

TITLE OF REPORT: TREASURY MANAGEMENT STRATEGY FOR 2012/13

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 2012/13 and recommend its adoption by Council.
- 1.2 To seek Member approval of the Treasury Limits for 2012/13, 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. FORWARD PLAN

- 2.1 This report contains a recommendation on a key decision that was first notified to the public in the Forward Plan on the 1st November 2011.

3. BACKGROUND

- 3.1 The Strategy Statement on Treasury Management in Local Authorities was revised by Cabinet on 25th January 2011 (Investments longer than 364 days to be increased to £20M in total).
- 3.2 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:
 - 3.2.1 Clause 1
This organisation will create and maintain, as the cornerstones 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 by Cabinet on 25th January 2011.
 - 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). This remains unchanged to the Policy Statement approved by Cabinet on 25th January 2011.

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 amendments will not result in the organisation materially deviating from the Code's key principles.

- 3.2.2 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.
- 3.2.3 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, CIPFA's Standard of Professional Practice on Treasury Management.
- 3.2.4 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.
- 3.3 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. This replaced part IV of the Local Government and Housing Act 1989, which required Local Authorities to set the overall borrowing limit, the short term borrowing limit and the proportion of interest which is payable by them at variable rates. This is the ninth year (2012/13) where this act applies.
- 3.4 During the unprecedented economic turmoil within the money markets and the collapse of banks and other financing institutions, more regard than ever has 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.
- 3.5 A key underlying principle of the Treasury Strategy is for Security, Liquidity and Yield in that order.

4. ISSUES

- 4.1 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 of these risks, 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
- 4.1.1 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, Public Corporations and Discount Houses.
- 4.1.2 The average rate of interest achieved on investments by NHDC compares very favourably to our Hertfordshire neighbours. This is mainly due to our investment strategy which permits investments to be placed with non-rated building societies. 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.
- 4.1.3 Building societies are regulated to the same standards as UK banks and are prevented by law from undertaking risky financial trading.

- 4.1.4 When local authority deposits are placed with building societies, they are treated as “wholesale” and not “retail”. In the event of a building society collapsing, “wholesale” investments are better protected and are paid back before “retail” deposits. However, 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 in the current uncertain times.
- 4.2 **Liquidity Risk** – the possibility that the Authority may not have funds available to meet its commitments to make payments.
- 4.2.1 Investments are split between two Cash Managers and the In-House team. The 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.
- 4.2.2 The Council is currently seeking to increase the amount of borrowing either in the short or longer term to ensure adequate levels of cash are available and to fund the immediate capital programme. The low base rate does mean borrowings in the short term are at preferential rates. However, the affordability of the amount of borrowing will need to continually be monitored through the quarterly monitoring reports.
- 4.3 **Market Risk** - the possibility that financial loss might arise as a result of changes in interest rates.
- 4.3.2 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.
- 4.3.3 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 £20m to be invested for longer than 364 days at any one time.
- 4.3.4 However, to reflect the current uncertainty in the financial markets an additional control has been inserted (paragraphs 3.6.1 and 5.16 of Appendix C) which requires the approval of the S151 Officer of any deal longer than two years.
- 4.4 **Borrowing**
- 4.4.1 The level of cash balances is decreasing as expenditure on the capital programme continues but capital receipts from asset disposals are not forthcoming. In order to maintain our level of investment balance and fund capital expenditure it may be financially beneficial to borrow to fund capital expenditure rather than consume the investment principal.
- 4.4.2. NHDC has £46M of investments placed via Cash Managers. Total investment interest in 2012/13 will be in the region of £1m. Currently investments can be placed that achieve higher rates of interest than interest rates paid on any new borrowing.
- 4.5 **Treasury Management Statement**
- 4.5.1 The Treasury Management Statement for 2012/13 is attached in Appendix C. There are no major changes from the 2011/12 Statement, except for the insertion of an additional control whereby the Section 151 officer must approve investments deals that are for a period greater than 2 years (see 4.3.4).

- 4.5.2 Officers will continue to be diligent to ensure the underlying principles for security, liquidity and yield, in that order. A recent example of this is where officers turned down an investment deal, suggested by a cash manager, for investing in a Building Society, which on investigation appeared to have an unusually high exposure to the Eurozone. An alternative Building Society was chosen, albeit at a slightly lower rate of interest on the investment. Officers have also recently turned down deals of relatively high interest rates for longer term deals (greater than 2 years) because, although it was allowable in the Strategy, it was felt that the exposure to market risk was too great.
- 4.5.3 The 2003 Local Government Act changed the requirements to set-aside Housing capital receipts. Officers are continuing to work with our external auditors to conclude that the Council may now be able use some of the Council's set-aside receipts for funding capital expenditure. This may result in a revision during the year to the Prudential Indicators and the investment interest forecast.

5. LEGAL IMPLICATIONS

- 5.1 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.”
- 5.2 The proposed code of practice complies with this statutory provision.
- 5.3 The proposed Prudential Indicators comply with the Local Government Act 2003.

6. FINANCIAL AND RISK IMPLICATIONS

- 6.1 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 £1million a year of interest from its cash investments and this is used to help fund general fund expenditure. The Strategy has a significant 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.
- 6.2 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 unlikely since the estimates are based on low interest rates which reflect the low Base Rate of 0.5%.
- 6.3 The Treasury Management Strategy reflects the council's risk appetite , which inevitably varies between different authorities, as referenced in 4.1.2 above.
- 6.4 Treasury Management is internally audited annually. The Audit Report in November 2010 concluded that a substantial to full level of assurance can be gained from the system of controls in operation over Treasury Management. A further audit was recently completed and the auditor has indicated in the draft report that they can provide an overall 'Substantial' level of assurance.

7. HUMAN RESOURCE AND EQUALITIES IMPLICATIONS

- 7.1 There are no direct human resource or equalities implications arising from the adoption of the Code and the Treasury Management Strategy.

8. RECOMMENDATIONS

- 8.1 Cabinet is requested to approve the Strategy for 2012/13 and recommend to Council its adoption (Appendix C).
- 8.2 Cabinet is requested to approve the Treasury Limits for 2012/13.
- (i) Interest Rate Exposure (see paragraph 3.4.3, Appendix C)
 - (ii) Maturity Structure of Borrowing (see paragraph 3.5.3, Appendix C)
 - (iii) Total Principal Sums invested for periods longer than 364 days (see paragraph 3.6.1, Appendix C)
 - (iv) Investment Strategy to continue to use Building Societies and UK Banks (as per paragraph 5.11, Appendix C)

9. REASONS FOR RECOMMENDATIONS

- 9.1 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.

10. APPENDICES

- 10.1 Appendix A - Treasury Management Policy Statement
Appendix B - Treasury Management Practices
Appendix C - Treasury Strategy Statement

11. CONTACT OFFICERS

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12. BACKGROUND PAPERS

- 12.1 CIPFA Treasury Management in the Public Services Code of Practice fully revised third addition 2009.
- 12.2 CIPFA Prudential Code for Capital Finance in Local Authorities fully revised second addition 2009.

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