

TITLE OF REPORT: ITEM REFERRED FROM CABINET: 27 JANUARY 2015 – TREASURY MANAGEMENT STRATEGY FOR 2015/16

The following is an extract from the Draft Minutes of the Cabinet meeting held on 27 January 2015.

106. TREASURY MANAGEMENT STRATEGY FOR 2015/16

The Portfolio Holder for Finance and IT presented a report of the Strategic Director of Finance, Policy and Governance in respect of the Treasury Management Strategy for 2015/16. The following appendices were submitted with the report:

Appendix A – Treasury Management Policy Statement;
Appendix B – Treasury Management Practices; and
Appendix C – Treasury Strategy Statement.

The Portfolio Holder for Finance and IT advised that the Strategy had been considered by the Finance, Audit and Risk Committee, and no changes had been proposed.

The Portfolio Holder for Finance and IT drew attention to the major changes to the 2015/16 Treasury Strategy Statement, as follows:

- Increase the maximum balance allocated to Tradition and in-house Officers to £30million each (previously £23million and £22million respectively). This would enable the allocation of Sterling's investments as they matured (following Sterling's termination of their role as NHDC's Cash Manger) (see Appendix C 4.2);
- Remove the limit of £20million as a maximum amount that could be invested longer than 364 days and replace this numeric maximum with a percentage value of outstanding investments – maximum of 40%. As the level of investment balance falls £20million becomes a larger percentage of the total investments. This would remove the need to annually revise this limit (see Appendix C 4.2);
- Allow in-house deals to be made for longer than 364 days – some Sterling Investments would be brought back in-house to fund Capital expenditure during the year. If the Capital programme slipped there may be an opportunity to invest funds longer than 364 days (see Appendix C 4.3);
- Continue to exclude foreign banks from NHDC's lending list, but include UK subsidiaries of foreign banks that were subject to the same stress tests as UK banks. This may increase the investment interest generated in-house from short term deals. (see Appendix C 4.2);
- Retain maximum monetary values with counter parties, but introduce a maximum percentage value. No more than 10% of outstanding investments to be placed with any one counter party. This would result in a greater spread of investments, but may mean a reduced level of interest (see Appendix C 4.2);
- Exclude the Council's current account with the general banking provider (Lloyds) from restrictive limits. Interest earned on the current account was in some instances more favourable than short term investments. This would remove the need to move funds from the current account and place them with another counter party at a reduced rate of interest when the total balance of cash in Lloyds accounts reached £9million (or 10% of total investments) (see Appendix C 4.2);

- Limit sector exposure:
 - No more than 75% of investments to be placed with Banks
 - No more than 75% of investments to be placed with Building Societies
 - No more than 25% of investments to be placed with Money Market FundsThis would result in a greater spread of investments, but may mean a reduced level of interest (see Appendix C 4.2); and
- Add Certificates of Deposit – This would offer another outlet for investments if rates were favourable. (Appendix C 4.2).

The Strategic Director of Finance, Policy and Governance answered a number of Members' questions on the proposed Strategy.

RECOMMENDED TO COUNCIL:

- (1) That the Treasury limits for 2015/16 be approved as follows:
 - (i) Interest Rate Exposure (as at Paragraph 3.4, Appendix C);
 - (ii) Maturity Structure of Borrowing (as at Paragraph 3.4, Appendix C);
 - (iii) Investment Strategy to continue to use Building Societies and UK Banks, as detailed in Paragraph 8.5.1 of the report (as at Paragraph 4.2, Appendix C);
 - (iv) Total Principal Sums invested for periods longer than 364 days (as at Paragraph 4.3, Appendix C); and
- (2) That the Treasury Management Strategy for 2015/16, as set out at Appendix C to the report, be approved;

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

The following is the report considered by Cabinet at its meeting held on 27 January 2015.

