REFERRAL FROM THE AUDIT COMMITTEE – TREASURY MANAGEMENT STRATEGY 2017/18

Chairman of the Committee: Councillor Mike Appleyard

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PROPOSED RECOMMENDATIONS TO COUNCIL

That:

(i) the Treasury Management strategy for 2017/18 and the Treasury Management indicators contained therein be approved; and

(ii) the Treasury Management policy statement, attached at Appendix A of the report, be noted.

Reason for decision

In February 2012, the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice (fully revised 2011 edition), which requires the Council to approve a treasury management strategy before the start of each financial year, a mid year report, and an annual report after the end of each financial year.

Corporate Implications

1. There are no direct financial implications associated with approval of the Treasury Management Strategy or Treasury Indicators, although it sets the framework within which the Council operates its treasury management function.

2. There is a statutory duty for the Council to determine and keep under review the amount of money it can afford to borrow – the “Affordable Borrowing Limit”. The prudential indicator that sets the affordable borrowing limit is called the Authorised Limit for External Debt and is approved in the prudential indicator report but also set out here for information.

3. The detail in this report is provided in line with “Guidance on Local Authority Investments”, issued by the DCLG. This guidance is in fact a requirement, and there is consequently little scope for making the detail in the appendices more user-friendly and accessible to the lay person.

Executive Summary

4. In February 2012, the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice (fully revised 2011 edition), which requires the Council to approve a treasury management strategy before the start of each financial year, a mid-year report, and an annual report after the end of each financial year.

5. The Code of Practice also requires Council to approve the Treasury Management

Policy Statement at Appendix A..

6. As part of the Code local authorities are required to charge a body of members to scrutinise the treasury management strategy and Council agreed at its meeting on 25 February 2010 to appoint the Audit Committee to this role.

7. This report is the Annual Treasury Management Strategy for the next financial year, which amongst other things lays down the criteria within which investments are made, with particular regard to counter party limits. It also sets the treasury management indicators and borrowing limits for the year

8. In addition, the Department for Communities and Local Government (CLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year. This report fulfils the Council's obligations under both these sets of guidance.

Treasury Management Policy Statement

11. It is the Council's responsibility to approve a Treasury Management Policy Statement on a periodic basis and Council approve this annually. The Policy Statement is included in Appendix A.

12. The Treasury Management Policy sets out the objectives and the regulatory requirements of the Council's treasury management function.

13. The principal objectives of this Treasury Management Policy Statement are to provide a framework within which:

i) risks which might affect the Council's ability to fulfil its responsibilities or which might jeopardise its financial security, can be identified;

ii) borrowing costs can be minimised should the Council be required to or choose to borrow, whilst ensuring the long term security and stability of the Council's financial position; and

iii) Investment returns can be safely maximised and capital values maintained.

Treasury Management Strategy Statement

14. CIPFA's *Treasury Management in the Public Services: Code of Practice (2011 Edition)* and their *Prudential Code for Capital Finance in Local Authorities (2011 Edition)* require local authorities to determine the Treasury Management Strategy Statement on an annual basis.

15. The Strategy Statement comprises two main components:

i) the 'External Context', drafted by the Council's external treasury advisers, Capita (Sector) Asset Management. This is important as the rate at which the Council can borrow and the return it will obtain on cash balances are linked to the performance of the wider UK and global economy. This is included in Appendix B

ii) a Borrowing and Investment Strategy, including the approved sources of long term and short term borrowing and details of the type of institutions the Council is able to place its cash with and the limits with each type of institution. This is included in Appendix C.

16. The main changes in the Treasury Management Strategy are:

- Increase of investment limits with existing A- credit rated or above counterparties by £1m to ensure adequate avenues for placing cash without diluting the credit quality of the Council's counterparties. This action is in response to the cut in interest rates and a fall in demand for Local Authority deposits due to increased requirements for financial institutions to set aside corresponding capital against deposits.

Table 1 Change in Treasury Limits

Category	**2016/17 Limit**	**2017/18 Proposed Limit**
Banks and building societies (including Supranationals) holding long-term credit ratings no lower than AA- or equivalent. (either UK based or domiciled in a country with a AA rating)	£5m	£6m
Banks and building societies holding long-term credit ratings no lower than A or equivalent (either UK based or domiciled in a country with a AA rating)	£4m	£5m
UK building societies holding a long-term credit rating no lower than A- or equivalent.	£3m	£4m

Bail in Risk

17. In 2013 the UK has implemented bail-in provisions of the EU Bank Recovery and Resolution Directive in the form of the Financial Services (Banking Reform) Act. This means that if a Bank faces difficulty in future, it may take a 'haircut' of depositors' funds before any potential support from Government is sought and thus funds placed with banks are at higher risk than they previously had been before the Banking Reform Act came into place

18. An important element of the Council's investment decision making is the credit rating of the counterparty derived from the three leading credit rating agencies (Fitch, Moody's and Standard and Poor). The rating agencies have reviewed their methodologies for determining ratings following Bail-in Regulations and changes in the regulatory regime, removing the 'uplift' for implied sovereign support of bank. However, new regulations strengthening banks by requiring more capital to be set aside has netted this off, leaving most credit ratings unaffected.

