Chichester District Council

CABINET **3 March 2015**

Treasury Management Strategy 2015-16

1. Contacts

Cabinet Member:
Tony Dignum, Cabinet Member for Finance and Governance,
Tel: 01243 538585 E-mail: tdignum@chichester.gov.uk

Report Author:
Helen Belenger, Accountancy Services Manager,
Tel: 01243 521045 E-mail: hbelenger@chichester.gov.uk

2. Recommendation

2.1. That Cabinet considers and recommends the following for approval by Full Council:

(a) The Treasury Management Policy and Treasury Management Strategy Statement for 2015-16 as contained in appendix 1 of the report.

(b) The Investment Strategy 2015-16 as detailed within the treasury management strategy statement (appendix 1).

(c) The Prudential Indicators and Limits for 2015-16 to 2019-2020 as detailed in appendix 2 of the report.

(d) The Minimum Revenue Provision (MRP) Statement contained within appendix 2, which sets out the Council's policy on MRP.

2.2. That Cabinet notes the investment performance for the first, second and third quarters of 2014-15 (appendices 3, 4 and 5).

3. Background

3.1. Local authorities' treasury management activities are prescribed by statute i.e. the Local Government Act 2003, and the regulations issued under that Act. This is where the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice derives its legal status.

3.2. In March 2012 the Council adopted CIPFA's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code), which requires the Council to approve a treasury management strategy before the start of each financial year. In addition, the Department for Communities and Local Government (DCLG) issued revised guidance on local authority investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

3.3. This report will fulfil the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG guidance, when considered by Full Council in March 2014.

4. Outcomes to be achieved

4.1. The Cabinet is requested to consider and recommend to Council the proposed changes as set out in paragraph 5.10 of the Treasury Management Policy, Treasury Management Strategy Statement, and the Investment Strategy for 2015-16.

4.2. The performance in the current year for quarters two and three are noted.

5. Proposal

5.1. The appendices attached to this report have been amended and updated for 2015-16. Appendix 1 sets out the Council's treasury management policy, treasury management strategy and investment strategy.

5.2. The prudential indicators are shown in Appendix 2 to enable members to have an understanding of the implications of the Council's spending plans and their impact on the treasury management activities as set out in the strategy and investment policy. These indicators reflect the spending plans of the Council which are due to be considered by Full Council on 10 March 2015, for the council tax setting.

5.3. Estimated Interest rates

The financial strategy reflects a down grading on the estimated rate of return for the current and future years:

Assumptions for 2015-16 Strategy

Assumed Interest Rates	2014/15 Revised	2015/16	2016/17	2017/18	2018/19	2019/20
Investment Rates	1.20%	0.80%	0.75%	1.00%	1.15%	1.20%

The view of the Council's treasury adviser is that the bank base rate will remain at 0.50% until quarter 3 of 2015.

5.4. An average rate of return of 1.00% was built into the original estimate for the 2014-15 Treasury Management Strategy. However, based on the view of the adviser, and due to the loss of the higher long term investments, forecasts for slightly lower rates have been reflected in the 2015-16 Treasury Management Strategy and 2016-17. After this a slight increase has been assumed for future years. The investment rates will be monitored throughout the coming year.

5.5. In considering the investment strategy, the CLG Investment Guidance requires the Council to the note the following three matters each year as part of the investment strategy:

(a) The use of Treasury Management Advisers: The Council currently have a contract with Arlingclose Limited.

(b) Investment Training: How the training needs of the officers involved on treasury management are identified and addressed, plus the provision of training for those members who scrutinise and approve the treasury management strategy. Member training was delivered by the Council's treasury adviser prior to approval of the forthcoming year's Treasury Management Strategy.

(c) Investment of money borrowed in advance of need: As the Council does not anticipate the need to borrow in the foreseeable future, it is therefore not expecting to borrow in advance of need, and so it is not necessary to set out any operational criteria for this situation in the Treasury Management Strategy for 2015-16.

5.6. The issue that continues to influence the Council's Treasury Management and Investment Strategies is the transposition of two European Union directives into UK legislation, which will place the burden of rescuing failing EU banks disproportionately onto unsecured local authority investors.

5.7. The Council's adviser increasingly favours the use of secured investment options or diversified alternatives such as covered bonds, repos, non-bank investments and pooled funds over unsecured bank and building society deposits.

5.8. The Council's investment strategy as stated in Appendix 1 (Paragraph 13):

"Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2015-16. This is especially the case for the estimated £15m that is available for longer-term investments. The majority of the Council's surplus cash is currently invested in short-term unsecured bank deposits, and other local authorities. The new investment options that may be undertaken by this strategy would now include covered bonds, Government Agency Bonds, Supranational Bonds and Corporate Bond. This diversification will therefore represent a material change in strategy over the coming year, in order to manage the bail-in risk and spread the investment of surplus funds in a wider range of investment types."

5.9. In light of the advice from Arlingclose, and the subsequent view of Corporate Governance & Audit Committee (CG&AC), a new matrix for selecting investment counterparties is as set out in Appendix 1 (Table 4, paragraph 14 and the accompanying notes in paragraphs 15 to 21). This highlights the changes necessary in adopting this different approach to selecting counterparties, and managing the risks due to the legislative changes that will come into effect in July 2015.

