Report No. RES12021	**London Borough of Bromley**	**Agenda Item No.**

PART 1 - PUBLIC

Decision Maker:	**Resources Portfolio Holder** **Council**
Date:	**For pre-decision scrutiny by Executive and Resources PDS Committee on 25th January 2012** **Council meeting 20th February 2012**
Decision Type:	Non-Urgent Non-Executive Non-Key
Title:	**TREASURY MANAGEMENT - ANNUAL INVESTMENT STRATEGY 2012/13**
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Chief Officer:	Director of Resources
Ward:	All

1. Reason for report

1.1 This report presents the Treasury Management Strategy and the Annual Investment Strategy covering the years 2012/13 to 2014/15, which are required by the CIPFA Code of Practice for Treasury Management in the Public Services (revised in 2009) to be approved by the Council. The report also includes prudential indicators and the MRP (Minimum Revenue Provision) Policy Statement, both of which also require the approval of the Council).

RECOMMENDATION(S)

The PDS Committee, the Portfolio Holder and full Council are asked to:

2.1 Note the report and

2.2 Agree to recommend to Council the adoption of the Treasury Management Statement and the Annual Investment Strategy for 2012/13 (Appendix 1 on pages 6-26 of this report), including the prudential indicators (summarised on page 26) and the Minimum Revenue Provision (MRP) policy statement (page 9).

Corporate Policy

1. Policy Status: Existing policy. To maintain appropriate levels of risk, particularly security and liquidity, whilst seeking to achieve the highest rate of return on investments.

2. BBB Priority: Excellent Council.

Financial

1. Cost of proposal: N/A

2. Ongoing costs: N/A.

3. Budget head/performance centre: Interest on balances

4. Total current budget for this head: £2.691m (net) in 2011/12; surplus of £300k currently forecast plus £700k from part-reversal of Icelandic Bank impairment

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.4 fte

2. If from existing staff resources, number of staff hours:

Legal

1. Legal Requirement: Non-statutory - Government guidance.

2. Call-in: Call-in is applicable The Annual Investment Strategy and Prudential Indicators require Council approval

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Customer Impact

1. Estimated number of users/beneficiaries (current and projected): n/a

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Ward Councillor Views

1. Have Ward Councillors been asked for comments? N/A.

2. Summary of Ward Councillors comments:

3. COMMENTARY

General

3.1 Under the requirements of the CIPFA Code of Practice on Treasury Management, the Council is required to approve an annual treasury strategy in advance of the year, a mid-year review report and an annual report following the year describing the activity compared to the strategy. In practice, the Finance Director has reported quarterly on treasury management activity for many years, as well as reporting the annual strategy before the year and the annual report after the year-end. The mid-year review for 2011/12 was considered by the PDS Committee on 14th November 2011 and will be reported to the Council meeting on 20th February. This report presents the annual strategy, including the MRP Policy Statement (page 9) and prudential indicators (summarised on page 26) for 2012/13. Details of treasury management activity during the quarter ended 31st December 2011 and the period 1st April 2011 to 31st December 2011 are included in a report elsewhere on the agenda.

Treasury Management Strategy Statement and Annual Investment Strategy 2012/13 to 2014/15

3.2 Appendix 1 (pages 6-26) sets out the Treasury Management Strategy Statement and Annual Investment Strategy for 2012/13 to 2014/15. This combines the requirements of the CIPFA Code of Practice for Treasury Management in the Public Services (revised in 2009) and the Prudential Code. The Strategy includes throughout details of proposed prudential indicators, which are summarised in Annex 3 (page 26) and will be submitted for approval to the February Council meeting. Many of the indicators are academic as far as the Council is concerned, as they seek to control debt and borrowing, but they are a statutory requirement.

3.3 Members will be aware that, since the Icelandic bank crisis in October 2008, the Council has approved a number of changes to the eligibility criteria and maximum exposure limits (both monetary and time) for banks and building societies. The rating criteria use the **lowest common denominator** method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one of which meets the Council's criteria while the other does not, the institution will fall outside the lending criteria. The Council also applies a minimum sovereign rating of AA+ to investment counterparties.

3.4 While the Council effectively determines its own eligible counterparties and limits, it also uses Sector Treasury Services as an advisor in investment matters. Sector use a sophisticated modelling approach that combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes indicate Sector's recommendations on the maximum duration for investments. The Council will use its own eligibility criteria for all investment decisions, but will also be mindful of Sector's advice and information and will not use any counterparty not considered by Sector to be a reasonable risk. In line with the requirements of the CIPFA Treasury Management Code of Practice, the Council will always ensure the security of the principal sum and the Council's liquidity position before the interest rate.

