South Bucks District Council

Treasury Management Strategy

2015/2016

1. Background

1.1. The Council adopted the CIPFA code of practice on Treasury Management in June 2002, which includes the creation of a Treasury Management Strategy, which sets out the policies, and objectives of the Council's treasury management activities for the year ahead. For Members information the requirements of the Code are detailed below.

1.2 The Code is built largely on what was recommended practise in the previous version, but does place greater or new emphasis in certain key areas. The main points in the new Code are as follows:-

a) All councils must formally adopt the revised Code and four clauses, these are shown as at Appendix A which also sets out the scheme of delegation and the treasury management role of the section 151 officer.

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities. This is consistent with the approach always adopted by this Council.

c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.

d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation. This is something the Council has always been very clear about, in that whilst it uses advisers and external sources of information, that it is the officers and members of the authority who are accountable for policy and decisions.

e) Credit ratings should be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on Government support for banks and credit ratings of that Government support.

f) Councils need a sound diversification policy with high quality counterparties and should consider setting country, sector and group limits.

g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme. As a debt free authority this is not an issue that arises for the Council. The Council is required to review its debt free status each year. The option of borrowing funds to finance additional capital expenditure could be considered in the future as a means of enabling more costly schemes, which would otherwise not be affordable, to take place, but it is not felt to be necessary for current planned expenditure.

h) The main annual treasury management reports must be approved by full Council.

i) There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved. For South Bucks DC this requirement is met by the regular reports to the Resources Portfolio Holder.

j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body. For South Bucks DC this is carried out by the Resources PAG.

k) Treasury Management performance and policy setting should be subjected to prior scrutiny. This is achieved via the regular discussions on Treasury Management at the RPAG.

l) Members should be provided with access to relevant training. This has been provided in the past by the Council's treasury management advisers.

m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

n) Responsibility for these activities must be clearly defined within the organisation.

o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

1.3 This strategy statement has been prepared in accordance with the Code. As in previous years the Council's Treasury Management Strategy will be approved annually by the full Council. In addition there will also be regular monitoring reports to the Resources PAG one of which will be the annual report. In addition the Resources Portfolio Holder will be emailed each month with information showing where the Council's investment portfolio has been invested. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.4 The Council will adopt/reaffirm the following reporting arrangements in accordance with the requirements of the revised Code:-

Area of Responsibility	Reporting Arrangements	Frequency
Treasury Management Policy	Resources PAG /Cabinet/Council	Reviewed annually.
Treasury Management Strategy Annual Investment Strategy MRP policy	Resources PAG /Cabinet/Council	Annually before the start of the financial year
Treasury Management Strategy Annual Investment Strategy MRP policy – in year report	Resources PAG /Cabinet	Appropriate report to RPAG
Treasury Management Strategy Annual Investment Strategy MRP policy – updates or revisions at other times	Resources PAG /Cabinet/Council	As appropriate
Annual Treasury Outturn Report	Resources PAG /Cabinet	Annually by 30th September after the end of the year
Monitoring Reports	Resources PAG /Cabinet	Regularly
Treasury Management Practices	Resources PAG /Cabinet/Council	Annually
Investment Portfolio Detail	Resources Portfolio Holder	Monthly
Scrutiny of treasury management strategies & performance	Resources PAG	Ongoing but with particular focus when considering annual Strategy

1.5. The Local Government Act 2003 and supporting regulations requires the Council to have regard to the CIPFA Prudential code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investments plans are affordable, prudent and sustainable.

1.6. The Act requires the Council to set out its Treasury Strategy and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.7. It is a statutory requirement under section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, section 32 requires a local authority to calculate its budget requirements for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenues from :

- Loss of investment interest caused by the use of capital receipts to finance additional capital expenditure.
- Any increases in running costs from new capital projects.

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

1.8. The DCLG's investment guidance states that authorities could combine the Treasury Strategy Statement and the Annual Investment Strategy (AIS) into one report and the AIS supporting this Strategy Statement is attached as Appendix A.

1.9. The Council employs Capita Asset Services, Treasury Solutions as its external treasury management consultants. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon external service providers. It is recognised that there is value in employing an external provider in order to access specialist skills and resources. The Council contract with Capita Asset Services is a joint one with Chiltern District Council for a three year period and commenced on 1st July 2013.

1.10. Following consideration of the Council's future funding requirements and economic forecasts and other relevant information, the proposed target figure for investment returns for 2015/2016 is £400,000.

1.11. This Strategy seeks approval for this target level of return, how realistic it is and sets out how it can be achieved.

