
Treasury Management

POLICY STATEMENT

FINANCE & RESOURCES
BUSINESS UNIT



Council of the
ISLES OF SCILLY

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REVISIONS TO THE SOURCE DOCUMENT

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EQUALITIES IMPACT ASSESSMENT RECORD

Date	Type of Assessment Conducted	Stage/Level completed (where applicable)	Summary of Actions Taken Decisions Made	Completed by.	Impact Assessment Review date

DOCUMENT RETENTION

Document retention period	
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1.1 The CIPFA TM Code requires that each Local Authority prepare a report outlining the proposed Treasury Management policies, strategy, and activities for the coming financial year.

1.2 Section 15(1) of the LGA 2003 requires that an Annual Investment Strategy (AIS) be submitted, outlining the proposed investment strategy. This can be combined with the Treasury Management Statement, but must state explicitly where it is dealing with the guidance by the Secretary of State.

1.3 Under Section 3(1) and (2) of the LGA 2003 (duty to determine affordable borrowing limit), a Local Authority must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which, Treasury and Investment Management, and Capital Financing are managed.

1.4 The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits and the risk of exposure to interest rate changes; the maturity structure of borrowing; and longer-term investments.

1.5 This policy brings together the requirements of the LGA 2003, and the 2011 revised CIPFA TM, and Prudential Codes. In presenting the Treasury Management and Investment Strategies, and the Prudential Indicators, account is taken of the current treasury position and the outlook for interest rates. They provide a transparent framework, and benchmarks within which, Treasury and Investment Management, and Capital Financing are managed.

1.6. In receiving funding for its functions, the Council effectively turns over approximately £6 million a year. This represents significant cash movements, and it is important that the Authority has strategies and policies in place to manage such turnover effectively.

Introduction and Background

2.1 The Authority adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the code), as described in Section 5 of the Code

2.2 Accordingly, the Authority will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

2.3 The Authority (i.e. full Authority Members) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

2.4 The Authority accepts responsibility for the implementation and regular monitoring of its TMPs and practices and for the execution and administration of treasury management decisions to its Chief Finance Officer, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

2.5 The Authority is also responsible for ensuring effective scrutiny of the treasury management strategy and policies.

POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

3.1 The Authority defines its treasury management activities as:

"The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

3.2 This Authority regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

3.3 This Authority acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

3.4 The Authority's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and re-financing risk. The source from which the borrowing is taken and the type of borrowing should allow the Authority transparency and control over its debt.

3.5 The Authority's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important, but are secondary considerations.

TREASURY MANAGEMENT STRATEGY (TMS)

4.1 Introduction

4.1.1 An Authority may at times need to borrow for capital purposes as determined by the agreement of a Capital Programme. It may also need to borrow to cover short-term fluctuations in cash flow.

4.1.2 Where borrowing is required, Prudential Indicators are set as part of the framework for Treasury Management in relation to the overall borrowing limit, the level of exposure to changes in interest rates, and the maturity structure of borrowing.

4.2 Long/Short-Term Borrowing

4.2.1 The Authority currently holds four loans with the Public Works Loans Board (PWLB) which had a fair value of £193,000 at the 31 March 2015. Any potential further borrowing would be driven by the capital plan. There are currently no plans that would necessitate significant borrowing during 2016-17.

4.2.2 When future borrowing is agreed, and Prudential Indicators set, the Section 151 Officer will make specific decisions with regard to the timing of any borrowing and the length of maturities. Borrowing would be undertaken to minimise borrowing costs, and would be consistent with the Authorities' Prudential Indicators.

4.2.3 The Section 151 Officer has the delegated power to raise capital finance from such sources as is deemed appropriate within the statutory limitations that apply to the Authority. These are termed 'borrowing instruments' and include:

- PWLB loans – Fixed or Variable
- Transferable loan instruments - LOBOs (Lender Option Borrower Option Market Loans)
- Non-transferable loan instruments - Local bonds - Other (e.g. commercial loan)
- Bank overdraft

4.2.4 For such long term funding as may be required, the most likely source would be the Public Works Loan Board (PWLB). Internal resources may be used in lieu of external borrowing, and leasing or soft loans will form an alternative to borrowing where appropriate.

4.3 Debt Rescheduling

4.3.1 The Authority currently holds four loans with the Public Works Loans Board (PWLB) which had a fair value of £193,000 at the 31 March 2015. Any potential further borrowing would be driven by the capital plan. There are currently no plans that would necessitate significant borrowing during 2016-17.

