

South Bucks District Council

Treasury Management Strategy 2011/2012

1. Background

- 1.1. The Council adopted the CIPFA code of practice on Treasury Management in June 2002, which includes the creation of a Treasury Management Strategy, which sets out the policies, and objectives of the Council's treasury management activities for the year ahead.
- 1.2. In the light of the Icelandic situation in 2008, CIPFA has amended the CIPFA Treasury Management in the Public Services Code of Practice (the Code), Cross -Sectoral Guidance Notes and Guidance Notes and the template for the revised Treasury Management Policy Statement. It is also a requirement that the Council formally adopt the Code which it did on 23rd February 2010. For Members information the requirements of the Code are detailed below.
- 1.3 The revised Code is built largely on what was recommended practise in the previous version, but does place greater or new emphasis in certain key areas. The main points in the new Code are as follows:-
 - a) All councils must formally adopt the revised Code and four clauses, these are shown as at appendix A which also sets out the scheme of delegation and the treasury management role of the section 151 officer.
 - b) The strategy report will affirm that the effective management and control of risk are prime objectives of the Council's treasury management activities. This is consistent with the approach always adopted by this Council.
 - c) The Council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.
 - d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation. This is something the Council has always been very clear about, in that whilst it uses advisers and external sources of information, that it is the officers and members of the authority who are accountable for policy and decisions.
 - e) Credit ratings should be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and credit ratings of that government support.
 - f) Councils need a sound diversification policy with high quality counterparties and should consider setting country, sector and group limits.
 - g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme. As a debt free authority this is not an issue that arises for the Council.
 - h) The main annual treasury management reports must be approved by full council.
 - i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved. For South Bucks DC this requirement is met by the regular reports to the Resources Portfolio Holder.
 - j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body. For South Bucks DC this is carried out by the Resources PAG.

- k) Treasury Management performance and policy setting should be subjected to prior scrutiny. This is achieved via the regular discussions on Treasury Management at the RPAG.
- l) Members should be provided with access to relevant training. This is something that is being considered to be run in the coming year in conjunction with the Council's Treasury Management advisers, and would be open to all members of the Council to attend.
- m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.
- n) Responsibility for these activities must be clearly defined within the organisation.
- o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Council (this will form part of the updated Treasury Management Practices).

1.4 This strategy statement has been prepared in accordance with the revised Code. As in previous years the Council's Treasury Management Strategy will be approved annually by the full Council. In addition there will also be quarterly monitoring reports to the Resources PAG one of which will be the annual report. In addition the Resources Portfolio Holder will be emailed each month with a spreadsheet showing where the Council's investment portfolio has been invested. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

1.5 The Council will adopt/reaffirm the following reporting arrangements in accordance with the requirements of the revised Code:-

Area of Responsibility	Reporting Arrangements	Frequency
Treasury Management Policy (revised)	Resources PAG /Cabinet/Council	Initial adoption 2010
Treasury Management Strategy Annual Investment Strategy MRP policy	Resources PAG /Cabinet/Council	Annually before the start of the year
Treasury Management Strategy Annual Investment Strategy MRP policy - mid year report	Resources PAG /Cabinet/Council	Appropriate quarterly report to RPAG
Treasury Management Strategy Annual Investment Strategy MRP policy - updates or revisions at other times	Resources PAG /Cabinet/Council	As appropriate
Annual Treasury Outturn Report	Resources PAG /Cabinet/Council	Annually by 30 September after the end of the year
Monitoring Reports	Resources PAG /Cabinet/Council	Quarterly
Treasury Management Practices	Resources PAG /Cabinet/Council	Annually
Investment Portfolio Detail	Resources Portfolio Holder	Monthly
Scrutiny of treasury management strategies & performance	Resources PAG	Ongoing but with particular focus when considering annual Strategy

- 1.6. The Local Government Act 2003 and supporting regulations requires the Council to have regard to the CIPFA Prudential code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investments plans are affordable, prudent and sustainable.
- 1.7. The Act requires the Council to set out its Treasury Strategy and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.8. It is a statutory requirement under section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, section 32 requires a local authority to calculate its budget requirements for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenues from :
 - Loss of investment interest caused by the use of capital receipts to finance additional capital expenditure.
 - Any increases in running costs from new capital projects.