TITLE OF REPORT: TREASURY MANAGEMENT STRATEGY FOR 2015/16

REPORT OF THE STRATEGIC DIRECTOR OF FINANCE, POLICY & GOVERNANCE

PORTFOLIO HOLDER: COUNCILLOR T.W. HONE

1. SUMMARY

- 1.1 To seek Member approval of the Treasury Strategy Statement for 2015/16 and recommend its adoption by Council.
- 1.2 To seek Member approval of the Treasury Limits for 2015/16, 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 2015/16 Treasury Strategy Statement (Appendix C).
- 2.2 That Cabinet recommend to Council the approval of the Treasury Limits for 2015/16.
 - (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, UK Banks and additions as detailed in 8.5.1 (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 Considerations for the Treasury Strategy can be summarised under the headings; Security, Liquidity and Yield. These considerations are listed in order of importance but all have an influence on the adopted Strategy. In particular the yield from investments is an important income stream for the general fund. The current strategy enables an above average yield (compared to the other Hertfordshire Districts) of approximately £0.36M of interest per annum. Sector Treasury advisors promote a more risk averse approach in our opinion, which would not currently allow investment with most Building Societies. This option has been dismissed on the basis of Members' appetite for risk and the impact on the general fund.

5. CONSULTATION WITH EXTERNAL ORGANISATIONS AND WARD MEMBERS

- 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 1 August 2014.

7. BACKGROUND

- 7.1 The Treasury Strategy Statement for 2014/15 was approved by Council on 13 February 2014. A mid year review of the Treasury Strategy was provided to Members in December 2014. There have been no changes made to the Strategy during the course of 2014/15.

- 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 13 February 2014.
- 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 8.5.1.

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 During the unprecedented economic turmoil within the money markets and the collapse of banks and other financing institutions, more regard than ever has had to be placed on sound treasury management. 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.
- 7.5 A key underlying principle of the Treasury Strategy is for Security, Liquidity and Yield in that order.
- 7.6 When the housing stock was transferred to North Herts Homes in 2003, the Council employed two Cash Managers (Sterling and Tradition) to arrange investments from the proceeds. This arrangement has continued successfully until December when Sterling gave notice that they would be terminating the contract from 31st December. See 8.5.1 below.

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 Authorities 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. Firstly, **Credit Risk** – The possibility that other parties fail to pay amounts due to the Authority.
- 8.1.1 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. Money Market Funds were added to the counterparty list in the 2013/14 strategy to give another outlet for our investments. No funds have yet been placed with a Money Market Fund but this is expected to change in 2015/16. The inclusion of Certificates of Deposits and UK subsidiaries of foreign banks has been clarified in the counterparty list in 2015/16.
- 8.1.2 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 adverse position with regards to counterparties.
- 8.1.3 Building societies are regulated to the same standards as UK banks and are prevented by law from undertaking risky financial trading.
- 8.1.4 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.

- 8.1.5 The Authority has not previously used Money Market Funds as a counterparty for investments. The high rated funds (AAA) are considered a low risk counterparty because of the nature of the way investments in the fund are grouped and then invested widely. The return of such funds is relatively low but the availability of a fund in the Authority's portfolio of counterparties will help to ensure the continued spread over a number of counterparties.
- 8.2 **Liquidity Risk** – the possibility that the Authority may not have funds available to meet its commitments to make payments.
- 8.2.1 Investments have been managed in a split between two Cash Managers (Sterling and Tradition) and the in-house treasury team. In-house investments cover the day to day cash flow activity of the Council whilst the Cash Managers' investments take advantage of higher long term interest rates when they become available. In December 2014 Sterling gave notice to terminate their contract and so it is necessary to consider how funds will be managed in 2015/16. After a review of the options it is proposed to continue with one cash manager, Tradition, with the remaining funds managed in-house.
- 8.3 **Market Risk** - the possibility that financial loss might arise as a result of changes in interest rates.
- 8.3.1 Investing long term (greater than one year) currently achieves higher interest rates than short term deals. The risk 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.
- 8.3.2 Members have indicated that they are prepared to accept this risk within the limits expressed in the Treasury Strategy. There is a proposed change to the current strategy. The limit to allow no more than £20m to be invested for longer than 364 days at any one time is proposed to be replaced with a limit to allow no more than 40% of outstanding investments to be invested longer than 364 days at any one time. This change ensures the on going relevance of this limit as cash balances continue to decline. The S151 Officer will be required to approve any deal longer than two years.
- 8.4 **Borrowing**
- 8.4.1 The Authority has a negative Capital Financing Requirement (CFR). As the Authority's credit ceiling is negative to such a significant extent, it is not likely that it would be considered prudent if any more external finance were to be raised. 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.
- 8.4.2 The balance of investments placed via Cash Managers at the start of 2014/15 was £36.5million The level of balances with the Cash Managers is expected to reduce by a £3.5million during the final quarter of 2014/15 to fund the capital programme. Total investment interest in 2015/16 will be in the region of £0.4million.

