Report No. RES13022	**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 31st January 2013** **Council meeting 27th February 2013**
Decision Type:	Urgent Non-Executive Key
Title:	**TREASURY MANAGEMENT - ANNUAL INVESTMENT STRATEGY 2013/14**
Contact Officer:	Martin Reeves, Principal Accountant (Technical & Control) Tel: 020 8313 4291 E-mail: martin.reeves@bromley.gov.uk
Chief Officer:	Director of Resources
Ward:	All

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1. Reason for report

1.1 This report presents the Treasury Management Strategy and the Annual Investment Strategy for 2013/14, 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 approve the inclusion of Certificates of Deposit, Commercial Paper and Floating Rate Notes as eligible investment vehicles (see paragraph 3.7); and

2.2 Agree to recommend to Council the adoption of the Treasury Management Statement and the Annual Investment Strategy for 2013/14 (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 2012/13; currently forecast on target

5. Source of funding: Net investment income

Staff

1. Number of staff (current and additional): 0.25 fte

2. If from existing staff resources, number of staff hours: 9 hours per week

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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 and has always met the requirements with regard to the annual strategy, the mid-year review and the annual report. The mid-year review for 2012/13 was considered by the E&R PDS Committee on 18th October 2012 and was reported to the Council meeting on 12th November. This report presents the annual strategy, including the MRP Policy Statement (page 9) and prudential indicators (summarised on page 26) for 2013/14 to 2015/16. Details of treasury management activity during the quarter ended 31st December 2012 and the period 1st April 2012 to 31st December 2012 are included in a report elsewhere on the agenda.

Treasury Management Strategy Statement and Annual Investment Strategy 2013/14

3.2 Appendix 1 (pages 6-26) sets out the Treasury Management Strategy Statement and Annual Investment Strategy for 2013/14. 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 been the subject of credit ratings downgrades, which has resulted in reductions to the number of eligible counterparties and to monetary and duration limits on our lending list. It should be emphasised that the downgrades were, in most cases, relatively minor and were not an indication of a likely bank default, but, nevertheless, they were enough to impact on our lending list. As a result, the total of investments placed with money market funds has increased significantly in the last year.

3.6 Although Investment options remain limited, no changes to eligibility criteria for individual banks and building societies are proposed at this stage. Sector's advice since September 2011 has been to place investments for short periods (a maximum of 3 months) with all but the two part-nationalised banks (Lloyds TSB and RBS), for which a maximum duration of 1 year is recommended. Whilst our current approved strategy would permit investment for longer periods (up to 2 years with Lloyds TSB and RBS and up to 1 year with some of the other UK banks and building societies), we have taken a cautious view and have followed Sector's advice to the letter. On 11th January, however, Sector lifted the temporary 3 month cap and, as result, we are now able to invest for slightly longer periods with some of the UK banks and building societies on our list, which will enable slightly higher rates to be achieved.

3.7 Officers have, however, discussed the strategy with Sector and it is proposed that, following the recent agreement of the Council to include corporate bonds as eligible investment vehicles, the strategy be extended to include a number of other vehicles, as follows. All of these are included in Sector's model investment strategy. While they may not actually be used, their inclusion would give us more flexibility on potential investment routes going forward.

- Certificates of deposit – these are tradable time deposits and are issued by depositing institutions, which have a banking license. CD's are generally issued with a maturity ranging from one month to a year, though local authorities can get maturities even further out, which break the boundaries of a suitably defined money market instrument. Denominations of issuance can be from £10,000, with a minimum investment of £100,000. They are zero-coupons bonds, issued at par, paying a principal at maturity and with fixed interest.

- Commercial paper - similar to CD's, Commercial paper can be issued by both financial firms and creditworthy corporations. Issued at discount, from par value, and most commonly issued with time to maturities: from a week to within a year.

- Floating rate notes – also known as floating rate bonds, these are bonds that have a variable coupon equal to a money market reference rate, such as Libor, plus a quoted spread/margin that remains constant. They normally pay out interest every three months.

Regulatory Framework, Risk and Performance

3.8 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.

3.9 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 2012/13 revenue budget (£2.69m), in line with interest rate forecasts provided in January 2012 by the Council's external treasury advisers. The average rate obtained on all new investments placed since the budget was agreed (including money market funds and notice accounts) is 1.03%. Rates are still expected to rise, but the expected start of the rise has been put back to the start of 2015 and may well slip back even further. The latest financial forecast assumes a rate of 1.0% for new investments from 2013/14 through to 2016/17. A variation of 0.25% in these assumptions would result in a variation in interest earnings of around £400k pa from 2013/14. The latest forecast outturn for net interest on balances in 2012/13 is broadly in line with the budget.

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