CABINET

TREASURY MANAGEMENT STRATEGY 2010/11
16 February 2010

Report of Head of Financial Services

PURPOSE OF REPORT					
This report sets out the position regarding the 2010/11 to 2012/13 Treasury Management Strategy for Cabinet's approval.					
Key Decision	✓	**Non-Key Decision**		**Referral**	
Date Included in Forward Plan	February 2010				
This report is public.					

RECOMMENDATIONS OF OFFICERS

1. **That Council be recommended to adopt the updated Code of Practice as reflected in *Appendix A*.**

2. **That Council be recommended to approve the Treasury Management Policy Statement as set out at *Appendix B*.**

3. **That Council be recommended to approve the Treasury Management Strategy for the period 2010/11 to 2012/13 as set out in Appendix C, incorporating the Investment Strategy and Treasury Management Indicators, and as updated for Cabinet's final budget proposals.**

1 **INTRODUCTION**

1.1 It is a requirement of the CIPFA Code of Practice on Treasury Management that a strategy outlining the expected treasury activity for the forthcoming 3 years is adopted, but that this be reviewed at least annually. The proposed Treasury Management Strategy for the period 2010/11 to 2012/13 needs to cover the following forecasts and activities:

- the current treasury position
- expected movement in interest rates
- the borrowing and debt strategy
- the investment strategy
- specific limits on treasury activities
- treasury management indicators (previously reported as prudential indicators).

1.2 Further to the difficulties experienced in the Icelandic banking collapse and the wider banking crisis generally, the Code was updated in November 2009 and as a result several specific changes have been made. Also Government has recently consulted on changes to its investment guidance and these also need to be taken into account. That said, the Code and draft investment guidance still remain flexible in order to cater for different public sector organisations and their differing operating arrangements, circumstances and risk appetites. Proposals regarding the various aspects of this authority's treasury management framework are set out below for Cabinet's consideration, although these would need to be updated should there be any changes to Cabinet's final budget proposals. It is not known when the investment guidance will be finalised, but it is not expected that there will be any substantive changes to the current draft. The treasury framework, as updated, will be referred on for approval at Budget Council on 03 March.

2 ADOPTION OF THE UPDATED CODE AND POLICY STATEMENT

2.1 The Code was originally adopted by Council back in 2002. Whilst in essence much of the updated 2009 Code remains the same, there are some changes required to the key principles and supporting requirements and these are reflected in ***Appendix A***; the wording is prescribed in the Code and in essence, the content underpins the rest of the framework proposals as set out in this report. It is therefore recommended that the updated Code be adopted by the Council. In due course, Audit Committee will be recommended to update the Financial Regulations accordingly.

2.2 Similarly, prior to reviewing any detailed proposals regarding the framework for next year, Cabinet also need to consider the Treasury Policy Statement as set out at ***Appendix B,*** for referral on to Council. This has been amended slightly to reflect the updated Code's requirements and will be included in the Council report accordingly.

3 TREASURY MANAGEMENT STRATEGY

3.1 Taking account of the above changes, the proposed Treasury Management Strategy Statement for 2010/11 to 2012/13 is set out at ***Appendix C*** for Cabinet's consideration. This document contains the necessary details to comply with both the Code and investment guidance. Responsibilities for treasury management are set out at ***Appendix D.*** These are broadly unchanged from previous years but are updated to reflect the new Code and that a single document covering the Treasury Management Strategy and the Investment Strategy is to be approved by Council.

3.2 Key elements and assumptions feeding into the proposals are outlined below. These take account of Cabinet's existing budget proposals. Should there be any changes to the budget, then the treasury framework would need to be updated accordingly.

3.3 Borrowing Aspects of the Strategy

3.3.1 Based on the draft budget, the borrowing position of the Council is currently projected to remain constant over the next three years. This however, assumes no impact from compensation claims for Luneside East regeneration and also assumes that the Council will benefit from capital receipts linked to the sale of land at South Lancaster. The position on Iceland is also far from certain; whilst assumptions have been made, as yet the Council's creditor status has yet to be finally determined through the courts.

3.3.2 The above points represent major assumptions and depending on their outcome, the debt strategy may vary greatly from that attached. There is also the potential for significant impact on revenue, through associated increased interest charges/lost investment income and making minimum revenue provisions (MRP) for any additional debt repayment. Cabinet's proposals in respect of the General Fund Capital Programme are most likely to affect this element of the Strategy.

3.4 Investment Aspects of the Strategy

3.4.1 The investment strategy for 2009/10 came in the aftermath of the Icelandic banking crisis. This had a direct impact on the Council in terms of frozen investment balances, as well as a broader influence on the treasury management function. Several changes were introduced to reduce counterparty risk in relation to investments, as follows:

– The maximum amount to be invested with any one institution (other than the UK Government) was reduced from £6M to £4M. This limit applies mainly where there is instant access (i.e. not fixed term investments), but with the exception of investments placed with other local authorities or the European Central Bank. Should any other fixed term deposits be considered, a lower limit of £2M applies.

– The lowest common denominator approach to interpreting credit ratings from all 3 agencies was introduced.

