

Agenda Item No: 9.6 **Report No:** 27/16
Report Title: Annual Treasury Management Strategy Statement and Investment Strategy 2016/2017 to 2018/2019
Report To: Cabinet **Date:** 8 February 2016
Cabinet Member: Councillor Bill Giles
Ward(s) Affected: All
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Purpose of Report:

To advise Cabinet of the proposed Treasury and Investment Strategies for 2016/2017 to 2018/2019.

To seek Council determination of (i) the 2016/2017 authorised borrowing limit (as required by section 3(1) of the Local Government Act 2003), (ii) the Council's 2016/2017 Investment Strategy and (iii) the method of calculating the Council's Minimum Revenue Provision.

Officers Recommendation(s):

1 To recommend to Council that:

- a. It adopts the Treasury Management Strategy Statement and Investment Strategy 2016/2017 to 2018/2019 set out in Appendix 1.
- b. The Council's 'Prudential Indicators' for the year are those set out in Appendix B of the Strategy document.
- c. The Council's level of affordable borrowing, determined in accordance with the Local Government Act 2003, is subject to the following limits:

	2016/2017	2017/2018	2018/2019
Authorised limit for external debt	£76.5m	£76.5m	£76.5m

- d. The Council's approach to allocating debt and associated costs between the Housing Revenue Account and General Fund be as set out in Section 9 of the Strategy Statement.
 - e. The Council's Minimum Revenue Provision be calculated as set out in Section 13 of the Strategy Statement.
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Reasons for Recommendations

1. The Council has adopted the CIPFA Code of Practice on Treasury Management. In accordance with the Code of Practice, the Cabinet recommends to Council an Annual Treasury Strategy Statement before the start of each financial year. This includes an Investment Strategy for the year ahead (which Government guidance notes should be adopted by full Council) as well as 'Prudential Indicators' which are required to be set in order to comply with the 'Prudential Code for Capital Finance in Local Authorities' (The Prudential Code). The majority of these indicators are an essential element of an integrated treasury management strategy.
2. The Local Authorities (Capital Finance and Accounting)(England)(Amendment) Regulations 2008 place a duty on local authorities to make a prudent provision for debt redemption. Guidance has been issued by the Secretary of State on determining 'Minimum Revenue Provision'.
3. Section 3 of the Local Government Act 2003 requires the Council to determine and keep under review how much money it can afford to borrow. This is known as the 'affordable borrowing limit'.

Annual Treasury Management Strategy Statement and Investment Strategy 2016/2017 to 2018/2019

1. Introduction

- 1.1. The draft Strategy Statement (Appendix 1) sets out the background to the Council's treasury management activity both in terms of the wider economy and the Council's own current and projected financial position. It sets out the approach which will be taken to borrowing and the investment of cash balances. It explains the risks which are inherent in treasury management and how these are to be mitigated. The Strategy Statement specifies the Prudential Indicators which the Council is to set in order to meet the requirements of the Prudential Code; contains an 'MRP Statement' which defines the approach that the Council will take to make prudent provision for debt redemption; and establishes the policy for the separate management of General Fund and Housing Revenue Account borrowing.
- 1.2. The content of the draft Strategy Statement follows the requirements of CIPFA's revised Code of Practice which was published in November 2011. Arlingclose, the Council's Treasury advisers provided general support to the preparation of the draft Strategy Statement, and also made specific observations ahead of the review by the Audit and Standards Committee.
- 1.3. The Strategy Statement is a lengthy document and includes the use of technical terms where they are unavoidable. Arlingclose hold a briefing session at the Council each year (most recently in October 2015) to which all Councillors are invited. The intention of the briefings is to 'demystify' the more technical aspects of treasury management, and to explain those factors which are impacting on the Council's investment returns and borrowing costs.

