CABINET

Treasury Management Strategy 2011/12
15 February 2011

Report of Head of Financial Services

PURPOSE OF REPORT					
This report sets out the position regarding the 2011/12 to 2013/14 Treasury Management Strategy for Cabinet's approval.					
Key Decision	✓	**Non-Key Decision**		**Referral**	
Date Included in Forward Plan	February 2011				
This report is public.					

RECOMMENDATIONS OF COUNCILLOR LANGHORN:

1. **That the monitoring report as set out at Appendix A be noted and referred on to Council for information.**

2. **That Council be recommended to approve the Treasury Management Strategy for the period 2011/12 to 2013/14 as set out in Appendix B, 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 ("the Code") 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 2011/12 to 2013/14 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 implemented in the 2010/11 Strategy. Both the Code and investment guidance issued by Government 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. The treasury framework, as updated, will be referred on for approval at Budget Council on 02 March 2011.

1.3 One of the changes introduced under the updated Code was that as well as receiving an outturn report on treasury performance, Council should also receive a mid-year update. In line with this principle, a summary of the latest monitoring report is included at ***Appendix A*** for information and referral on to Council.

1.4 In terms of Member training, the last formal session was held in September 2009. As demand was low, and treasury activity over the last year has been very low risk, it is not intended to undertake any further formal sessions until after the local elections. Very recently the Audit Committee indicated their support for this approach but training can be provided in the interim if Members require it.

2 TREASURY MANAGEMENT STRATEGY

2.1 The proposed Treasury Management Strategy for 2011/12 to 2013/14 is set out at ***Appendix B*** for Cabinet's consideration. This document contains the necessary details to comply with both the Code and Government investment guidance. Responsibilities for treasury management are set out at ***Appendix C***. A single document covering the Treasury Management Strategy and the Investment Strategy is to be approved by Council.

2.2 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.

2.3 Borrowing Aspects of the Strategy

2.3.1 Based on the draft budget, the physical borrowing position of the Council is projected to remain constant over the next three years. This 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 although essentially the worst case scenario was provided for in the prior year accounts. The resolution of Luneside East land acquisition is also still a material uncertainty. Another potential factor relates to managing any redundancy costs arising from any future staffing reductions, as the Council takes action to balance its medium term budget forecasts. The Council may choose to manage these through its proposed Restructuring reserves, but depending on affordability, it may seek capitalisation directives that could give rise to further borrowing pressures.

2.3.2 The above points represent major assumptions and depending on their outcome, the debt strategy may need to vary greatly from that attached. There is also the potential for a significant net impact on revenue, through associated increased interest charges or 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.

2.3.3 Even more significant, however, is the planned implementation of self-financing for council housing from April 2012. These reforms are covered in the Localism Bill and information on the methodology has now been received from Government. To give context, in broad terms the proposals may involve the Council taking on around £30M debt, potentially, in return for the housing subsidy system (and the obligation to pay negative subsidy) being withdrawn.

2.3.4 At this point though, as the proposals for these reforms are still going through Parliament, the proposed Strategy does not provide for the impact of these potential changes. A revision of the Strategy will need to be considered by Cabinet and Council in due course, once the legislative position is clearer.

2.4 **Investment Aspects of the Strategy**

2.4.1 The current strategy follows on from previous, "post Iceland" strategies. It still represents a marked step back in terms of the perception of 'risk' from the position a few years ago. Several changes were introduced post Iceland to reduce counterparty risk in relation to investments. These included reducing limits both in terms of deposit length and amount, increasing the use of the Government's Debt Management Accounts Deposit Facility (DMADF), and excluding forward deals.

2.4.2 Although the financial sector has remained relatively stable over the last 12 months, following the General Election public services are facing budget cuts of such a scale and there are views that that there could potentially be serious, adverse, knock on effects to the wider economy. Similar issues also face a number of other EU countries such as Ireland, Greece, Portugal and Spain. Overall, this means that there is no strong argument for significant relaxation of the measures taken post Iceland as there is still a great deal of uncertainty over the direction of the economy, and therefore risk to the banking sector. There is the need, however, to ensure sufficient flexibility in managing investments without undermining security, and to ensure that risk appetite is appropriate.

2.4.3 Accordingly, the main changes to investment limits for 2011/12 onwards include some increases to the proposed limits with banks that meet investment criteria. This reflects the vastly reduced counterparty list of quality institutions that the Council can trade with, but also retains a strong link between investment amounts and the length of deposit with higher value deposits being held only on instant access. This will allow the Council to utilise more fully the value present in instant access call accounts and money market funds, without reducing credit criteria or liquidity. In addition the time limit for upper tier banks has been increased to 1 year but on a maximum deposit of £2M (see table 4, ***Appendix B***) to allow the Council to take advantage of the increased yields (see 2.4.6 below), where it is judged that adequate security and liquidity are not being sacrificed.

2.4.4 Under the Code, 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 Strategy as well as Officer related training programmes. Member development will be considered by the Council's Business Committee after the local elections.

2.4.5 Overall, the strategy put forward follows on from 2010/11 in that it is based on the Council having a low risk appetite, with a focus on highly liquid, high quality deposits. The Code encourages greater involvement from Members in terms of setting benchmarks for risk, above those set down in investment strategy and Treasury Management Indicators. This is to be taken forward after the local elections. The development of benchmarking should help Members in future to set the strategic framework for Treasury Management, allowing for a more sophisticated method of setting the level of risk that is judged to be acceptable.

2.4.6 At present, given very low interest rates, the opportunity cost attached to a low risk strategy is considered to be small. However, the markets are starting to offer significantly improved rates for longer term deposits with rates of 1.5% for a 12 month deposit rising to 2.3% for a 2 year deposit. This is in comparison to 0.75% being the Council's best instant access account and 0.25% being the prevailing rate on the

DMADF account. Having said this, many of the instant access investments are linked to the bank rate so a low risk, high liquidity strategy will still benefit from an increase in interest rates. Although the margins between short and long term deposits may increase; the Council should avoid defaulting to an overly cautious approach and should look to ways, such as through the use of security and liquidity benchmarks, to manage risk effectively whilst improving slightly its investment returns.

2.4.7 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.

3 CONSULTATION

3.1 Officers have liaised with Sector, the Council's Treasury Advisors, in developing the proposed Strategies.

3.2 The proposals are also to be considered by Budget and Performance Panel at its meeting on 22 February 2011 and any recommendations arising will be fed directly into Budget Council.

4 OPTIONS AND OPTIONS ANALYSIS

4.1 As part of the adoption of the CIPFA Code of Practice on Treasury Management (2009) 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.

4.2 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 are also covered in the Budget report elsewhere on this agenda.

5 OFFICER PREFERRED OPTION AND JUSTIFICATION

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

RELATIONSHIP TO POLICY FRAMEWORK

This report is in accordance with the Council's Treasury Management Policy, and fits with the development of the Medium Term Financial Strategy. As well as approving the Strategy Council will be requested to re-approve the Policy Statement, as it does every year.

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.

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.

DEPUTY MONITORING OFFICER'S COMMENTS

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

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