2. Current Portfolio Position

2.1. <u>Investment Criteria</u> – Investment income is mainly generated by Officers placing money in callable or fixed deposits with approved counter parties. When making the decision to invest Officers take into account security, liquidity and yield which are inter-related and the balance of the three is determined by the authority's needs and risk appetite. Decisions to invest are made following discussion between the Director of Resources and the Principal Accountant (Capital & Treasury) both of whom have sufficient experience in this area. The discussion on investment is based upon information that is available from the Council's treasury consultants, Capita Asset Services, and brokers acting in the local authority money market, combined with general intelligence available from money market briefings made available to the authority. The approved for in house counterparty investments made by Officers as part of the Treasury Management Strategy is as follows:

	Duration	Maximum Amount	Fitch Rating	Comment
UK Institutions	Up to 5 years	£5m	A- or better	
	Up to 3 years	£3m	BBB+ or better	
Non UK Institution	Up to 3 years	£2m	A- or better	Sovereignty rating AA or better
Corporate Bonds/Bond Funds	Up to 5 years	£5m	A- or better	
Other Approved Investments	Up to 3 years	£1m	A- or better	Includes Money Market Funds

2.2 In recent years officers have been keeping under review the potential to diversify up to £5m of the investment portfolio into corporate bonds. This has focused on the non-financial sectors, in order to spread risk on the investments. However due to the effect that the Bank of England's Quantative Easing programme has had on bond yield, no investments with a sufficiently attractive return, duration, and counterparty credit rating have been identified.

2.3 A summary of the Council's current (at the end of October 2014) holdings of fixed deposits invested for a period in excess of one year is shown below:

	Credit Rating	Amount Loaned £	Interest Rate	Matures
UK Institutions - High				
(Max £5m)				
Lloyds Bank	A	1,000,000	2.85%	May 15
Lloyds Bank	A	1,000,000	3.07%	May 15
Barclays Bank	A	1,000,000	0.63%	Jun 15
Barclays Bank	A	1,000,000	3.05%	May 15
Halifax Bank of Scotland	A	1,000,000	0.6%	Feb 15
Royal Bank of Scotland	A	5,000,000	1.13%	Feb 17
Close Brothers	A	1,000,000	1.7%	Feb 16
Close Brothers	A	1,000,000	1.3%	Oct 16
Close Brothers	A	1,000,000	1.7%	Mar 16
UK Institutions - Low				
(Max £3m)	-	-	-	-
Non UK Institutions				
(Max £2m)	-	-	-	-
Other Approved Investments				
(Max £1m)				
UK Gilts	AAA	517,209	6%- 8.75%	Dec 15 – Jul 28
CDs	A	606,761	5.8%- 6.3%	Jun 21 – Feb 24
Money Market Funds	-	-	-	-
Total Deposits		14,123,970		

2.4 In addition the Officers invest short term cash flow. Short term reserves are required mainly in the last quarter of the year when council tax and grant payments tail off but precept payments continue. A summary of the Council's current short term cash holdings with a maturity of less than one year is shown below.

	Fitch	Amount £	Interest Rate	Period
Nat West 95 day notice	A	1,000,000	0.6%	Rolling 95 day period
Nat West SIB A/c	A	9,067,000	0.3%	On call, instant access
Total		10,067,000		

The high level of short term cash investments with NatWest reflects the fact that they have been the Council's banker for a number of years, however this arrangement will change from February 2015 when the Council's banker will become Barclays. In advance to that change a proportion of this short term cash will be placed in a range of other short term investments to increase the diversity of the portfolio.

3. Prospects for Interest Rates and Economic Background

3.1 Part of the service provided by the Council's treasury management advisers is to assist the Council to formulate a view on interest rates. The following table gives the Capita Asset Services central view on the bank rate and short term money rates.

	2015/16				2016/17		2017/18	
	Q1	Q2	Q3	Q4	Q1	Q4	Q1	Q4
Bank Rate	0.50%	0.75%	1.00%	1.00%	1.25%	1.50%	1.75%	2.50%
3 M LIBID	0.50%	0.60%	1.10%	1.30%	1.40%	2.10%	2.10%	2.60%
6M LIBID	0.70%	1.00%	1.20%	1.40%	1.50%	2.20%	2.30%	2.80%
12M LIBID	0.90%	1.20%	1.40%	1.70%	1.80%	2.30%	2.40%	3.00%

3.2 Capita Asset Services forecast that by the end of the March 2018 quarter the bank rate will be 2.5% with LIBID rates at 2.6 % 3 month, 2.8 % 6 months and 3.0% 12 months. A detailed view of the current economic background is shown in Appendix B. The key points that influence the Invest Strategy are as follows:

- The UK economy is showing signs of recovery but is still burdened with consumer debt, which will mean any increase in rates will be slow and incremental. The economy needs rebalancing to be less dependent on consumer expenditure and to increase productivity if growth is to be robust and sustainable.
- The UK is vulnerable to external factors, primarily the Euro Zone economy and the situation in Eastern Europe and the Middle East.
- The Euro Zone is showing low or negative growth, and there are still significant risks over a number of individual economies (e.g. Italy).
- Uncertainty in markets usually provokes a shift from equities to bonds/gilts, which acts to depress rates.

