Item No: 13.	Classification: Open	Date: 22 November 2017	Meeting Name: Audit Governance and Standards Committee
Report title:		Treasury Management Strategy 2018-19 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 the audit, governance and standards committee:

1. Notes that the proposed 2018-19 treasury management strategy is to be managed by the strategic director of finance and governance under financial delegation.

2. Notes the proposed annual investment strategy 2018-19 as referred to in paragraph 13 to 19 of this report and set out at Appendix A.

3. Notes the prudential indicators covering capital finance and treasury management for the years 2018-19 to 2020-21 set out at Appendix B.

4. Notes the minimum revenue provision statement, as unchanged from 2017-18, for setting aside prudent sums to reduce debt and long term liabilities set out at Appendix C.

BACKGROUND INFORMATION

1. Each year council assembly agrees an annual treasury management strategy, covering the management of council debt and cash investments. The strategy also includes a series of prudential indicators as specified by the CIPFA Prudential Code for Capital Finance in Local Authorities in addition to the council policy on the minimum revenue provision (MRP) to repay debt arising from capital expenditure. This requirement arises from the Local Government Act 2003.

2. 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.

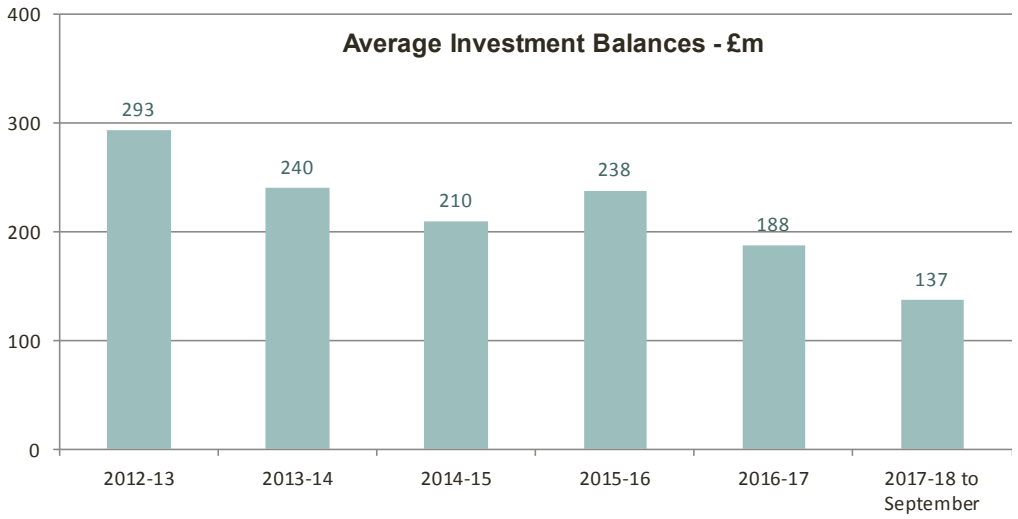
KEY ISSUES FOR CONSIDERATION

Investment Position and activity.

3. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 30 September 2017 were £116m (£206m at 30 September 2016).

4. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the DCLG Guidance on Local Authority Investments and the approved investment strategy. The DCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

5. The overall level of investments held by the council has reduced over the previous five years as shown in the following graph. This is a consequence of the reduction in overall council reserves, continuation of internal borrowing policy, and the scheduled repayment of historical debt.



6. The half year return for council treasury management assets was 0.16%. The yield on short dated gilts, depressed as a result of additional monetary stimulus following the referendum on EU membership, remained persistently low for the first quarter of 2017-18 acting as a drag on investment returns.

7. UK Gilts sold off during the second quarter of 2017-18 as increasingly hawkish tones from the Monetary Policy Committee (MPC) led to greater speculation that a base rate rise would follow in the last quarter of the calendar year. The negative impact on asset price valuations from an increase in yields further dampened investment performance for the year.

8. By way of a comparison, a composite benchmark of three month LIBID and one to three year gilt index returned -0.07% for the period leading to an outperformance of 0.23%; a solid relative, if not absolute, return.

9. The 2017-18 treasury strategy stipulates that no investment may be for a duration longer than five years and holdings beyond one year in duration are restricted to; government bonds, supranational bonds, quasi-sovereign bonds or covered bonds issued by major banks.

10. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and, to a lesser extent, call accounts and term deposits diversified across major banks and building societies

11. The external fund managers invest over a longer term in UK government gilts, supranational bank bonds, and certificates of deposits issued by major

banks/ building societies. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

12. The distribution of investments across counterparties by rating and maturity as at 30 September 2017 is set out in the table below:

	A		AA		AAA		Total
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**
Up to 1 Year	24.5	21%	11.7	10%	51.9	45%	**88.1**
1 - 2 Years		0%	0.5	0%	9.8	9%	**10.3**
2 - 5 Years		0%	2.4	3%	15.0	13%	**17.4**
Total	**24.5**	**21%**	**14.6**	**13%**	**76.7**	**66%**	**115.8**

Proposed Investment Strategy

13. 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.

