

TONBRIDGE & MALLING BOROUGH COUNCIL

CABINET

01 February 2011

Report of the Director of Finance

Part 1- Public

Matters for Recommendation to Council

1 TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY FOR 2011/12

Members are invited consider a number of amendments to the Council's investment parameters and to review the Treasury Management Strategy Statement and Annual Investment Strategy for 2011/12 and to recommend its adoption to full Council.

1.1 Introduction

- 1.1.1 The Local Government Act 2003 requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- 1.1.2 The Act, therefore, requires the Council to set out its Treasury Management Strategy Statement for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.1.3 The Strategies are set out in a single document at **[Annex 1]** to this report.
- 1.1.4 The portfolio of the Audit Committee includes the review of treasury management activities. Accordingly, that Committee was asked to review the matters covered by this report and **[ANNEX 1]** on 24 January 2011. Due to timing issues it will be necessary to verbally report upon any recommendations or observations made by the Audit Committee.
- 1.1.5 The Strategy is a complex technical document and is a specialist area of work, I should be grateful if Members could **raise any queries with the author of this report (Michael Withey ext. 6103) in advance of the meeting as Michael will not be present on 1 February.**

1.2 Proposed amendments to the investment parameters and reporting arrangements for 2011/12

- 1.2.1 The Council's approach to assessing counterparty creditworthiness and the diversification of investments across sovereigns, groups and counterparties themselves was reviewed in detail in response to the recent banking crisis. A revised approach for 2009/10 was adopted by Council in November 2009 and reaffirmed in the 2010/11 Strategy adopted by Council in February 2010. The Council's Treasury Management Team have reviewed the current investment parameters in detail and propose a number of amendments to ensure an adequate number of counterparties are available with whom to invest, simplify existing arrangements and provide a common approach to both internally and externally managed funds. The most significant amendments are detailed in paragraphs 1.2.2 to 1.2.4 below.
- 1.2.2 At present no investment can be undertaken with a bank or building society that is not regulated by a AAA sovereign. That rating however is determined by reference to a single rating agency, Fitch. The Treasury Management Team proposes retaining the security of a AAA sovereign but broadening that view to at least two of the three main rating agencies (Fitch, Moody and Standard & Poor). This will allow access to Australian banks which as a sovereign is largely immune to Eurozone concerns and has a preponderance of very highly credit rated banks.
- 1.2.3 The current minimum counterparty credit rating for a non-UK nationalised / part nationalised bank is Fitch long term AA- and short term F1+. These ratings signify 'very high credit quality' and 'highest short-term credit quality' respectively. In addition, counterparties must have an individual Fitch rating of no lower than B and a support rating of no lower than 2. The Treasury Management Team propose retaining the long and short term ratings as present but allowing a modest lowering of the individual rating to C (an 'adequate bank') whilst enhancing the support rating to 1 ('A bank for which there is an extremely high probability of external support. The potential provider of that support is very highly rated in its own right and has a very high propensity to support the bank in question'.) This will allow access to a number of highly credit rated banks such as Germany's Deutsche Bank and France's Credit Industrial et Commercial. This change will alleviate current difficulties of ensuring an adequate number of counterparties with whom to invest without significantly altering credit risk.
- 1.2.4 The 2010/11 Strategy requires 25% of core funds to be invested outside the UK and introduced different group and counterparty limits for non-UK banks and also different group and counterparty limits for the investment of cash flow surpluses. Our exposure limits have been reviewed by Sector Treasury Services, our treasury management advisors, and a much simpler approach suggested. The 2011/12 Strategy allows 100% investment in the UK but limits exposure to non-UK sovereigns to a maximum of 25% per sovereign. A common maximum 25% exposure to counterparties and groups is also suggested. These simplifications are welcomed by our external fund manager.

1.2.5 More recently, treasury management activity has been reported in detail to both the Finance and Property Advisory Board and the Audit Committee. Due to the timing of meetings the same report has, on occasion, been considered by both groups of members. The delegation arrangements detailed in Appendix 1 of **[Annex 1]** aim to rationalise this approach. Whilst the Finance & Property Advisory Board will continue to receive high level information on treasury performance via the regular Financial Planning and Control reports more detailed activity reports will only be subject to scrutiny by the Audit Committee.

1.3 Legal Implications

1.3.1 These are set out above and at **[Annex 1]** to this report. In addition, Sector Treasury Services are employed to provide independent advice on legislative and professional changes that impact on the treasury management function.

1.4 Financial and Value for Money Considerations

1.4.1 The Bank Rate is expected to remain at a historical low (0.5%) for the majority of 2011. Given the low interest rate environment the Strategy is geared towards keeping investments short in order to benefit from the compounding of interest. The expected returns from cash flow and core investments are 0.7% and 1.3% respectively.

1.4.2 The performance of our fund manager and internal management of core funds is monitored against all of the players in the public sector cash management market place using data provided by Sector Treasury Services. In addition, internal cash flow investments are monitored against the money market and a passive investment policy.

1.4.3 In respect of our “defaulted” £1m investment with Landsbanki the contract remains in default and action is now being taken by Bevan and Brittan, our legal advisors, to confirm local authority depositors’ status as **priority creditors**. The Council’s submission to the Icelandic courts is due to be presented in Spring 2011.

1.5 Risk Assessment

1.5.1 Sector Treasury Services are employed to advise on the content of the Treasury Management Strategy Statement and Annual Investment Strategy and this, coupled with a regular audit of treasury activities ensures that the requirements of the Strategy and the Treasury Policy Statement adopted by this Council are complied with.

1.5.2 Credit ratings remain a key tool in assessing risk. It is recognised that their use should be supplemented with sovereign ratings and market intelligence. Appropriate sovereign, group and counter party limits need to be established to ensure an appropriate level of diversification.

1.5.3 In the light of these safeguards and stringent Treasury Management Procedures it is considered that any risks to the authority implicit in the Strategy have been minimised.

1.6 Equality Impact Assessment

1.6.1 See 'Screening for equality impacts' table at end of report.

1.7 Recommendations

1.7.1 Cabinet are invited to consider and **RECOMMEND** that full Council:

- 1) amends the investment parameters and reporting arrangements for 2011/12 as outlined in paragraphs 1.2.2 to 1.2.5; and
- 2) adopts the Treasury Management Strategy Statement and Annual Investment Strategy for 2011/12 set out at **[Annex1]**.

Background papers:

contact: Michael Withey

Templates and forecasts provided by Sector and Investec.

Sharon Shelton
Director of Finance

Screening for equality impacts:		
Question	Answer	Explanation of impacts
a. Does the decision being made or recommended through this paper have potential to cause adverse impact or discriminate against different groups in the community?	NO	N/A
b. Does the decision being made or recommended through this paper make a positive contribution to promoting equality?	NO	N/A
c. What steps are you taking to mitigate, reduce, avoid or minimise the impacts identified above?		N/A

In submitting this report, the Chief Officer doing so is confirming that they have given due regard to the equality impacts of the decision being considered, as noted in the table above.