CABINET

12 February 2013

Title: Treasury Management Strategy Statement 2013/14	
Report of the Cabinet Member for Finance	
Open Report	**For Decision**
Wards Affected: None	**Key Decision: Yes**
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Accountable Divisional Director: Jonathan Bunt, Divisional Director of Finance	
Accountable Director: Graham Farrant, Chief Executive	

Summary:

This report deals with the Treasury Management Annual Investment Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance under section 15 (1) (a) of the Local Government Act 2003.

The production and approval of a Treasury Management Annual Strategy Statement and Annual Investment Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.

The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which take into account the Council's capital investment plans for the next three years.

Recommendation(s)

The Cabinet is asked to recommended the Assembly to approve the Treasury Management Strategy Statement for 2013/14 attached at Appendix 1 to the report, and in doing so:

(i) The current treasury position for 2012/13 and prospects for interest rates, as referred to in sections 6 and 7 of Appendix 1;

(ii) The revised Authorised Borrowing Limit (General Fund and HRA) of £502m for 2012/13, which includes an estimated £15m borrowing to finance the 2012/13 Capital Programme;

(iii) The Council's Borrowing Strategy, Debt Rescheduling Strategy and Policy on borrowing in advance of need for 2013/14, including the effects on treasury management of Housing Revenue Account reform, as referred to in sections 9 - 12 of Appendix 1;

(iv)	The Minimum Revenue Policy Statement for 2013/14 setting out the Council's policy on repayment of debt as set out in Appendix 1C;
(v)	The Authorised Borrowing Limit (General Fund and HRA) of £499m for 2013/14, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as set out in Appendix 1B;
(vi)	The Treasury Management Indicators and Prudential Indicators for 2013/14, as set out in Appendix 1B; and
(vii)	The Annual Investment Strategy and Creditworthiness Policy for 2013/14 outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1D.
Reason(s) To enable the Council to accord with the requirements of the Local Government Act 2003.	

1. Introduction and Background

1.1 This report provides a brief explanation of the key elements of the Council's Treasury Management Strategy, its MRP Strategy and the Annual Investment Strategy for 2013/14, which are set out in detail in Appendix 1 to this report. The Council is statutorily required to approve the Treasury Management Strategy prior to the new financial year.

1.2 The key elements of the Strategy relate to the following:

- Investment Strategy – relating to the management of the Council's cash balances;
- Borrowing Strategy – relating to the financing of the Council's capital programme;
- Minimum Revenue Provision Strategy – a council has a duty to charge to its general fund an amount of MRP which it considers to be "prudent".

1.3 The report also summarises proposed changes to strategy from last year.

2. Proposal and Issues

2.1 Cash Management

2.1.1 The Council has cash balances arising from its operational activities, i.e. sources of income such as grants and Council Tax are received during the year and this is offset by daily expenditure to run services. Due to the timing of these cash inflows and outflows, a surplus of cash is available at any point in time for investing. This is because, in general, significant sources of income for the year such as grants are receipted in advance of expenditure, plus the Council also holds specific reserves for future expenditure plans.

2.1.2 Cash balances are also affected by "working capital", which relates to amounts of outstanding payments to be made to suppliers (accounts payable) offset by amounts owed to the Council (accounts receivable). Cash balances are higher when the level of accounts payable is greater than accounts receivable, because the Council has incurred net expenditure in accounting terms which has not been paid for in cash terms.

2.1.3 The Council's historical cash balances as at the year end (31 March) since 2009 are provided below.

2011/12 - £100m
2010/11 - £94m
2009/10 - £116m
2008/09 - £125m

The forecast for 2012/13 is for the Council to have a cash balance of £125m, which is significantly higher than the cash balance for 2011/12.

2.1.4 These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund and HRA Fund balances;
- Earmarked Reserves;
- Capital Receipts;
- Provisions;
- Loans from Public Works Loan Board and banks to fund capital expenditure but not yet spent;
- Working Capital.

2.1.5 At the end of December 2012, the Council's cash balances totalled £135m and were invested as follows:

Bank / Counterparty	£m
Internally Managed:	
Lloyds TSB Group	46.0
Royal Bank of Scotland	30.0
Santander Group	0.1
Barclays	15.0
Money Market Funds	
Federated Prime Rate	4.7
Goldman Sachs	0.1
External Fund Managers:	
Investec Asset Management	39.1
Total	**135.0**

2.2 Investment Strategy

2.2.1 The Council's investments are managed on the following principles, in order of priority:

- **Security** – minimising the risk of losing cash arising from a bank failure and consequent default (as occurred with Icelandic Banks in 2008).
- **Liquidity** – ensuring the Council will have access to cash as required to meet daily expenditure obligations.
- **Yield** – after ensuring the above are met, the Council will aim to maximise interest earnings on cash invested.