19. On 30 November 2016 the Bank of England released its Stress Test results for the UK Banking System, assessing the adequacy of capital held by the Banks in a stressed scenario. Seven institutions were tested: Barclays, HSBC, Lloyds Banking Group, Nationwide, the Royal Bank of Scotland (RBS) Group, Santander UK and Standard Chartered. All seven banks passed the aggregated levels. However The

Royal Bank of Scotland Group, Standard Chartered and Barclays fell short on some individual measures. The Bank of England noted that the test was based on a snapshot of the balance sheet of these banks at the end of 2015 and because of actions taken subsequently, no further capital raising actions were required from Barclays and Standard Chartered. RBS submitted revised capital plans which were accepted by the Prudential Regulation Authority (PRA) Board.

20. The Council has taken action to limit its exposure to Bail in risk by:

- Keeping limits held with any individual counterparty low and restricting investments in time limit and to only the most creditworthy counterparties.

- Investing in Money Market Funds which are AAA rated and offer a wider level of diversification.

- Investing with other Local Authorities where opportunities are available at a reasonable rate of return.

21. As at 30th November 2016 the Council had cash balances of £83.1m invested as follows:

- £44.1m with twelve different Banks and Building Societies including the Council's banking services provider Natwest plc.

  - £30m with four different AAA rated Money Market Funds
  - £4m with two different Local Authorities
  - £5.0m UK Government Gilts.

Interest Rates and Investment Options

22. On 4th August 2016 the Bank of England reduced its base rate from 0.5% to 0.25% and the Council has continued to face a challenging environment for placing funds and generating an adequate yield. Due to the requirements for financial institutions to set aside increased capital to cover deposits, there has been a decrease in demand for Local Authority deposits. With the bank rate decreasing, Local Authorities can borrow at low rates and therefore the rates for inter Local Authority borrowing have reduced. In (12/12/2016) December 2016 the Council's bank, Natwest, reduced the current account rate to 0.05%.

23. In the absence of counterparties to place funds, the Council invests short term with the UK Government Debt Management Office (DMO) with a yield of 0.15%. To increase yield the Council has a number of options:

  - Invest directly in Local Property – The Council is actively pursuing this. In 2016/17 the Council purchased a large commercial property at Sword house for £6.8m for regeneration and investment purposes. The Council is taking forward a number of other such investments, where there is a strong regeneration imperative with returns of between 6-8%. These are detailed within the Council's major projects programme.
  - Invest indirectly in a Property Fund – The option of investing in such a fund is included within the treasury strategy although the Council is currently prioritising investments within its own borders where the Council has investment experience, local knowledge and can combine other objectives

with the investment. Investing in indirect property funds have a specific set of risks requiring due diligence, with detailed assessment of current economic conditions and their impact on the national property market.

- Treasury Investments with more Risk – Although Council investments are restricted in a number of areas; there are investments available where the Council can take on more risk for a higher return. These include cash funds where the capital invested can decrease as well as increase, or widening the Council's credit criteria. The option of investing in a 'VNAV' (Variable Net Asset Value) funds are included within the Council's treasury strategy although the increase in return over and above what the Council is currently achieving varies according to the volatility of the fund and overall does not provide a financially material uplift. Widening the Council's credit criteria is not proposed at this time given the limited impact on return relative to the increase in risk.
- Increase limits with existing counterparties. Limits to existing counterparties are proposed to increase by £1m for all A-rated institutions as part of this report increasing exposure to counterparties who have a credit rating the Council is comfortable investing with whilst obtaining a yield that is respectable in the current economic environment.

A list of Counterparties available for use by the Council is enclosed at Appendix E.

Prudential Indicators

17. The CIPFA *Prudential Code for Capital Finance in Local Authorities (2011 Edition)* requires performance against specified key indicators to be measured and reported on a regular basis. The purpose of these indicators is to demonstrate prudence, affordability and sustainability.

18. An explanation of PIs is included in Appendix D. Key objectives of the indicators are to:

    - ensure borrowing is less than the Council's Capital Financing Requirement (CFR), demonstrating that all long term borrowing has been undertaken for capital purposes in line with the Prudential Code;
    - set the Council's authorised and operational borrowing limits;
    - show the percentage of the revenue budget required to be spent on financing borrowing; and
    - show the incremental impact of new capital investment decisions on Council Tax.

19. PIs are monitored throughout the year and reported to Audit Committee at Council mid-year and at the end of the financial year, in line with the best practice requirements outlined in the CIPFA Treasury Management Code of Practice.

20. Appendix D also includes a statement of the Council's Minimum Revenue Provision (MRP) policy, used to calculate the amount the Council is annually required to set aside towards repaying its CFR.