4 Achieving the investment target in 2015/16

4.1 The Council has as part of the funding strategy for its revenue budget an assumption that interest earned on cash investments will be used to support the council tax, and by implication that the Council will continue to be debt free. For the current financial year the budget for investment income is £550k.

4.2 There are two elements to the Council's cash balances. Firstly there is the element that relates to the Council's working balance and from its cashflow over the course of the year. These cash balances need to be kept in a very liquid form with investments of one year or less duration. Secondly there is the element of cash retained for investment purposes or to finance capital expenditure, this can be invested for longer periods and does not need to be so liquid. Broadly speaking this second element is around £14m, and has reduced significantly over the last two years as a result of the higher level of capital expenditure.

4.3 In undertaking investments the Treasury Management Code of Practice sets out three important principles to have regard to:

- Security of Capital
- Liquidity
- A return consistent with these principles.

In recent years since the Icelandic Banks issue, authorities have been encouraged to see security as the most important principle.

4.4 The Council's current core investment portfolio is split between short term investments of up to one year and those with a longer duration of up to five years.

4.5 Current market returns on cash investments are historically low and the likelihood is that this will continue for some years to come even if rates start to rise in 2015. This was initially primarily a result of the Funding for Lending Scheme and the Quantitative Easing strategy followed by the Bank of England which has depressed interest rates, but going forward sensitivity about the sustainability of the recovery and the weakness of growth in Europe is likely to keep rates low.

4.6 The depressed interest rate market and the issues around having a range of acceptable counterparties have proved to be a problem when the longer term investments that the Council have within its investment portfolio reach their maturity. At a time where interest rates have been and continue to be low these longer term investments which were made when rates were considerably higher have helped to underpin the return on investments each year. However it is proving difficult in the current climate to reinvest these at a return anywhere near to that which had previously been achieved for anything long term and subsequently these maturities have been reinvested on a short term basis only.

4.7 As a result of the period of low interest Members considered alternative investments to cash as part of the Treasury Management Strategy 2013/14. This included investigating corporate bonds in the non-financial sector as possible additional investment opportunities. There have been few bonds that have become available under the extended search that meet the Council's investment criteria however nothing with an effective interest rate (the calculated interest rate that the Council would receive taking into account the purchase price of the bond) that have been particularly appealing.

4.8 In summary the Council is unlikely to see any growth in its investment income due to reduced cash reserves and the fact that interest rates, even if they do increase in 2015, are likely to remain below the historic average for the foreseeable future.

4.9 The proposed policy therefore for the coming year is to extend the duration of the investment portfolio, reducing the level of short term balances if possible when the differential between short and medium term rates return more to the historic norm. The policy will also aim to increase the number of counterparties. Diversifying the number of counterparties will include considering corporate bonds and certificates of deposit. Based upon this policy it is thought to be realistic to set the estimated return from investments for 2015/16 at £400,000.

5 Stoke Poges Memorial Gardens Fund

5.1 The investment returns from the fund is no longer credited directly to the Stoke Poges Memorial Gardens Fund cost centre but has been incorporated with all of the Council's other investment returns. The current value of this element of the overall investment portfolio is £1.124m.

6 Financial Summary & Risks

6.1 The budget for investment interest was set as £550,000 for 2014/15. Current estimated returns show that there is likely to be a shortfall against the current year's budget of £100,000.

6.2 For 2015/16 investment income will be based on total core cash reserves of £14m. In addition officers invest surplus cash flow during the year and estimated returns are based on short-term interest rates remaining within the range of 0.30% to 1.50%.

6.3 Based upon the recommended Strategy outlined above the estimated investment returns for 2015/2016 is £400,000.

6.4 This target for investment income reflects the latest forecasts for interest rates. It is regarded as realistic and achievable. Loss of £37,000 of investment income is equal to £1 council tax on a band D property.

6.5 As stated the investment returns are based upon a core level of balances for 2015/16 of £14m. The estimated capital programme shows that this is realistic based on the current level of approved expenditure. It also assumes the Council will remain a debt free authority.

6.6 As with any budgets based on forecasts of future interest rates there is a risk of variation due to factors outside of the Council's control. This risk will need to be taken into account in determining the level of revenue reserves held by the authority.

6.7 The Local Government Act 2003 sets out the new capital regulations and specifies that local authorities must comply with the Prudential Code produced by CIPFA. The Council has a duty to determine an affordable borrowing limit. As a debt free authority this would be nil, however the regulations also incorporate the limit for temporary borrowing any temporary borrowing since 1990/1991 it is necessary under statute to approve a limit in case the circumstances arise should it be required. It is recommend that Members approve an authorised borrowing limit of £3 million and an operational borrowing limit of £3 million, these together with other prudential indicators that the Council are required to set under the code are shown at Appendix C, and Appendix D covers the technical requirement in respect of calculating the minimum revenue provision.

Appendices

A – Annual Investment Strategy Policies
B – Economic Background
C – Prudential Indicators
D – Minimum Revenue Provision