

Agenda Item No: 9

**Report No:
18/16**

**Report Title: Annual Treasury Management Strategy Statement and
Investment Strategy 2016/2017 to 2018/2019**

Report To: Audit and Standards Committee Date: 25 January 2016

Ward(s) Affected: All

Report By: Alan Osborne, Director of Corporate Services

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Purpose of Report:

**To present the draft Treasury Management Strategy Statement and
Investment Strategy 2016/2017 to 2018/2019.**

Officers Recommendation:

1. To receive the draft Treasury Management Statement and Investment Strategy 2016/2017 to 2018/2019 and make comments to Cabinet as the Committee sees fit.
2. To note the contents of this report.

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 approves an updated 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).
- 2 It is appropriate for the Audit and Standards Committee to review and comment on the draft Strategy before it is approved by Cabinet as part of the overall budget cycle, rather than to carry out this function after the Strategy has been formally adopted.

Information

1 Purpose of the Strategy Statement

- 1.1 The draft Strategy Statement is attached at Appendix 1. It 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 and has been prepared with the support of Arlingclose, the Council's Treasury advisers.
- 1.3 It is important to note that values shown in the draft Strategy Statement (eg capital expenditure, use of reserves, capital financing requirement) are best estimates at the time of preparing the report, and may be revised when draft budget papers are finalised for consideration by Cabinet at its February meeting. Any revisions are expected to be immaterial, with no bearing on the Strategy proposed.

2 2016/2017 Strategy Statement in context

- 2.1 As explained to Councillors by the Council's Treasury advisers, Arlingclose, at a briefing meeting held in October 2015, 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.
- 2.2 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.

3 Proposed Changes to Investment Strategy

- 3.1** The current 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).
- 3.2** 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.
- 3.3** 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.
- 3.4** 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.

4 Borrowing Strategy

- 4.1** 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.
- 4.2** 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.

5 Prudential Indicators

A number of the Prudential Indicators relate to elements of the Capital Programme and General Fund and Housing Revenue Account budgets which are to be considered by Cabinet in February 2016 as a full 'budget package'. It has not been possible to include future values for these Prudential Indicators at this stage, and they will be outside the scope of the Audit and Standards Committee's review.

6 Financial Implications - All relevant implications are referred to in the Draft Strategy Statement.

7 Legal Implications - The legislative context is set out in the Draft Strategy Statement.

8 Risk Management Implications - The risk management implications associated with this activity are explained in the Draft Strategy Statement.

9 Equality Screening - 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 1 – Draft Treasury Management Statement and Investment Strategy
2016/2017 to 2018/2019

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