*PART 1 – PUBLIC DOCUMENT	AGENDA ITEM No. 7

TITLE OF REPORT : TREASURY MANAGEMENT STRATEGY FOR 2013/14

REPORT OF THE STRATEGIC DIRECTOR OF FINANCE, POLICY & GOVERNANCE

This report is in its final format and will be presented to Cabinet at the meeting to be held on 29 January 2013. This Committee is requested to review and note the report and that the Strategic Director of Finance, Policy and Governance to take note of any comments raised.

1. SUMMARY

1.1 To seek Member approval of the Treasury Strategy Statement for 2013/14 and recommend its adoption by Council.

1.2 To seek Member approval of the Treasury Limits for 2013/14, 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 2013/14 Treasury Strategy Statement (Appendix C).

2.2 That Cabinet recommend to Council the approval of the Treasury Limits for 2013/14.

(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 (as per 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 of approximately £700k of interest per annum. Sector Treasury advisors promote a more risk adverse approach which would not currently allow investment with most Building Societies. This would result in a yield of approximately £530k per annum. 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 Managers (Sterling and Tradition) and regular meetings with Treasury advisors (Sector).

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 September 2012.

7. BACKGROUND

7.1 The Treasury Strategy Statement for 2012/13 was approved by Council on 9 February 2012. A mid year review of the Treasury Strategy was provided to Members in December 2012.

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 9 February 2012.

- 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 on 9 February 2012.

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.

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.

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 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.

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. AAA Money Market Funds have been added to the counterparty list to give another outlet for our investments. The mid year review identified that it had become challenging to find counterparties willing to pay a reasonable return on cash investments, either long or short term. Sector had advised this could be in part due to the Government scheme to lend money to counter-parties who are willing to then lend to businesses. As a result there is less of a demand for Local Authority funds. This issue is expected to continue and there is also concern the quite preferable rate the Council receives on it's call account may reduce. Other options for cash investment therefore need to be considered in order to protect the overall yield from investment.

8.1.2 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 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 in the current uncertain times.

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 are split between two Cash Managers 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.

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

8.3.2 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.

8.3.3 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. 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. NHDC has £46M of investments placed via Cash Managers. Total investment interest in 2013/14 will be in the region of £0.7m. Any drawdown of these investments will be reported to Members through the Treasury Management quarterly monitoring reports.

8.4.3 As in the previous two years, given the pattern of cashflow over the 12 month period it may be necessary to borrow at the year end for a very short period of time. This is in part due to the collection of Council Tax and Business Rates over 10 months of the year, rather than in 12 equal instalments. The amount of borrowing will be within limits of the strategy.

8.5 **Treasury Management Statement**

8.5.1 The Treasury Management Statement for 2013/14 is attached in Appendix C. There is one major change from the 2012/13 Statement for the inclusion of Money Market Funds as a counterparty.

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

8.6 **Annual Treasury Management Audit 2012/13**

8.6.1 Treasury Management is audited on an annual basis by the Shared Internal Audit Service. The Audit Report in December 2011 concluded that a substantial level of assurance can be gained from the system of controls in operation over Treasury Management. At the time of writing the 2012/13 audit was underway, however the following initial comments were received from the auditor:

(i) Discount Houses. Following the Bank of England's decision to sanction the use of gilt repos as an approved instrument for 'Open Market Operations' and to widen its list of approved counterparties, discount houses no longer occupy a position in money market operations.
Management Response: Discount Houses are now removed from the list of counterparties.

(ii) It is common for organisations to monitor ratings from more than 1 agency.
Management Response: While the Treasury Management team use Fitch on a daily basis, the team also receive the creditworthiness service provided by Sector. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

(1)credit watches and credit outlooks from credit rating agencies;

(2)CDS spreads to give early warning of likely changes in credit ratings;

(3)sovereign ratings to select counterparties from only the most creditworthy countries.

(iii) With regard to the inclusion of Building Societies as a counter-party, past experience of Government support or mergers when a Society is in trouble can not necessarily be relied upon as evidence of what may happen in the future.

Management Response: Unrated Building Societies produce annual reports known as Pillar 3 reports. These provide some information regarding the risks and capital adequacy of the Society. These reports are reviewed by the Treasury Team before agreeing to deposit funds with the Society. A decision was taken recently, following such a review not to place a deposit with a Building Society because it had a high percentage of it's own deposits placed with European organisations.

(iv) It might be helpful to be clear how the Council ensures that in working with two investment houses and making its own investments the total investment with any single institution does not exceed the limits agreed by the Council for that Counterparty.

Management Response: A spreadsheet is maintained that shows counter party limits permitted for each of the Cash Managers and In House. Every investment is updated on this spreadsheet and a summary sheet ensures that the overall approved investment limits are not exceed. This spreadsheet is always referred to before a deal is agreed. In addition to the cash balances shown by counter party, their percentage of the total outstanding investments is recorded. This is used to try and spread the investments over a wide range of counter parties.

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 £700k 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.

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 internally audited annually. The Audit Report in December 2011 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 dependant 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 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.