4.4 Short-Term Borrowing

4.4.1 Headroom - Authority short-term cash balances are kept to a minimum in order to maximise monthly investment. Short-term borrowing will be sought from the Authority's bankers in the form of overdraft or otherwise.

4.4.2 Whilst pursuance of this policy intends to maintain a positive short-term cash balance, the timing of sizable grant receipt and investment decisions, may mean being occasionally overdrawn for a day or so within short-term cash balances.

4.4.3 By monitoring cash flow during the month, and with the option to withdraw funds from the Bank the Authority mitigates the risk to liquidity.

4.4.4 The Council has an overdraft facility in place with its bankers to cover any unforeseen emergency requirement.

4.4.5 Credit Cards - In order to administer and better facilitate certain payments for goods and services some posts within the Authority are issued with Corporate Cards, the eligibility for a corporate card is tied to the Post, not the employee. The use of Cards enables the Authority to make on-line and retail purchases that would otherwise not be possible, which in turn facilitates cost effective methods for some low value purchases, or those that can only be purchased in this way. Further, the use of Cards enables the Authority to enable its officers who are travelling on official business a method of paying for business expenditure outside of the approved 'Subsistence Expenses Scheme'.

4.4.6 Cards are issued on a business need application basis and each card holder is required to sign a card usage agreement to ensure that card expenditure is in line with approved process. The credit limit stands at £50,000 across the Authority. This is not the amount of credit on actual charge cards in circulation, but the overall limit that the Council can apply for in total and provides us with flexibility to issue new cards to eligible post holders as business need arises.

ANNUAL INVESTMENT STRATEGY (AIS)

5.1 Introduction

5.1.1 The Office of the Deputy Prime Minister, (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003. Revised guidance became effective from 1st April 2010.

5.1.2 The overriding aim of the guidance is to encourage authorities to invest prudently, without burdening them with detailed prescriptive regulation. The priority given to security and liquidity, rather than yield is re-emphasised. The Guidance states:

“Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities”.

5.1.3 Under the guidance there are two types of investment, ‘Specified’ and ‘Non-Specified’:

- **Specified investments** are those that offer high security and high liquidity, are made in Sterling, and with a maturity of no more than one year. Investments with the UK Government, other Local Authorities, or bodies with ‘high credit quality’ will count as specified investments.
- **Non-Specified investments** are all other investments that fall outside of this description, and must be dealt with in more detail than those classified as Specified.

5.1.4 Revised guidance states that the AIS can be replaced by a revised strategy, if circumstances change during the year, subject to full Authority approval. Guidance also suggests that the AIS reports on procedures for ensuring that the Authority’s staff responsible for treasury management has the right kind of training in investment management.

5.2 Investment Strategy

5.2.1 The Authority intends to continue to maximise returns by investing when possible. Cash flow balances be closely monitored by Council Officers to identify any funds not needed in the immediate future. Investments or disinvestments will be made on a monthly basis, making this an extremely liquid investment.

5.2.3 As stated in point 4.4.1, it is intended that the Authority short-term cash balances be kept to a minimum in order to maximise monthly investment returns.

5.2.4 The revised Section 15(1)(a) guidance states that Authorities should review and address the needs of staff involved in treasury management for training in investment management. In addressing this, the current job specification and qualification requirement for posts involved with treasury management is deemed adequate for the current level of decision-making although it should be noted that it is best practice for Council Treasury Management practitioners to hold investment, as well as accounting qualifications.

5.3 Counterparties for Lending

5.3.1 The Authority is to maintain a counterparty list in compliance with guidance issued by the Secretary of State under section 15(1)(a) of the LGA 2003. This forms the basis of delegation to the Section 151 Officer who then operates, as the Chief Finance Officer, his/her own system of ‘vetting’ of counterparties.

5.3.2 Now it is a requirement of the revised CLG guidance, the Authority will use a range of indicators to assess counterparties, not just credit ratings. Among other indicators to be taken into account will be:

- Credit Default Swaps and Government Bond Spreads.

- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Government Guarantees and Support, including ability to support.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.

Other macroeconomic factors.

PRUDENTIAL INDICATORS

6.1 The first Prudential Indicator in respect of treasury management is that the Authority has adopted the CIPFA TM Code. The Authority adopts the content and the spirit of the revised 2011 code.

6.2 The Authority is required to set an authorised limit for total external debt, gross of investments, separately identifying borrowing from other long-term liabilities. The Authority is also required to set an operational limit separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the operational boundary. They are both set for the forthcoming, and the following two years. The authorised limit will, in addition, need to provide headroom over and above the operational boundary sufficient for example to accommodate unusual cash movements.