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

- 1.9. The DCLG's investment guidance states that authorities could combine the Treasury Strategy Statement and the Annual Investment Strategy (AIS) into one report and the AIS supporting this Strategy Statement is attached as Appendix B.
- 1.10. Following discussions with Sector Treasury Services, the Council's treasury management advisors, the proposed target figure for investment returns for 2011/2012 is £900,000.
- 1.11. This Strategy seeks approval for this level of return, how realistic it is and sets out how it can be achieved.

2. Current Portfolio Position

- 2.1. Investment Criteria - Investment income is mainly generated by Officers placing money in callable or fixed deposits with approved counter parties. When making the decision to invest Officers take into account security, liquidity and yield which are inter-related and the balance of the three is determined by the authority's needs and risk appetite. Decisions to invest are made following discussion between the Director of Resources and the Technical Services Manager both of whom have been involved in treasury management for many years. The discussion on investment is based upon information that is available from the Council's treasury consultants, Sector, and brokers acting in the local authority money market, combined with general intelligence available from money market briefings made available to the authority. Members approved a new matrix for in house investments made by Officers as part of the Treasury Management Strategy 2010/11 as follows:

	Credit Rating	Maximum Amount	Comment
UK Institutions	AAA	£10 million	The durations of the investment would be informed by the detailed credit rating information
	AA+ or AA-	£7 million*	
	A to A+	£1 million	
Non UK Institutions	AA or better	£2 million	As above but also sovereignty rating must be AAA
Corporate Bonds	AA or better	£2 million	Investment decision will be based on balancing yield against duration

* Members agreed that for RBS only this limit is increased to £10 million whilst the bank substantially remained in state ownership.

2.2 A summary of the Council's current holdings of fixed deposits is shown below:

UK Institutions	Credit Rating	Maximum Amount £7 Million*				
		Principal £	Interest Rate	Invested	Matures	Notes
Royal Bank of Scotland	AA-					
Fixed Deposit		5,000,000	4.25%	08/02/11	08/02/16	(1)
Fixed Deposit		2,000,000	2.75%	02/06/10	02/06/13	(2)
Total RBS		7,000,000				
Cater Allen	AA-					
Fixed Deposit		1,000,000	2.25%	01/04/10	03/10/11	
Fixed Deposit		1,000,000	3.50%	21/07/10	21/07/13	
Fixed Deposit		2,000,000	3.20%	30/09/10	30/09/13	
Fixed Deposit		1,000,000	2.50%	02/11/10	02/11/11	
Fixed Deposit		2,000,000	2.50%	16/11/10	16/11/11	
Total CA		7,000,000				
Lloyds Bank	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 2.85%, Cap 5.85%	11/05/10	11/05/15	
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.07%, Cap 5.00%	19/05/10	19/05/10	
Bank of Scotland	AA-					
Fixed Deposit		3,000,000	2.10%	15/07/10	15/07/11	
Fixed Deposit		1,000,000	1.90%	04/10/10	04/10/11	(3)
Total Lloyds Group		6,000,000				
Barclays	AA-					
Fixed Deposit		1,000,000	3 Month Libor, Floor 3.05%, Cap 5.00%	24/05/10	26/05/15	
Total Barclays		1,000,000				
Total Deposits		21,000,000				

(1). This investment is funded from the two 5 year RBS callable deposits of £2.5 million paying 4.10% which RBS called on their first call dates in January & February. Officers have been able to negotiate this new 5 year investment which pays 4.25% in years 1&2 with RBS having the option to switch to 3 month LIBOR plus 30 basis points in years 3, 4 &5.

(2) RBS have the option to switch to 3 month LIBOR plus 20 basis points in years2&3.

(3) 20% of the investment can be withdrawn on 32 days notice.

In addition the Officers invest short term cash flow. Short term reserves are required mainly in the last quarter of the year when council tax and grant payments tail off but precept payments continue.

3. Prospects for Interest Rates and Economic Background

3.1 Part of the service provided by the Council's treasury management advisers is to assist the Council to formulate a view on interest rates. Appendix C draws together a number of current City forecasts for short term (the Bank Rate) and longer fixed interest rates. The following table gives the Sector central view on interest rates.