14. The annual investment management strategy 2018-19 is attached at Appendix A. The strategy allows investment access to high rated sovereigns, banks quasi-sovereigns, covered bonds whilst limiting excessive to market volatility and maintaining the overarching objective of ensuring appropriate security and liquidity. External fund managers will be utilised to implement the strategy when appropriate.

15. In considering the investment strategy for 2018-19 the council has taken advice from the external treasury advisor Arling Close in addition to ongoing engagement with the council's external fund managers to ensure that any investment limits and restrictions remain appropriate to meet the investment objectives.

16. The investment strategy for the council for 2018-19 is proposed to remain broadly unchanged. The strategy is considered to be sufficiently flexible to allow the council and delegated managers to access suitable investment opportunities without undue risk to the security of assets or the preservation of liquidity.

17. The changes to the proposed treasury strategy for 2018-19 from the existing strategy for 2017-18 are set out below

18. Limits attributable to certain investment asset categories were solely by way of a percentage of the overall portfolio, these have been amended to include relative and absolute investment limits. The limits for UK government money market funds has been amended to reflect the limits in place for conventional money market funds.

Investment Category/Counterparty	Investment Limit 2017-18 Strategy	Investment Limit 2018-19 Strategy
Short duration low volatility enhanced cash funds	10% per fund	£10m per fund and 20% of the total portfolio
Sterling government money market funds	10% per fund	£50m per fund on portfolios up to £150m and 35% per fund on portfolios above £150m

19. The council does not currently hold investments in the above two investment types.

External debt management position and activity

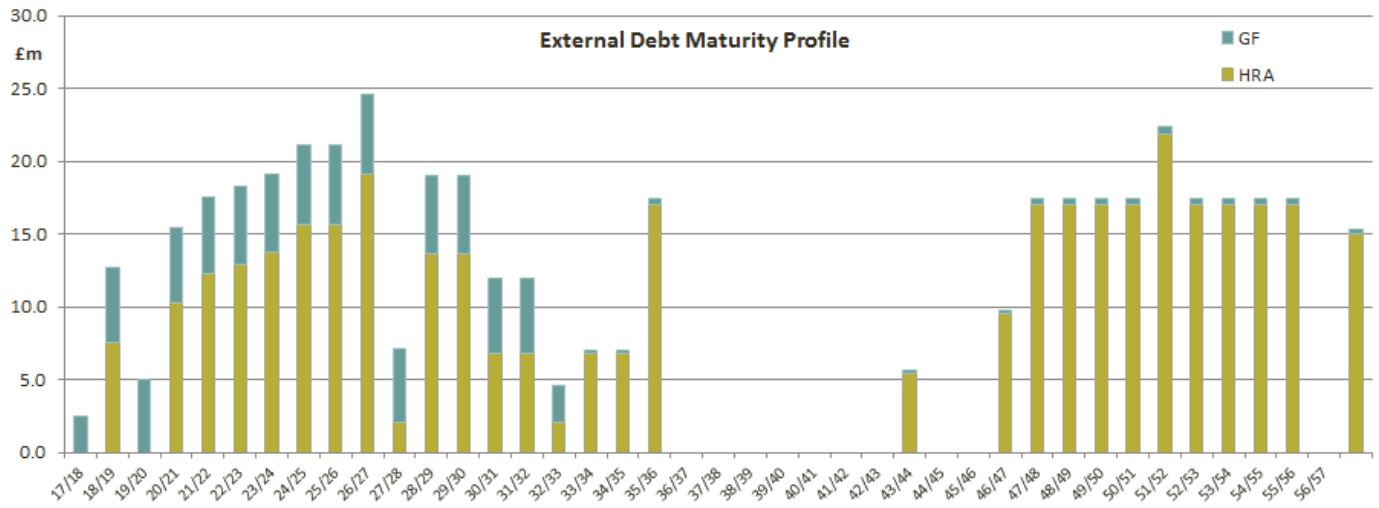
20. Capital expenditure for the council is financed through a variety of sources, typically receipts from the sale of capital assets, capital grants, external contributions, such as S106 or Community Infrastructure Levy (CIL), from reserves or from revenue budget contributions. Any capital expenditure that is not financed by the above will need to be financed by borrowing. Existing council debt is therefore the consequence of historical capital expenditure.