6.3 The interest exposure indicators relate to net interest on, or to the net principal sum outstanding on borrowing/investments. The percentage of variable rate exposure is deliberately set high because the return on the investment is not counted as fixed. The risk posed by this is totally mitigated because the bank account position is reported to Senior Officers on a weekly basis, and investment decisions are made against a known return of base rate. Funds could be removed immediately if they were to under-perform. With this contingency in mind, the fixed interest indicator has also been set to 100% to afford maximum flexibility.

6.4 The Authority has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. These indicators are referred to as the upper and lower limits respectively for the maturity structure of its borrowing. The calculation is the amount of projected borrowing that is fixed rate maturing in each period, expressed as a percentage of the total projected borrowing that is fixed rate. The periods in question are:

- Under 12 months
- 12 months and within 24 months
- 24 months and within 5 years
- 5 years and within 10 years
- 10 years and above

The 'maturity structure of borrowing' indicators have been set taking into account the contingent possibility of an overdraft facility being necessary.

6.5 The next treasury management prudential indicator is referred to as the total principal sum invested for a period longer than 364 days. The purpose of this indicator is to help the Authority to contain its exposure to the possibility of loss that might arise as a result of having to seek early repayment or redemption of principal sums invested. This indicator has therefore been set at zero for the foreseeable future.

6.6 CIPFA introduced a new indicator in 2013-14, 'Gross debt and the Capital Financing Requirement'. The objective of the indicator is to ensure that borrowing only takes place for capital purposes over the medium to long-term. Where the gross debt is greater than the CFR, the reasons should be clearly stated in the Treasury Management Strategy.

6.7 In order that preceding Treasury and Investment Management Strategies are carried out, the following Prudential Indicators are recommended to the Authority:

	2016/17	2017/18	2018/19
	£s	£s	£s
<i>Authorised limit (borrowing only)</i>	500,000	500,000	500,000
<i>Operational boundary</i>	500,000	500,000	500,000
<i>Upper limit on fixed interest rate exposure</i>	100%	100%	100%
<i>Upper limit on variable interest rate exposure</i>	100%	100%	100%
<i>Maturity structure of borrowing</i>			
	<i>Upper Limit</i>		<i>Lower Limit</i>
<i>Under 12 months</i>	100%		0%
<i>12 months and < 24 months</i>	0%		0%
<i>24 months and < 5 years</i>	0%		0%
<i>5 years and < 10 years</i>	0%		0%
<i>10 years and above</i>	0%		0%
	2016/17	2016/17	2017/18
	£s	£s	£s
<i>Prudential Limit for principal sums invested for periods longer than 364 days</i>	0	0	0

6.8 The 2011 Revision suggested that Authorities may wish to create an indicator that considers Credit Risk. The Authority considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of the Authority's assessment of credit risk, but they are not a sole feature in their assessment of counterparty credit risk. The only indicators with prescriptive values are credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

REPORTING ARRANGEMENTS

7.1 The Chief Finance Officer will report to the Authority on treasury activities in the form of an Annual Treasury Management Report after the close of the financial year.

7.2 Furthermore, in compliance with clause two of the four revised CIPFA TM clauses formally adopted, a mid-year review will be reported to this Authority. Further information or updates will be produced on request.

7.3 The statement details interest earned, received, and accrued for the period, as well as capital invested, and performance statistics.

LENDING COUNTERPARTY CRITERIA

8.1 The following criteria will be used to manage counterparty risks to Council Investments for new deposits from the time that the new Treasury Management Strategy Statement, (which includes the Annual Investment Strategy) is passed by Full Council at its meeting in March 2016:

- **Deposits** - Any Financial Institution that is authorised by the PRA to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society can be lent to, subject to the rating criteria below at the time of the deposit.
- **Unrated Building Societies** - Unrated Building Societies as identified by Treasury Advisors can be used, with a maximum of £1m per Society and a maximum maturity of 1 year.
- **Marketable Instruments** – Any bank, other organisation, or security whose credit ratings satisfy the criteria below:
- **Rating of Counterparty**
 - Deposits or instruments of less than 13 months duration (Refer to long-term ratings)
 - Fitch A- or above
 - S&P A- or above
 - Moody's A3 or above
 - The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £500,000m (approximately 15% of investment balance at February 2016).
 - The maximum deposit / investment amount for any authorised counterparty or security that has as a minimum - Fitch AA-, S&P AA-

, and Moody's Aa3, will be £500,000 (approximately 15% of investment balance at February 2016).