– The Strategy included a separate limit of £10M (now proposed to be increased to £20M) specifically for the Government's Debt Management Accounts Deposit Facility (DMADF). This is included as a minimal return 'safe haven'.

– UK institutions were given precedence over other countries, and sovereign ratings (i.e. the credit ratings of countries) were applied. Aside from the UK, only other EU countries were to be used.

– No forward deals were to be entered into.

– No investments were to be made for any period longer than a year.

3.4.2 Although the financial sector has remained relatively stable over the last 12 months, the UK is only just out of recession and it is still facing an unprecedented public sector deficit. Uncertainty in the financial sector still remains. This means that there is no argument for relaxation of the measures taken in the prior year. The only real changes to investment limits for 2010/11 onwards are an increase to the proposed limit with the DMADF and a reduction on the time limits for fixed term deposits to 3 months on upper limit counterparties (see table 4, ***Appendix C***). This reduction reflects the Authority's lack of appetite for the risk associated with longer term deposits; even through the limit was set at 1 year for 2009/10, no fixed term deposits were placed (except with the DMADF).

3.4.3 In line with the updated Treasury Management Code and Investment Guidance though, there are additional elements to be introduced to help manage risk. These include:

- the explicit nomination of Budget and Performance Panel as the scrutiny committee for Treasury Management; and
- an increased frequency of reporting to Members, insofar as a formal mid-year review will be included.

3.4.4 Whilst in essence the requirements of the new Code and guidance do not materially change the Council's existing arrangements, they do seek to clarify responsibilities. In particular, it is crucial that training is provided to help ensure that both Members and Officers have the necessary skills to fulfil their respective responsibilities. This area will continue to feature in the Member Development Plan as well as Officer related training programmes. It will be considered by the Council's Business Committee in due course.

3.4.5 Overall, the strategy put forward follows on from 2009/10 in that it is based on the Council having a low risk appetite, with a focus on highly liquid, high quality deposits. Going forward, the development of benchmarking should help Members in future to set the strategic framework for Treasury Management, allowing for a degree of risk that is judged to be acceptable. At present, given very low interest rates, the opportunity cost attached to a low risk strategy is considered to be low also – but this would change should interest rates start to increase.

3.4.6 It is stressed in terms of treasury activity, there is no risk free option. It is felt, however, that the measures set out above provide a sound framework within which to work over the coming year.

4 CONSULTATION

4.1 Officers have liaised with Butlers, the Council's Treasury Advisors, in developing the proposed Strategies and they have also consulted KPMG LLP as the Council's external auditors. Following the Icelandic difficulties, additional audit work was undertaken regarding the Council's treasury management arrangements. This led to a number of recommendations and Officers have given these due consideration and responded accordingly. Where appropriate, further discussions have taken place. At this stage it is considered that the actions taken (or planned) are reasonable, though clearly progress will be reviewed and reported in future audit work. More information is included at ***Appendix E***.

4.2 The proposals are also to be considered by Budget and Performance Panel at its meeting on 23 February 2010 and any recommendations arising will be fed directly into Budget Council.

5 OPTIONS AND OPTIONS ANALYSIS

5.1 As part of the adoption of the updated CIPFA Code of Practice on Treasury Management it is a statutory requirement that the Authority has a Treasury Management Strategy Statement and Investment Strategy. In this regard, Cabinet may put forward alternative proposals or amendments to the proposed documents, but these would have to be considered in light of legislative, professional and economic factors, and importantly, any alternative views regarding the Council's risk appetite. As such, no further options analysis is available at this time.

5.2 Furthermore, the Strategies must fit with other aspects of Cabinet's budget proposals, such as investment interest estimates and underlying prudential borrowing assumptions, feeding into Prudential and Treasury Management Indicators. It should be noted that the Prudential Indicators will also be covered in the Budget report, elsewhere on this agenda.

6 OFFICER PREFERRED OPTION AND JUSTIFICATION

6.1 The Officer Preferred Options are as reflected in the recommendations to this report. This is based on the Council having a low risk appetite regarding investments, and it takes into account the requirements of the new Code.

RELATIONSHIP TO POLICY FRAMEWORK

This report is in accordance with the Council's Treasury Management Policy, and fit with the development of the Medium Term Financial Strategy.

CONCLUSION OF IMPACT ASSESSMENT
(including Diversity, Human Rights, Community Safety, Sustainability etc)

No direct implications arising.

FINANCIAL IMPLICATIONS

None directly arising. The Strategy is in support of achieving the borrowing cost and investment interest estimates included in the draft base budget, based on a low risk approach.

DEPUTY SECTION 151 OFFICER'S COMMENTS

This report and its content forms part of the S151 Officer's responsibilities.

LEGAL IMPLICATIONS

Legal Services have been consulted and have no observations to make regarding this report; there are no implications directly arising.

MONITORING OFFICER'S COMMENTS

The Monitoring Officer has been consulted and has no further comments.

BACKGROUND PAPERS CIPFA Code of Practice	**Contact Officer: Nadine Muschamp** **Telephone:01524 582117** **E-mail:nmuschamp@lancaster.gov.uk**