	2011				2012			
	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
Bank Rate	0.50%	0.50%	0.50%	0.75%	1.00%	1.25%	1.50%	1.75%

There is a downside risk to these forecasts if economic growth is weaker than expected. There is also a risk that the MPC could decide to start raising Bank Rate in quarter 3 of 2011 if it feels it needs to defend its credibility in containing inflation and the inflation expectations of the public. A detailed view of the current economic background is shown in appendix D with the Sector view shown below.

3.2 Sector's View

Sector recognises that at the current time it is difficult to have confidence as to exactly how strong the UK economic growth is likely to be during 2011/12 and there are a range of views in the market. Both of the scenarios shown in appendix D are founded on major assumptions and research which may or may not turn out to be correct.

Sector has adopted a moderate view between the two scenarios outlined.

There are huge uncertainties in all forecasts due to the major difficulties of forecasting the following areas:

- The speed of economic growth in our major trading partners - the US and EU
- The danger of currency war and resort to protectionism and tariff barriers if China does not adequately address the issue of its huge trade surplus due to its undervalued currency.
- The degree to which government austerity programmes will dampen economic growth and undermine consumer confidence.
- The changes in the consumer savings ratio
- The speed of rebalancing of the UK economy towards exporting and substituting imports.
- The potential in the US for more quantitative easing, and the timing of this and its subsequent reversal in both the US and UK.
- Potential changes in financial regulation which could require financial institutions to purchase and then hold a much higher level of government debt instruments which can be quickly sold to meet sudden liquidity pressures experienced by such institutions if another financial crisis should occur.
- The speed of recovery of banks' profitability and balance sheet imbalances. Banks and building societies have borrowed £180bn from the Bank of England under the Special Liquidity Scheme which will need to be repaid by January 2012. If the wholesale funding market unfreezes by then, this will considerably ease the

pressure on financial institutions facing significant challenges to their debt maturity profiles over the next few years.

- The potential for a major EU sovereign debt crisis to cause a major dislocation in financial markets and plunge western economies into a renewed recession. This could depress UK gilt yields even further as gilts are perceived as being a safe haven from EU debt.
- Political risks in the Middle East and Korea

The overall balance of risks is weighed to the downside i.e. the pace of economic growth disappoints and Bank Rate increases are delayed and/or lower.

There is an identifiable risk of a double dip recession and deleveraging, creating a downward spiral of falling demand, falling jobs and falling prices and wages leading to deflation but this is considered to be a small risk although one that is increasing.

Sector believes that the longer run trend is for gilt yields and PWLB rates to rise due to the high volume of gilt issuance in the UK, and the high volume of debt issuance in other major western countries.

4 Achieving the investment target in 2011/12

- 4.1 The level of interest returns in 2011/12 will be driven by the speed of the UK economic recovery. If the recovery is weak then interest rates will continue at the current historically low levels. However a reasonably strong recovery will lead to rises in interest rates during the next year and going forward. These two scenarios are outlined in appendix D of this strategy.
- 4.2 Sector have taken a moderate view between these two scenarios which forecasts interest rates rising by 0.25% quarter on quarter from quarter 4 of 2011 and reaching a level of 1.75% by the last quarter of 2012. In December the CBI gave their view that interest rates will rise from the second quarter of 2011 quarter on quarter first by 0.25% then rising to 0.50% and reaching 2.75% by the end of 2012. The views of Sector and the CBI are therefore similar with the difference being the pace of interest rate increases. In addition in a Daily Telegraph interview Paul Fisher a member of the MPC and Bank of England Director of Markets warns that households should prepare themselves for a gradual return to normal interest rates of around 5% eventually.
- 4.3 As part of the Treasury Management Strategy 2010/11 Members approved a new counterparty matrix which expanded the number of counterparties available subject to limits dependant on the credit rating of the counterparty. It was thought that the adoption of this new matrix and limits would open up more investment opportunities however this has not proved to be the case to date with the best payers in the market remaining as RBS, Lloyds, Barclays and Cater Allen. The Co operative Bank Plc was included on the Council's previous counterparty list however as its credit rating is A- it is not included on the current counterparty matrix which starts at A. The Co-op is used extensively by local authorities for investment and pays reasonable rates for short term cash and it would be reasonable to add it to the Council's counterparty matrix with a maximum investment limit of £1 million.
- 4.4 The Council will have received the £2.3 million Section 106 monies from the William King Flour Mill site by the beginning of 2011/12 which will generate additional investment income. In addition officers will look at investing more short term cash at the start of the year for 6, 9 and 12 month periods dependant on when cash flow is required.
- 4.5 The budget for interest in the current year is £1.050 million the Council are on target to achieve this however only because of the receipt of £250,000 of interest from HMRC in respect of a successful VAT appeal on green fees. Without this the return in 2010/11 would