- Deposits or instruments of more than 13 months duration (Refer to long-term ratings)
 - Fitch AA- or above
 - S&P AA- or above
 - Moody's Aa3 or above

- The maximum deposit / investment amount for more than 13 months for any authorised counterparty or security that has as a minimum at least two ratings of the three above will be £500,000. This figure is to be included in the overall figure above.

- The allowed deposit amounts above are the single maximum per counterparty at any one time, and that counterparty or security must be rated as above or better by at least two of the three agencies. Short-term ratings will be monitored and considered in relative rather than absolute terms.

- It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the other factors below give rise to concern. Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors. Where deposits held were made under previous criteria, there will be no compulsion to terminate those deposits to meet new criteria, where a penalty would be incurred.

8.2 Operational Bank Accounts Amounts contained in operational bank accounts with the Authority's main Bank (currently Lloyds) will not count in the calculation of Lloyds' limit as defined above. In the event of unexpected receipts after 2pm on any given working day, money may be placed in an instant access call account overnight, in breach of the above limits. Whenever this occurs the total lending to Lloyds must be reduced to back within their limit on the following working day.

8.3 If the Council's current bankers, Lloyds have their ratings downgraded below the minimum criteria, the instant access Call Account facility may still be used for short-term liquidity requirements and business continuity arrangements.

8.4 Public Sector Bodies Any UK Local Authority or Public Body will have a limit of £5m and a maximum maturity of 5 years. The UK Government Debt Management Office (DMADF) will be unlimited in amount and duration. The table below gives a definition and approximate comparison of various ratings by the three main agencies:

Definitions of Rating Agency Ratings

	<i>Fitch</i>	<i>Moody's</i>	<i>S&P</i>
<i>ShortTerm</i>	<i>F1+ Exceptionally strong</i> <i>F1 Highest quality</i> <i>F2 Good quality</i> <i>F3 Fair quality</i> <i>B Speculative</i>	<i>P-1 Superior</i> <i>P-2 Strong</i> <i>P-3 Acceptable</i> <i>NP Questionable</i>	<i>A-1+ Extremely strong</i> <i>A-1 Strong</i> <i>A-2 Satisfactory</i> <i>A-3 Adequate</i> <i>B and below</i> <i>Significant speculative characteristics</i>
	<i>C High default risk</i>		
	<i>(+) or (-)</i>	<i>(1,2, or 3)</i>	<i>(+) or (-)</i>
<i>LongTerm</i>	<i>AAA Highest quality</i> <i>AA V High quality</i> <i>A High quality</i> <i>BBB Good quality</i> <i>BB Speculative</i>	<i>Aaa Exceptional</i> <i>Aa Excellent</i> <i>A Good</i> <i>Baa Adequate</i> <i>Ba Questionable</i>	<i>AAA Extremely strong</i> <i>AA Very strong</i> <i>A Strong</i> <i>BBB Adequate capacity</i> <i>BB and below</i> <i>Significant speculative characteristics</i>
	<i>B Highly Speculative</i> <i>CCC High default risk</i>	<i>B Poor</i> <i>Caa Extremely poor</i>	

8.5 Financial Groups - Where two or more separate counterparties are owned by the same eventual parent company, a consolidated limit of 1.25 times the limit of the constituent counterparty within the group that has the smallest limit of the counterparties being used at the time of deposit, as calculated using the above criteria will apply.

8.6 Country Limits Excluding the UK, there will be a limit of 25% of total investments in any one country.

8.7 Money Market Funds - Until such time as proposed regulatory changes come into effect, Constant Net Asset Value (CNAV) Money Market Funds must be rated by at least two of the main three ratings agency, and must have the following ratings:

Fitch AAmmf Moody's Aaa-mf Standard & Poor's AAAM

Subject to the above, deposits can be made with the following limits: -

- The lower of £500,000 or 0.5% of the total value for individual Funds.
- No more than 40% of total deposits outstanding are to be held in CNAV MMFs.

Currently, not all Variable Net Asset Value (VNAV) Funds carry a rating. Furthermore, proposed regulatory changes would see many CNAV Funds becoming VNAV, and a rating could not be sought. In this case, as currently, VNAV Funds will be considered on an individual basis. Limits for VNAV Funds will be:

- The lower of £100,000m or 0.5% of the total value for individual Funds.
- No more than £250,000m of total deposits outstanding are to be held in VNAV Funds.

8.8 Other Indicators - It is now a requirement of the revised CLG guidance that the Authority will use a range of indicators, not just credit ratings. Among other indicators to be taken into account will be:

- Credit Default Swaps and Government Bond Spreads.
- GDP, and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Government Guarantees and Support, including ability to support.
- Share Price.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Other macroeconomic factors