8.5 Treasury Management Statement

8.5.1 The Treasury Management Statement for 2015/16 is attached in Appendix C. There are several changes and clarifications from the 2014/15 Statement which will assist to ensure a reasonable diversification of the cash balances. Where limits have changed we will migrate to the new limits as timings allow during the course of 2015/16:

- Increase the maximum balance allocated to Tradition and in house Officers to £30million each (previously £23million and £22million respectively). This will enable the allocation of Sterling's investments as they mature (following Sterling's termination of their role as our Cash Manger). (Appendix C 4.5)
- Remove the limit of £20million as a maximum amount that can be invested longer than 364 days and replace this numeric maximum with a percentage value of outstanding investments – maximum of 40%. As the level of investment balance falls the limit of £20million becomes a larger percentage of the total investments. This will remove the need to annually revise this limit. (Appendix C 4.3)
- Allow in house deals to be made for longer than 364 days – Some Sterling Investments will be brought back in house to fund Capital expenditure during the year. If the Capital programme slips there may be an opportunity to invest funds longer than 364 days. (Appendix C 4.3)
- Continue to exclude foreign banks from our lending list but include UK subsidiaries of foreign banks that are subject to the same stress tests as UK banks. This may increase the investment interest generated in house from short term deals. (Appendix C 4.2)
- Retain maximum monetary limits with counter parties, but introduce a maximum percentage value. No more than 10% of outstanding investments to be placed with any one counter party. This will result in a greater spread of investments but may mean a reduced level of interest. (Appendix C 4.2)
- Exclude the Council's current account with the general banking provider (Lloyds) from restrictive limits. Interest earned on the current account is in some instances more favourable than short term investments. This will remove the need to move funds from the current account and place them with another counter party at a reduced rate of interest when the total balance of cash in Lloyds accounts reaches £9million (or 10% of total investments). (Appendix C 4.2)
- Limit sector exposure:
 - No more than 75% of investments to be placed with Banks
 - No more than 75% of investments to be placed with Building Societies
 - No more than 25% of investments to be placed with Money Market FundsThis will result in a greater spread of investments but may mean a reduced level of interest. (Appendix C 4.2)
- Add Certificates of Deposit – This will offer another outlet for investments if rates are favourable. (Appendix C 4.2)

- 8.5.2 Officers will continue to be diligent to ensure 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 £0.4M 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 8.1.2 above.
- 10.3 Treasury Management is audited annually. The Audit Report in December 2014 concluded that a substantial level of assurance can be gained from the system of controls in operation over Treasury Management

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.

16. CONTACT OFFICERS

Author:

- 16.1 Dean Fury, Corporate Support Accountant, Tel 474509, email dean.fury@north-herts.gov.uk
- 16.2 Tim Neill, Accountancy Manager, Tel 474461, email: tim.neill@north-herts.gov.uk
- 16.3 Andrew Cavanagh, Head of Finance, Performance and Asset Management, Tel 474243, email andrew.cavanagh@north-herts.gov.uk
- 16.4 Norma Atlay, Strategic Director of Finance, Policy & Governance, Tel 474297, email: norma.atlay@north-herts.gov.uk

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.