*PART 1 – PUBLIC DOCUMENT	AGENDA ITEM No. **11**

TITLE OF REPORT: TREASURY MANAGEMENT STRATEGY FOR 2017/18

REPORT OF THE STRATEGIC DIRECTOR OF FINANCE, POLICY & GOVERNANCE
EXECUTIVE MEMBER: COUNCILLOR T.W. HONE

1. SUMMARY

1.1 To seek Member approval of the Treasury Strategy Statement for 2017/18 and recommend its adoption by Council.

1.2 To seek Member approval of the Treasury Limits for 2017/18, including the Treasury Management Prudential Indicators, as required by the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

2. RECOMMENDATIONS

2.1 That Cabinet recommend to Council the adoption of the 2017/18 Treasury Strategy Statement (Appendix C). There are no major changes from the approved 2016/17 Treasury Strategy although there are a couple of clarifications to the Property Fund criteria detailed in 8.6.1.

2.2 That Cabinet recommend to Council the approval of the Treasury Limits for 2017/18.

(i) Interest Rate Exposure (see paragraph 3.4 Appendix C)
(ii) Maturity Structure of Borrowing (see paragraph 3.4 Appendix C)
(iii) Investment Strategy to continue to use Building Societies and UK Banks (see paragraph 4.2 Appendix C)
(iv) Total Principal Sums invested for periods longer than 364 days (see paragraph 4.3 Appendix C)

3. REASONS FOR RECOMMENDATIONS

3.1 To ensure the Council's continued compliance with the CIPFA Code of Practice on Treasury Management and the Local Government Act 2003 and that the Council manages its exposure to interest and capital risk.

4. ALTERNATIVE OPTIONS CONSIDERED

4.1 The Council must have in place a Treasury Strategy Statement, adopted by full Council, before the start of the financial year.

4.2 The primary principle governing the Council's investment criteria is the security of its investments, which include credit, liquidity and market risk (see section 8 below). After this the return (or yield) is then considered, which provides an income source for the Council. In general, greater returns can be achieved by taking on greater risk. Our current strategy is relatively low risk, but we have still been able to achieve a yield that is above the average achieved by the Capita Hertfordshire and Buckinghamshire Investment Benchmarking Group. Capita Asset Services advisors promote a more risk adverse approach in relation to investments with most Building Societies as they are not rated. This option has been dismissed on the basis of Members' appetite for risk, the impact on the general fund and controls on the value of investments with each Building Society.

5. CONSULTATION WITH RELEVANT MEMBERS AND EXTERNAL ORGANISATIONS

5.1 There is ongoing dialogue with the Authority's Cash Manager (Tradition) and regular meetings with Treasury advisors (Capita Asset Services).

6. FORWARD PLAN

6.1 This report contains a recommendation on a key decision that was first notified to the public in the Forward Plan on the 17 October 2016.

7. BACKGROUND

7.1 The Treasury Strategy Statement for 2016/17 was approved by Council on 11 February 2016. A mid year review of the Treasury Strategy was provided to Members in December 2016. There have been no changes made to the Strategy during the course of 2016/17.

7.2 The Code of Practice on Treasury Management requires that a report be submitted setting out four clauses which should be formally passed in order to approve adoption of the code. CIPFA recommends that public service organisations adopt as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses:

7.2.1 Clause 1

This organisation will create and maintain, as the cornerstone for effective treasury management:

- A Treasury Management Policy Statement stating the policies, objectives and approach to risk management of its treasury management activities (Appendix A). This remains unchanged to the Policy Statement approved on 11 February 2016.

- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities. (Appendix B). Changes to the Strategy that amend the TMPs are detailed in 8.6.1.

The content of the Policy Statement and TMPs will follow the recommendations contained in sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendment will not result in the organisation materially deviating from the Code's key principles.