21. Current debt for the council is from the Public Works Loans Board (PWLB) an executive agency of HM Treasury. The debt balance outstanding as at 30 September was £455m (£460m as at September 2016) with £371m attributable to the HRA and £84m as attributable to the general fund.

22. The majority of existing debt is structured on a maturity basis such that the principal is repaid in full at the end of a fixed loan period. The exception is £100m debt drawn in 2012 on an equal instalment of principal basis. A fixed amount of principal (£5m) is repaid per year over the lifetime of these loans and forms the majority of the debt attributable to the General Fund, of which £75m remains as at 30 September 2017.

23. Each year, the General Fund sets aside sums known as the minimum revenue provision (MRP) to reduce its borrowing liabilities. In February 2017 council assembly approved an updated MRP strategy. The revised approach continues to make a prudent provision for the repayment of debt but now takes account of other factors, most notably affordability. The HRA may also set aside sums to reduce its own borrowing liabilities.

24. The maturity profile for all council debt is set out in the below chart split between the HRA and the GF.



25. The council is able to repay existing loans due to the PWLB in advance of scheduled maturity, but that this is accompanied by an additional premium on repayment. The additional cost for this repayment when assessed alongside the interest cost for drawing replacement debt has traditionally meant that this option is not financially beneficial to the council. Officers regularly monitor the prospective costs and benefits of early repayment and this opportunity will be further reviewed as part of the 2018-19 treasury strategy.

Internal borrowing and future borrowing decisions

26. The council began to pursue a policy of utilising existing cash and investment resources to meet capital and debt repayment obligations, rather than through external borrowing, during 2012 using existing resources to part fund the purchase of 160 Tooley St, alongside a significant debt refinancing.

27. The rationale for deferring the drawing of additional debt is that the use of short term cash resources to meet capital demands in lieu of borrowing allowed the authority to minimise external interest payments over the period from 2012-13.

28. Council investment balances are surplus resources that are earmarked for another purpose, typically reserves, provisions, S106 receipts, borrowing in advance of need or revenue expenditure. The use of balances, earmarked for other purposes, to fund capital expenditure is called ‘internal borrowing’. This is because the organisation has funded current capital expenditure, which would otherwise have required external debt financing by using resources set aside for other future commitments.

29. The savings for the council from deferring external borrowing for the purchase of Tooley St equate to £20m for the five year period from 2012-13 to 2017-18 or £4m per annum.

30. The opportunity cost of a reduction in overall investment income, arising from lower cash balances, was more than offset by reduced external interest expenses. Throughout this period there has been a significant variance between income earned from short term investments and the expense incurred from longer duration debt.

31. Efficient use of existing council resources to fund capital expenditure through internal borrowing has also reduced the council's counterparty risk, the risk that a bank or other organisation is unable to repay funds the council has deposited.

32. The level of internal borrowing as at 31 March 2017 was £224m, split between £17m for the HRA and £207m for the GF. This increased by £26m from the previous financial year.

33. As reported to cabinet on 19 September 2017 as part of the monitoring of capital programme budget, the indications are that the council would need to borrow in 2017-18 to finance the capital programme (Policy and Resources Strategy: Capital Monitoring report, including Capital Programme Update 2017-18 Month 4). The extent and timing of any external borrowing will depend upon short and medium cashflow forecasts for the council, in conjunction with consideration as to interest rate forecasts. Further, the strategic director of finance and governance will review the sustainability of the internal borrowing approach.

34. Officers regularly monitor current and forecast interest rates to determine the appropriateness of the current borrowing strategy, such that the reduction in current borrowing costs from use of internal balances, is not offset by higher borrowing costs in the future. Decisions with regard to external borrowing will be made with the advice of the council's external treasury advisor, Arling Close.

35. All historical debt for the council has been drawn from the PWLB, however the council is investigating the possibility of sourcing future debt from other organisations, including the Municipal Bond Agency, other local authorities and from other banks or financial institutions.

36. Short term borrowing from other local authorities may provide an opportunity for the council due to the low rates typically offered between local authorities. Loans from other local authorities can offer a spread against similar duration PWLB debt of between 0.15% to 0.55%.

Prudential Indicators

37. 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 2018-19 to 2020-21 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)

38. 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.

39. 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.

40. 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.

41. 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.

42. 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

43. 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.

44. 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.

45. 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.

46. 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.

47. 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 2018-19
Appendix B	Prudential Indicators - Recommended for Approval
Appendix C	Annual Minimum Revenue Provision Statement

AUDIT TRAIL

Lead Officer	Duncan Whitfield, Strategic Director of Finance and Governance	
Report Author	Alex Moylan, Senior Finance Manager	
Version	Final	
Version Date	10 November 2017	
Key Decision	No	
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 sent to Constitutional Team		10 November 2017