2. Audit and Standards Committee Review

- 2.1.** At the timing of writing this report, the Audit and Standards Committee is due to consider the draft Strategy Statement at its meeting on 25 January 2016 in line with the Code of Practice's recommendation that the annual Treasury Strategy should be subject to scrutiny. The Audit and Standards Committee's comments will be reported verbally to Cabinet. The Audit and Standards Committee's review will not encompass the Prudential Indicators, because some of these were still subject to final calculation pending the finalisation of the draft Capital Programme.
- 2.2.** The Audit and Standards Committee were to be made aware that the draft Strategy Statement presented to them contained values (eg capital expenditure, use of reserves, capital financing requirement) which were best estimates at the time of preparing their report, and which may be revised when draft budget papers are finalised for consideration by Cabinet at this meeting. It was explained that any revisions were expected to be immaterial, with no bearing on the Strategy proposed.

3. 2016/2017 Strategy Statement in context

- 3.1.** As explained to Councillors by the Council's Treasury advisors Arlingclose at the October 2015 briefing, the transposition of two European Union directives into UK legislation has placed the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors. The combined effect is to leave public authorities and financial organisations as the only senior creditors likely to incur losses in a failing bank. The credit risk associated with making unsecured bank deposits has increased relative to the risk of other investment options.
- 3.2.** Given the risk and continued low returns from short-term unsecured bank investments, the Strategy enables the Council to diversify into more secure and/or higher yielding asset classes during 2016/2017. Diversification is of increasing importance in the context of the Council's reserves and balances reducing as they are called on to support the Council's organisational change programme. With diminishing reserves, the impact of a single counterparty default would be greater. This diversification represents a continuation of the new strategy adopted in 2015/2016.

4. Proposed changes to Investment Strategy

- 4.1.** The minimum credit rating for investments permissible under the current Strategy is long-term 'A'. A proviso was built into the current Strategy that, in the event of widespread downgrading of major UK banks by credit rating agencies in response to the implementation of the bail-in provisions of the EU Bank Recovery and Resolution Directive, unsecured deposits can be made with banks with a rating of 'A-' (maximum duration 6 months) or 'BBB+' (maximum duration 100 days).

- 4.2. Widespread significant downgrading has not materialised in 2015/2016, and Arlingclose advise that their clients can consider adopting a minimum credit rating criteria of long term 'BBB+', two marks below the 'A' rating. It is proposed to exercise more caution, and to move to a minimum credit rating of long term 'A-' for investments made in 2016/2017. In the event of a widespread downgrade affecting all prospective counterparties, investments with counterparties rated at BBB+ or below would be permissible. Unsecured deposits with a bank rated at 'BBB' would be restricted to overnight deposits at the Council's current account bank only.
- 4.3. Appendix C (page 24) of the Strategy sets out approved counterparty types and limits for 2016/2017 in detail. A limit of £2m per counterparty will apply, with the exception of investments with Government bodies (unlimited) and pooled funds, for example Money Market Funds, for which the individual limit will be £3m. With the exception of the change to the long-term credit rating criteria referred to above, all counterparty types and investment durations remain unchanged from the current Strategy.
- 4.4. It should be noted that the presence of a counterparty type on the list at Appendix C does not necessarily mean that it will be used by the Council. Arlingclose have noted that the Council's investment returns in 2015/2016 are below those achieved by their other local authority clients, which have actively diversified and lengthened the duration of their investments. Officers intend to adopt a similarly flexible approach in 2016/2017, looking for opportunities to invest, for example, in covered bonds issued by Banks or property funds.

5. Borrowing Strategy

- 5.1. The current approach of 'internal borrowing' (ie using cash held as balances, reserves and working capital as an alternative to long-term borrowing) as a means of funding capital expenditure will continue in 2016/2017.
- 5.2. The Council will remain open to the possibility of debt rescheduling (ie replacing an existing loan with a new loan or loans, or repaying a loan without replacement) where this is expected to lead to an overall saving or reduction in risk.

Risk Management Implications

6. The risk management implications associated with this activity are explained in the Strategy Statement.

Financial Implications

7. All relevant implications are referred to in the Strategy Statement.

Legal Implications

8. The legislative context is set out in the Strategy Statement.

Equality Screening

9. The contents of this report is technical in nature, relating to the management of the Council's investments and borrowing. As such, Equality Screening was not required.

Appendix

10. Appendix 1 – Treasury Management Strategy Statement and Investment Strategy 2016/2017 to 2018/2019.

Background Papers

11. Treasury Strategy Statement 2015/2016 <http://www.lewes.gov.uk/council/20987.asp>