be in the region of £800,000. I have used this as a base figure for estimating investment income in 2011/12.

- 4.6 Taking into account all of the above factors a reasonable forecast for investment income for 2011/12 is £900,000. This figure is realistic and achievable but demanding, and is predicated on the assumption that interest rates will have started to rise by the last quarter of 2011. The forecast income is based on an assumed level of interest rates, and it is subject to the risk that interest rates will not rise as quickly as forecast particularly if the recovery from the recession is weak.

5 Stoke Poges Memorial Gardens Fund

- 5.1 The investment returns from the fund is no longer credited directly to the Stoke Poges Memorial Gardens Fund cost centre but has been incorporated with all of the Council's other investment returns.
- 5.2 Due to the current cost of buying a new bond it is current policy to reinvest any maturities within the Council's cash investment. There are no maturities from the Stoke Poges Memorial Gardens Fund due in 2011/12. The current market value of the fund is £1,566,412.

6 Financial Summary & Risks

- 6.1 The budget for investment interest was set as £1.050 million for 2010/11. As a result of appealing the VAT treatment on green fees the Council has received a VAT refund plus interest, and the interest payment is a one off addition of £248,000 to the total investment income for the year. Taking this one off payment into account and current estimated returns shows that the Council is currently on target to meet the investment target for 2010/11.
- 6.2 For 2011/12 investment income will be based on total cash reserves of £20m in line with the medium term financial strategy. In addition officers Invest surplus cash flow during the year and estimated returns are based on short-term interest rates remaining within the range of 0.50% to 1.75%.
- 6.3 Based upon the recommended Strategy outlined above the estimated investment returns for 2011/2012 are as follows:

	£'000
Fixed Deposits	646
SPMG Bonds & Gilts	75
Short Term Cash Flow	155
Paper Sort Facility Loan £300K @8%	24
Net Total Investment Income	900

- 6.4 This target for investment income reflects the latest forecasts for interest rates. It is regarded as realistic and achievable, but will be demanding, and is predicated on the assumption that rates will have started to rise by the end of 2011. The forecast income is based on an assumed level of interest rates, and it is subject to the risk that interest rates will not rise as quickly as forecast particularly if the recovery from the recession is weak.
- 6.5 As stated the investment returns are based upon a level of capital balances for 2011/12 of £20m. The estimated capital programme shows that this is realistic based on the latest programme. It is because of the level of balances that the Council hold that it will remain a debt free authority.

- 6.6 As with any budgets based on forecasts of future interest rates there is a risk of variation due to factors outside of the Council's control. This risk will need to be taken into account in determining the level of reserves held by the authority.
- 6.7 The Local Government Act 2003 sets out the new capital regulations and specifies that local authorities must comply with the Prudential Code produced by CIPFA. The Council has a duty to determine an affordable borrowing limit. As a debt free authority this would be nil, however the regulations also incorporate the limit for temporary borrowing required to cover short term cash flow. Whilst the Council has not needed to undertake any temporary borrowing since 1990/1991 it is necessary under statute to approve a limit in case the circumstances arise should it be required. It is recommend that Members approve an authorised borrowing limit of £3.5 million and an operational borrowing limit of £3 million, these together with other prudential indicators that the Council are required to set under the code are shown at Appendix E.

Appendices

A - Revised Policy Statements and CIPFA Code

B - Annual Investment Strategy

C - Interest Rate Forecasts

D - Economic Background

E - Prudential Indicators

F - Minimum Revenue Provision