7.2.2 Clause 2
Report annually on treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

7.2.3 Clause 3
Delegate responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet and for the execution and administration of treasury management decisions to the Strategic Director of Finance, Policy and Governance who will act in accordance with the Authority's policy statement and treasury management practices and the CIPFA Standard of Professional Practice on Treasury Management.

7.2.4 Clause 4
This organisation nominates the Finance, Audit and Risk Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

7.3 The Prudential Code, under the Local Government Act 2003, requires Local Authorities to set an authorised limit and an operational boundary for its total external debt.

7.4 CIPFA revised the Code of Practice on Treasury Management and the Prudential Code in 2009 to include new financial indicators that Local Authorities have to set. These are incorporated into the revised Treasury Strategy Statement.

8. ISSUES

8.1 The Council's activities expose it to a variety of risks (credit, liquidity and market). The Treasury Strategy sets out the Authority's appetite for the level of exposure to these risks. Each element of risk and the approach of the Authority to mitigate the exposure to the risks is described below.

8.2 **Credit Risk –** The possibility that other parties fail to pay amounts due to the Authority.

8.2.1 The Council's counterparty list comprises mostly UK building societies and UK banks with a Fitch credit rating greater than BBB but also includes other Local Authorities, and Public Corporations. Foreign banks with a UK subsidary, if they are subject to the same stress tests as UK banks, were added to the counterparty list in the 2015/16 strategy to give another outlet for our investments.

8.2.2 The average rate of interest achieved on investments by NHDC compares favourably to our Hertfordshire neighbours. This is mainly due to our investment strategy which permits investments to be placed with non-rated building societies and for a period of time of 12 months or more. This is in contrast to many authorities who will not lend to the building society sector, prefer to keep investments to less than one year and have taken a more risk averse position with regards to counterparties.

8.2.3 Building societies are regulated to the same standards as UK banks and are prevented by law from undertaking risky financial trading.

8.2.4 In the past when a building society has encountered difficulties, a merger with a stronger society has ensured that both wholesale depositors and retail savers experienced no interruption to service. There is of course no guarantee that this would continue to happen.

8.3 **Liquidity Risk –** the possibility that the Authority may not have funds available to meet its commitments to make payments.

8.3.1 Cash flow forecasts are prepared to determine the level of funds required to meet the day to day commitments with investments split between Tradition (NHDC's Cash

Manager) and the in-house treasury team. In-house investments cover the day to day cash flow activity of the Council whilst the Cash Manager's investments take advantage of higher longer term interest rates when they become available.

8.4 **Market Risk** - the possibility that financial loss might arise as a result of changes in interest rates.

8.4.1 Investing long term (greater than one year) currently achieves higher interest rates than short term deals. The risks of long term deals are two fold:

(i) The longer the time period the longer the investment is exposed to default.
(ii) If the investment has a fixed interest rate, interest rates could rise and the potential to invest at a higher rate will be lost until the investment matures.

8.4.2 Members have indicated that they are prepared to accept this risk within the limits expressed in the Treasury Strategy and there is no proposed change to the current practice of allowing no more than 40% of outstanding investments to be invested for longer than 364 days at any one time. The S151 Officer will be required to approve any deal longer than two years.

8.5 **Borrowing**

8.5.1 The Authority has a negative Capital Financing Requirement (CFR). As the Authority's credit ceiling is negative to such a significant extent, it would not be prudent to raise external finance (i.e. borrow) even though the Council could potentially benefit in the longer term from the low interest rates currently available. In other words, such action could be considered to be in breach of the requirements of S.1 of the Local Government Act 2003. Therefore instead of borrowing to finance capital projects there will be a drawdown of cash balances, such as capital reserves to fund the capital programme.

8.5.2. The balance of investments placed via Cash Managers at the start of 2016/17 was £28.5million The level of balances with the Cash Managers is expected to reduce by a £11.3million during 2016/17 to fund the capital programme. Total investment interest in 2016/17 will be in the region of £0.43million.

