

Executive

Treasury Management Strategy

2 March 2009

Report of Strategic Director for Customer Service and Resources and the Chief Accountant

PURPOSE OF REPORT

This report sets out the strategy and policy framework for treasury operations for 2009/10 and outlines the Council's prudential indicators for 2009/10 – 2012/13 as approved by Council on 23 February 2009. It fulfils two key requirements of the Local Government Act 2003:-

- approval of the Treasury Management Policy in accordance with the CIPFA Code of Practice on Treasury Management; and
- approval of the Investment Strategy in accordance with the DCLG investment guidance.

This report is public

Recommendations

The Executive is recommended:

- 1) to recommend to Council approval of the Treasury Management Policy and Investment Strategy 2009/10

Executive Summary

- 1.1 The Council is required to approve its Treasury Management Policy and Investment Strategy at the start of each financial year by the CIPFA Code of Practice which it has adopted. The updated investment strategy also ensures that the levels of risk and return continue to take account of prevailing market and economic conditions.
- 1.2 The current economic climate has seen interest rates fall from 5% in September 2008 to a base rate at February 2009 of 1%. Butlers, the Council's Treasury Management Advisors, are currently of the view that the Bank Rate may decrease by a further to 0.5% to 0.5% during 2009/10.
- 1.3 The planned reduction in interest rates continues to result in reductions to our investment income for 2009/10 and beyond. The magnitude of this reduction is seen by comparing 2007/08 investment income of £6.9m with budgeted 09/10 investment income of £2.8m. A result of reducing balances and falling returns.
- 1.4 In consultation with PWC and with full reference to the CIPFA Code of Practice, the Council has reviewed its risk appetite and associated priorities in relation to security, liquidity and yield in respect of returns from various financial instruments. The exercise undertaken has involved an independent fundamental review of the Council's investment strategy in the light of the exceptional nature of recent and

forecast market conditions. The instability in the banking financial sector results in an increased appetite for security on investments. The security of public funds remains of paramount importance. The unprecedented suppression of interest rates presents significant revenue challenges as such the money we have needs to be invested both prudently and wisely. The proposed strategy with supporting documentation is contained in Appendix 1.

Background Information

2.1 2008/09 Performance

The Executive approved its 2008/09 Treasury Management Strategy and Policy Statement at its meeting on 12 May 2008. The 2008/09 Annual Report on Treasury Management will be presented to the Executive in June 2009 along with the Revenue and Capital Outturn reports. This report will give full information on the performance of the Council's fund managers and in-house operation. This report will present a further opportunity to review our Treasury Management policies and practices and make further changes if needed.

- 2.2 The 2008/09 interest projections as at January 31st 2009 show an expected investment income of £5.2m which is on track to budget despite a write off of £0.5m in relation to investments at risk in Iceland.

2.3 Icelandic Investments

Cherwell District Council is one of at least 123 local authorities that have been affected by the collapse of Icelandic banking institutions. The Council currently has a total of £6.5 million in short term investments (i.e. those with maturity periods of up to one year) with one of the affected banks Glitner.

The position relating to the recovery of Council investments in Icelandic banks and the associated interest is uncertain with no reliable forecast available of what might be re-paid, or at what time. At this stage the extent of financial loss, if any, is unknown and in accordance with guidance from CIPFA we have not made any provision for loss of principal but have written off accrued interest of £0.5m. The Council is co-operating with and supporting the work of the Local Government Association (LGA) in its discussions with Treasury on these matters and any Government support to be made available to the affected authorities.

The resulting period of uncertainty poses a real issue for effective financial planning. The position will be closely monitored and members updated regularly as further information becomes know.

2.4 Economic Climate

Since mid-September when base rates were 5%, the global banking system has experienced its most serious disruption for almost a century. Since the beginning of the year, the Bank of England's Monetary Policy Committee (MPC) has set Base Rates to balance two perceived risks to the inflation outlook.

The downside risk was that a sharp slowdown in the economy, associated with weak real income growth and the tightening in the supply of credit, would pull inflation materially below the target level. The upside risk was that above-target inflation persisted for a sustained period because of elevated inflation expectations.