3.5 As is highlighted in the Treasury Performance report elsewhere on the agenda, a number of UK banks have recently been the subject of credit ratings downgrades, which has resulted in reductions to our lending limits and, in one case, in removal from our lending list. It should be emphasised that the downgrades were relatively minor and were in no way an indication of a likely bank default, but, nevertheless, they were enough to impact on our lending list. Consequently, we are left in the position where we have £30m invested with Barclays (limit reduced from £30m to £10m), £20m invested with Santander (limit reduced from £20m to £10m) and £12.5m invested with Clydesdale (previous limit £20m, now removed from our list). All of the relevant investments were placed before the ratings downgrades took place, but we will be unable to re-invest maturing deposits with any of these counterparties unless we rebase the eligibility criteria and reinstate the lending limits. If we do not do this, our investment options would be extremely limited and we would have to place significantly higher balances at relatively low rates with Money Market Funds.

3.6 Following discussion with Sector, the ratings criteria have been reviewed in depth and revised eligibility bands are proposed, as set out in Annex 2 (pages 24-25) of the Annual Investment Strategy. These are minor adjustments, but they would provide us with a few more options and flexibility, although still less than before the ratings downgrades were announced. Sector have been consulted on the proposals and advise that they are entirely prudent and would provide us with a reasonable degree of diversification while not increasing the investment portfolio's exposure to risk. As has always been the case, the proposed criteria will require a counterparty to have strong credit ratings before it can be put on our lending list and investment decisions will continue to be discussed by officers and with Sector. If approved and there are no further ratings changes, we would have the following limits for the major UK banks and building societies:

Banks 1A (£30m / 1 year) – HSBC Bank plc

Banks 1B (£20m / 1 year) – Barclays, Santander UK

Banks 1C (£10m / 6 months) – Nationwide

Banks 2 (£40m / 2 years) – Lloyds TSB, RBS (investments are currently limited to 1 year, subject to review by the Finance Director)

Regulatory Framework, Risk and Performance

3.7 The Council's treasury management activities are regulated by a variety of professional codes and statutes and guidance:

- The Local Government Act 2003 (the Act), which provides the powers to borrow and invest as well as providing controls and limits on this activity;
- The Act permits the Secretary of State to set limits either on the Council or nationally on all local authorities restricting the amount of borrowing which may be undertaken (although no restrictions were made in 2009/10);
- Statutory Instrument (SI) 3146 2003, as amended, develops the controls and powers within the Act;
- The SI requires the Council to undertake any borrowing activity with regard to the CIPFA Prudential Code for Capital Finance in Local Authorities;
- The SI also requires the Council to operate the overall treasury function with regard to the CIPFA Code of Practice for Treasury Management in the Public Services;
- Under the Act the CLG has issued Investment Guidance to structure and regulate the Council's investment activities;
- Under section 238(2) of the Local Government and Public Involvement in Health Act 2007 the Secretary of State has taken powers to issue guidance on accounting practices. Guidance on Minimum Revenue Provision was issued under this section on 8th November 2007.

3.8 The Council has complied with all of the above relevant statutory and regulatory requirements which limit the levels of risk associated with its treasury management activities. In particular its adoption and implementation of both the Prudential Code and the Code of Practice for Treasury Management means both that its capital expenditure is prudent, affordable and sustainable, and its treasury practices demonstrate a low risk approach.

4. POLICY IMPLICATIONS

4.1 In line with government guidance, the Council's policy is to maintain appropriate levels of risk, particularly with a view to ensuring security and liquidity, and to seek to achieve the highest rate of return on investments within these risk parameters.

5. FINANCIAL IMPLICATIONS

5.1 An average of 1.5% was assumed for the interest rate on new investments in the 2011/12 revenue budget (£2.69m), in line with interest rate forecasts provided in January 2011 by the Council's external treasury advisers. The average rate obtained on all new investments placed since the budget was agreed is slightly above this at around 1.60%. Rates are still expected to rise, but the expected start of the rise has been put back to the summer of 2013 and may well slip back even further. The latest financial forecast assumes 1.5% in 2012/13, 1.5% in 2013/14, 2.0% in 2014/15 and 2.5% in 2015/16. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2012/13. The latest forecast for 2011/12 is for a total surplus of £1.0m, comprising £0.3m from general investments and £0.7m as a result of the recent improvement in the Heritable administrator's recovery estimate (see paragraph 3.12 of Treasury Performance report elsewhere on the agenda).

Non-Applicable Sections:	Legal and Personnel Implications
Background Documents: (Access via Contact Officer)	CIPFA Code of Practice on Treasury Management CIPFA Prudential Code for Capital Finance in Local Authorities CLG Guidance on Investments External advice from Sector Treasury Services