8.6 **Treasury Management Statement**

8.6.1 The Treasury Management Statement for 2017/18 is attached in Appendix C. There have been no substantial changes from the 2016/17 Statement, however, some clarifications to the Property Fund criteria have been added:

(i) Clarification of how the maximum investment period operates in relation to property funds. There are both up-front set up and exit costs for Property Funds. The capital value of these funds also fluctuates over time. Whilst in general it is possible to exit these funds at any time, there are likely to be more optimum times to do so. Therefore, there will not be a requirement to disinvest in line with the maximum period of investment of 5 years, and instead investments will be monitored on a regular basis to balance the need for cash (liquidity risk) with exit costs (market risk).
(ii) No more than 25% of investments to be placed with Property Funds.

(iii) As Property Funds and Building Societies are exposed to the property market, the combined value of these investments will not exceed 75% of total investments.

8.6.2 Officers will continue to be diligent to ensure achievement of the underlying principles for security, liquidity and yield, in that order.

9. LEGAL IMPLICATIONS

9.1 Section 151 of the Local Government Act 1972 states that:
"every local authority shall make arrangements for the proper administration of their financial affairs and shall secure that one of their officers has responsibility for the administration of those affairs."

9.2 The proposed code of practice complies with this statutory provision.

9.3 The proposed Prudential Indicators comply with the Local Government Act 2003.

10. FINANCIAL IMPLICATIONS

10.1 There are no direct financial implications arising from the adoption of the Code and the Treasury Management Strategy. However, it is important to note that the Council currently receives approximately £0.3M a year of interest from its cash investments and this is used to help fund general fund expenditure. The Strategy has an impact on the amount of interest achievable and any significant change to the strategy would, as a result, impact on the general fund and lead to higher savings targets if interest receivable were to fall as a result.

10.2 The Treasury Management Strategy reflects the Council's risk appetite, which inevitably varies between different authorities, as referenced in 8.2.2 above.

10.3 The Treasury Management function is audited annually. The Treasury Management Audit Report in December 2015 concluded that a substantial level of assurance can be gained from the system of controls in operation.

11. RISK IMPLICATIONS

11.1 Risks associated with treasury management and procedures to minimise risk are outlined in the Treasury Management Practices document, TMP1 which was adopted by Cabinet in July 2003. The risk on the General Fund of a fall of investment interest below the budgeted level is dependent on banks and building societies need for borrowing. The introduction of the Funding for Lending Scheme which allows financial institutions access to low cost funding from Government for an extended period may impact on their need to borrow and the rates at which they are prepared to borrow. This will be monitored throughout the year.

12. EQUALITIES IMPLICATIONS

12.1 The Equality Act 2010 came into force on the 1st October 2010, a major piece of legislation. The Act also created a new Public Sector Equality Duty, which came into force on the 5th April 2011. There is a General duty, described in 12.2 that public bodies must meet, underpinned by more specific duties which are designed to help meet them.

12.2 In line with the Public Sector Equality Duty, public bodies must, in the exercise of its functions, give **due regard** to the need to eliminate discrimination, harassment, victimisation, to advance equality of opportunity and foster good relations between those who share a protected characteristic and those who do not.

12.3 There are no direct equalities implications arising from the adoption of the Code and the Treasury Management Strategy.

13. SOCIAL VALUE IMPLICATIONS

13.1 There are no social value implications arising from the adoption of the Code and the Treasury Management Strategy.

14. HUMAN RESOURCE IMPLICATIONS

14.1 There are no direct human resource implications arising from the adoption of the Code and the Treasury Management Strategy.

15. APPENDICES

15.1 Appendix A - Treasury Management Policy Statement.
Appendix B - Treasury Management Practices.
Appendix C - Treasury Strategy Statement.

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17. BACKGROUND PAPERS

17.1 CIPFA Treasury Management in the Public Services Code of Practice fully revised third addition 2009.

17.2 CIPFA Prudential Code for Capital Finance in Local Authorities fully revised second addition 2009.