The outcome is that the economy is in the midst of a recession. The recent crisis in the financial markets has delivered a sharp and involuntary tightening of monetary policy. This, along with the continued effects of high inflation and decelerating house price inflation is expected to undermine consumer confidence and deliver lower or nil growth. The Bank of England's ability to cut rates (current base rate 1%) will be tempered by continued concerns over future inflation performance, with CPI now running at 3.0%.

2.5 Investments

The Council has £29m and £26m respectively invested with fund managers Tradition UK and Investec. In addition it has around £38m managed in-house which fluctuates during the year. The report in Appendix A recommends a review of each of these operations in light of the current economic climate and overall reduction in investments planned to fund the Capital Programme, the need to maximise investment returns to contribute to efficiency savings and taking account of the three operations' investment performance.

2.6 Advisors

The Council's three year contract with Butlers for Treasury Management advisory services was extended for a further 12 months during 2008/09 and is due to expire on 31 March 2009. To ensure that the Council is receiving the best possible advice and value for money this contract is in the process of being re-tendered in line with the Council's contract procedure rules.

2.7 2009/10 Treasury Management Strategy

In accordance with the code of practice an annual treasury management strategy is approved each year which covers aspects such as borrowing and lending strategy, interest rate forecasts, working capital policies and the controls and limits in place for investment.

The strategy is attached in Appendix 1 together with our approved counterparty lending list and prudential indicators for 2009/10 – 2012/13 as approved by Council on 23 February 2009. The strategy seeks to achieve 1) security, 2) yield and 3) liquidity from the Council's investment portfolio.

Key Issues for Consideration/Reasons for Decision and Options

- 3.1 The Treasury Management Policy and Investment Strategy determines the Council's policy on the management of its loans and investments with reference to both risk and risk revenue implications.

The following options have been identified. The approach in the recommendations is believed to be the best way forward

Option One To approve or reject the recommendations above or request that Officers provide additional information.

Consultations

Corporate Management Team 11/02/09

Implications

Financial:

Financial Effects – Closer management of the Council's cash-flows and working capital will increase the level of short-term investment income. This will be monitored during the year and budgets amended accordingly.

It is possible that with falling interest rates and the tightening of the counterparty strategy this could impact significantly on the level of interest income.

Each 0.25% fall in interest rates has a potential impact of £138,000 on revenue budget. In order to mitigate this risk an interest rate reserve has been generated.

Efficiency Savings – None is arising direct from this report. Increased returns on investments do not meet the strict definitions of the Annual Efficiency Statements but in practice would contribute to the Council's savings and efficiency targets.

Comments checked by Julie Evans, Strategic Director for Customer Service and Resources , 01295 221595.

Legal:

There is a requirement for the Council to fulfil two key requirements of the Local Government Act 2003:-

- approval of the Treasury Management Policy in accordance with the CIPFA Code of Practice on Treasury Management; and
- approval of the Investment Strategy in accordance with the DCLG investment guidance.

Comments checked by Liz Howlett, Head of Legal and Democratic Services, 01295 221686.

Risk Management:

- a) Risk of capital loss – the prime objective of treasury management activities is to ensure the security of the amounts invested. This is managed by using a counterparty list which only includes organisations having a suitable credit rating and which has a maximum amount that can be invested with each organisation at any one time.
- b) Liquidity – investments are linked to known future cash flows to ensure sufficient funds are available as and when they are required.
- c) Interest Receivable – this is regularly monitored against budget and reported through the Performance management Framework.

Comments checked by Rosemary Watts, Risk Management and Insurance Officer, 01295 221566.

Wards Affected

All

Corporate Plan Themes

An Accessible and Value for Money Council

Executive Portfolio

Councillor James Macnamara
Portfolio Holder for Resources

Document Information – Appendix 1 to follow

Appendix No	Title
Appendix 1	Draft Revenue 2009/10 Budget and Analysis 3
Background Papers	
CIPFA Treasury Management Code of Practice 2008/09 Treasury Management Strategy 2009/10 Budget Medium Term Financial Strategy	
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