 as well as the current year.

SUPPLEMENTAL ADVICE FROM OTHER OFFICERS

Director of Legal Services

28. 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.
29. 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.
30. 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.
31. 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.
32. 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	Annual Investment Management Strategy 2015/16
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	Chris O'Brien, Senior Accountant	
Version	Final	
Version Date	6 February 2015	
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	No	No
Final Report Sent to Constitutional Team	12 February 2015	