2.2.2 As financial markets are still being affected by the Eurozone crisis, with increasing credit risk for banks in the Eurozone area and a number of bank and country rating downgrades, it is proposed to continue the policy of limiting investments to UK banks until there is a satisfactory resolution to the crisis. The TMS does allow for the use of AAA rated foreign banks and these will continue to be monitored.

2.2.3 Following a number of credit rating downgrades in 2012, the number of counterparties that the Council can invest in has decreased further. At the same time the amount of cash held by the Council has increased from £100m as at 31 March 2012, to £135m as at 31 December 2012. As a result of the reduction in counterparties, in the Treasury Management Strategy Statement Mid-year Review Report, Members agreed to increase the counterparty investment for Lloyds TSB from £30m to 40% of the current cash balance. It is proposed that this increase in limit is maintained throughout 2013/14.

2.2.4 In the past the Council has set a minimum short term rating and long term credit rating restriction for investment. While this is a reasonable approach, the Counterparties the Council invests in are exposed to a greater range of factors that should be considered when monitoring their counterparty risk. It is therefore recommended that the Council applies the creditworthiness service provided by its advisor, Sector, which 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:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

2.2.5 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments and are outlined in detail in Appendix 1 section 16.

2.2.6 The use of derivative financial products will continue to be excluded from the strategy due to potential losses arising from instability in the financial markets at this time.

2.3 Borrowing Strategy

2.3.1 The Council is allowed to borrow funds from the capital markets for two purposes:

(i) Short term temporary borrowing for day to day cash flow purposes to ensure liquidity. This is likeliest to occur towards the end of the financial year when the Council's cash balances are lowest and Council's own cash may be tied up in longer term investments.

(ii) Long term borrowing to finance the capital programme where the Council can demonstrate the borrowing is affordable. The Council receives external funding (e.g. grants, TfL contributions etc) to meet a large proportion of its capital expenditure but some projects do not attract specific funding. These projects have to be funded by the Council from sources such as capital receipts from the sale of property. However in recent years the Council has not had these funds available and therefore has had to borrow.

2.3.2 The Council's borrowing as at 31 December 2012 was made up of four elements:

a) External loans from Public Works Loan Board and private banks - £60m;
b) HRA PWLB Loans - £266m;
c) PFI/finance lease liabilities - £58m; and
d) "Internal" borrowing - £99m.

2.3.3 Internal borrowing represents the use of surplus available cash balances to pay for capital spend, rather than undertaking new external loans. The Council will use internal cash balances by reducing investments when deposit rates on investments are lower than interest rates on new loans. This is because the lost interest earnings on reduced cash balances are cheaper than increased interest payable on a new external loan. An additional advantage of maintaining a lower cash holding amount is that it ensure that the Council's investment risk exposure is lower.

2.3.4 In 2013/14 a continuation of low short term interest rates compared to the medium and longer term rates is expected. This indicates that it is likely that there will be an on-going "cost of carry" for holding cash through borrowing in advance of capital expenditure being incurred. Therefore it is recommended that the Council continues the strategy of keeping cash balances low and utilising internal borrowing to finance capital expenditure.

2.4 Repayment of Borrowing

2.4.1 The Council's external borrowings are all loans where the principal is repaid at maturity. A loan of £10m is scheduled to be repaid in 2013/14 and it is proposed to fund the principal repayment from revenue or generating capital receipts.

2.3.7 Internal borrowing can be also be reduced by generating capital receipts, which will replenish cash balances and in accounting terms be used for financing historic spend rather than for new capital projects.

3. Financial Implications

3.1 The financial implications have been discussed in detail in earlier sections of this report.

4. Legal Implications

Implications completed by: Eldred Taylor-Camara, Legal Group Manager

4.1 The Local Government Act 2003 (the "Act") requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

4.2 The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

4.3 This report sets out the Councils strategies in accordance with the Act.

5. Other Implications

5.1 **Risk Management** - This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would fall adversely. The mitigation of these is contained in this report.

Background Papers Used in the Preparation of the Report:

- Local Government Act 2003
- CIPFA – Revised Prudential Code for Capital Finance in Local Authorities
- CIPFA – Revised Treasury Management in the Public Services
- Budget Framework Report 2013/14
- HRA Business Plan v7 (16 Jan 2012)

List of appendices:

Appendix 1 – Treasury Management Strategy 2013/14
Appendix 1A – Interest Rate Forecasts 2013 – 2016
Appendix 1B – Prudential Indicators 2013/14 – 2015/16
Appendix 1C – Minimum Revenue Provision Policy Statement
Appendix 1D – Annual Investment Strategy
Appendix 1E – Approved countries for investments
Appendix 1F – Treasury management scheme of delegation and Section 151 officer responsibilities
Appendix 1G – Economic Background