5.10. The Treasury Management and Investment Strategies will be considered by Full Council on 10 March 2015.

6. Alternatives that have been considered

6.1. The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Strategy is considered by the Corporate Governance and Audit Committee to comment on whether the strategy represents an appropriate balance between risk management and cost effectiveness on the rate of return on investments.

6.2. The Task and Finish Group (TF&G) set up by the Corporate Governance & Audit Committee considered the alternative options for investments opportunities due to the new bank regulation and bail-in arrangements, including other investment opportunities that could offer the Council better security in the seniority of debt e.g. covered corporate bonds.

6.3. Neither the TF&G nor the Committee wished to extend the maximum investment period beyond 5 years that was suggested by the Council's adviser.

6.4. The impact of alternative strategies, with their financial and risk management implications are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses will be greater.
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses will be smaller

7. Investment Performance Quarters 1, 2 & 3 2014-15 (Appendices 3, 4 & 5)

7.1. The revised Treasury Management Strategy for 2014-15 was approved by full Council on 23 September 2014. The Cabinet Member for Finance and Governance and the members of the Corporate Governance & Audit Committee now receive month end reports of the investments held by the Council as part of the monitoring arrangements requested following the Task & Finish Group's review of the strategy.

7.2. The investment returns achieved in the first three quarters of the year were:

Investment Interest – 2014-15	Interest Achieved £	Annualised Average Rate %
Quarter 1 – April to June	108,827	1.00
Quarter 2 – July – September	109,995	0.88
Quarter 3 – October – December	98,316	0.85
Total to Date	317,138	

7.3. The returns achieved exceed the internally set investment performance indicators of the Local Authority 7 Day Deposit index, the 3 Month London Inter-Bank Offer Rate (LIBOR) and 3 Month London Inter- Bank Bid Rate (LIBID).

7.4. Two higher interest rate long term investments amounting to £2m matured during the current financial year, as detailed in appendices 4 and 5 paragraphs 1.1.3. The effect of these maturities is that the buffer of the slightly higher interest rates which helped to offset the very low rates being obtained on the short term investments is gradually being lost.

7.5. The original budget anticipated investment interest would amount to £331,000, at a rate of 1.00%. To reflect the higher amount of funds available for investment it is anticipated that the investment interest received will now amount to £413,280 in 2014-15.

7.6. Outlook for Q4 2014-15

There is momentum in the UK economy, but inflationary pressure is benign and external risks have increased, reducing the likelihood of immediate monetary tightening. In addition to the lack of wage and inflationary pressures, policymakers are evidently concerned about the bleak prospects for the Eurozone.

7.7. While the European Central Bank (ECB) is likely to introduce outright quantitative easing (QE), fears for the Eurozone are likely to maintain a safe haven bid for UK government debt, keeping gilt yields artificially low in the short term.

7.8. The Council's adviser, Arlingclose, projects a slow rise in Bank Rate. The pace of interest rate rises will be gradual and the extent of rises limited with the normalised level of Bank Rate post-crisis likely to range between 2.5% and 3.5%. Market expectations are now also for a later increase in interest rates and a more muted increase in gilt yields.

8. Resource and legal implications

8.1. The estimated rate of return for the forthcoming financial year and future financial years has been taken into account in the 5 year model underpinning the Council's Financial Strategy and resources statement.

9. Consultation

9.1. In adhering to the CIPFA Code, the forthcoming financial year's Treasury Management Strategy Statement, the Investment Strategy and MRP Policy are required to be considered by those members charged with governance, before being referred to Full Council for approval.

9.2. The Corporate Governance and Audit Committee considered the Treasury Management Strategy Statement and Investment Strategy at its meeting on 22 January 2015. The Committee considered the amendments proposed in relation to counterparty selection and the maximum investment limits for each counter party following a review by the Task and Finish Group set up by the Committee. The Committee supported the changes proposed which are reflected in the Strategy, and the proposed diversification into investments that offered greater protection from the bail-in arrangements that are expected to come into force during July 2015.

10. Community impact and corporate risks

10.1. The statutory and regulatory framework under which the treasury management function operates is very stringent, and each authority has to decide its own appetite for risk and the rate of return it could achieve.

10.2. Risk management is covered within the Treasury Management Strategy and specifically within TMP 1, an extract of which is shown in appendix 6.

11. Other Implications

	Yes	No
Crime & Disorder:		X
Climate Change:		X
Human Rights and Equality Impact:		X
Safeguarding:		X
Other (Please specify): Non- compliance or loss of an investment due to default by a counterparty could affect the financial wellbeing of the council dependent on the size of the loss and the ability to fund losses from its unallocated reserves.	X	

12. Appendices

12.1. Appendix 1 – Treasury Management Policy Statement, Treasury Management Strategy Statement, and Investment Strategy for 2015-16.
12.2. Appendix 2 – Prudential Indicators and MRP Statement 2015-16.
12.3. Appendix 3 – Treasury Management Activities 1st Quarter 2014-15
12.4. Appendix 4 – Treasury Management Activities 2nd Quarter 2014-15
12.5. Appendix 5 – Treasury Management Activities 3rd Quarter 2014-15
12.6. Appendix 6 – Treasury Management Practices (TMP's) Extract of TMP 1 Risk Management.

13. Background Papers

13.1. None