FINANCE, AUDIT & RISK COMMITTEE
22 JANUARY 2018

PART 1 – PUBLIC DOCUMENT	AGENDA ITEM No. 10

The following is the report to be considered by the Cabinet at its meeting to be held on 23 January 2018. The Committee is invited to comment on the report.

TITLE OF REPORT: TREASURY MANAGEMENT STRATEGY FOR 2018/19

REPORT OF: THE HEAD OF FINANCE, PERFORMANCE AND ASSET MANAGEMENT
EXECUTIVE MEMBER: CLLR JULIAN CUNNINGHAM
COUNCIL PRIORITY: RESPONSIVE AND EFFICIENT

1. EXECUTIVE SUMMARY

1.1 To seek Member approval of the Treasury Strategy Statement for 2018/19 and recommend its adoption by Council. This includes the Treasury Management Prudential Indicators, as required by the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities.

1.2 There have been no significant changes to the Treasury Strategy from 2017/18. The main changes relate to borrowing limits (paragraph 8.5.1) and clarifications as to how the Minimum Revenue Provision will be calculated (paragraph 8.6.1).

2. RECOMMENDATIONS

2.1 That Cabinet recommend to Council the adoption of the 2018/19 Treasury Strategy Statement (Appendix C).

2.2 That the Committee review and comment on the compliance with the Code of Practice on Treasury Management.

3. REASONS FOR RECOMMENDATIONS

3.1 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.

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 includes 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 Link (formerly Capita) Hertfordshire and Buckinghamshire Investment Benchmarking Group. Link 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. Link Asset Services would also promote greater diversification in relation to non-UK deposits, however the Council have chosen not to invest outside of the UK.

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 (Link).

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 24 November 2017.

7. BACKGROUND

7.1 The Treasury Strategy Statement for 2017/18 was approved by Council on 9 February 2017. A mid year review of the Treasury Strategy was provided to Members in November 2017. There have been no changes made to the Strategy during the course of 2017/18

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 relates to creating and maintaining a Policy and practices as a 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 is unchanged from the Policy Statement approved by Full Council on 9 February 2017.

- 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).

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

7.2.2 Clause 2

This relates to the reporting on treasury activities. In accordance with the Code, there will be:

- An annual report on Policy and practices (as referred to in 7.2.1 above), contained within this report
- Treasury Strategy (a plan for the year), contained within this report
- Annual report after the end of the year, reported to Full Council in July
- Quarterly monitoring reports on treasury activities to Cabinet. This exceeds the guidance which just requires a mid-year review.

All these reports will be in the form set out in the TMPs.

7.2.3 Clause 3

This relates to the delegation of responsibility for the implementation and regular monitoring of its treasury management policies. The Council delegates 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 Head of Finance, Performance and Asset Management (the Chief Finance Officer) 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 relates to the scrutiny of treasury management strategy and policies. The Council 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 Treasury Strategy Statement.

7.5 The Department for Communities and Local Government (DCLG) carried out a consultation on changes to guidance in relation to the prudential framework for capital finance. The consultation closed on the 22 December and the feedback will need to be analysed before final guidance is issued. Given the timing it is hoped that there will not be a requirement for any changes to be made to strategies for 2018/19. The most significant change could be that capital investments whose primary purpose is to generate a financial return will need to be assessed as though they are treasury investments. This will require an assessment of security and liquidity.

8. RELEVANT CONSIDERATIONS

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 investments to cover the day to day cash flow activity and longer-term investments that take advantage of higher 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 365 days at any one time. The Chief Finance Officer will be required to approve any deal longer than two years.

8.5 **Borrowing**

8.5.1 The Authority currently has a negative Capital Financing Requirement (CFR), although it is expected that it will reduce to close to zero during 2018//19. Depending on the timing of capital expenditure and receipts and any new opportunities for capital investment, there may be a need to borrow during 2018/19. The Treasury Management Strategy therefore proposes an operational boundary of £5m and an authorised limit of £15m (Appendix C at 3.2). These are both increases compared to 2017/18. The operational boundary is a maximum limit beyond which external debt is not normally expected to exceed. The authorised limit must not be exceeded. The Council will only borrow when it needs to do so, even though the Council could potentially benefit in the longer term from the low interest rates currently available. This would be imprudent and could be considered to be illegal as it would be in breach of the requirements of S.1 of the Local Government Act 2003. Therefore whilst they are still available the Council will continue to drawdown cash balances (i.e. capital reserves) to fund the capital programme.

8.5.2. The balance of longer term investments at the start of 2017/18 was £28.5million This is expected to reduce by £11.0million during 2017/18 to fund the capital programme. Total investment interest in 2017/18 will be in the region of £0.173million.

8.6 **Treasury Management Statement**

8.6.1 The Treasury Management Statement for 2018/19 is attached in Appendix C. There have been some changes in relation to borrowing limits (as referenced in 8.5.1 above) and some clarifications as to how the Minimum Revenue Provision (MRP) will be calculated have been added in Appendix C at 2.3. The MRP is a required charge to the General Fund (i.e. a cost to Council Taxpayers) when the Council borrows to fund capital expenditure. The intention is that it sets aside the money to repay the borrowing when it becomes due.

9. LEGAL IMPLICATIONS

9.1. Other than has already been set out in the report, section 151 of the Local Government Act 1972 provides 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." The Council has appointed such an officer and that person has delegated responsibilities in respect of these matters as set out in the body of the report.

9.2. The CIPFA Prudential Code provides that "Prudential Indicators… are required to be set… alongside the processes established for the setting… of the budget for the local authority". It also states that "*decisions around capital expenditure, investment and borrowing should align with the processes established for the setting and revising of the budget for the local authority*". As detailed in Appendix B, the Council sets Treasury Management Practices to comply with the CIPFA Treasury Management Code. This process includes a review by the Finance, Audit and Risk Committee and Cabinet, prior to Full Council approval. This is in line with the processes established for the setting of the Revenue Budget and Capital Programme, as detailed in the Constitution.

9.3. CIPFA Treasury Management Code recommends that "*local authorities should, as a minimum, report annually to full council on their Treasury Management Strategy and plan, before the start of the yea*r".

9.4. As a result, Full Council is asked to approve the Treasury Strategy Statement (Appendix C).

9.5 The CIPFA Prudential Code allows for detailed implementation and monitoring to be delegated to a Committee. As per the Constitution this is delegated to the Finance, Audit and Risk Committee, As a result. this Committee is asked to review and comment on the compliance with the Code of Practice on Treasury Management..

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 £0.2M 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 function is audited annually. The Treasury Management Audit Report in March 2017 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 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 has impacted on their need to borrow and the rates at which they are prepared to borrow.

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

12. EQUALITIES IMPLICATIONS

12.1 In line with the Public Sector Equality Duty, public bodies must, in the exercise of their 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.

12.2 There are no direct equalities implications arising from this report.

13. SOCIAL VALUE IMPLICATIONS

13.1 The Social Value Act and "go local" policy do not apply to this report.

14. HUMAN RESOURCE IMPLICATIONS

14.1 There are no direct human resource or equality implications.

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 and Cross Sectoral Guidance Notes 2017.

17.2 CIPFA Prudential Code for Capital Finance in Local Authorities, 2017.