

CAA/12/2007

**KENNET DISTRICT COUNCIL**

**RESOURCES EXECUTIVE COMMITTEE**  
**to be held on 20<sup>th</sup> March 2007**

Report by Janet Ditte, Chief Accountant & Auditor

**Treasury Management Policy Statement and Annual  
Investment Strategy 2007/08**

**1. Purpose of Report**

The purpose of this report is to present Members with the proposed Treasury Management Policy Statement and Annual Investment Strategy for 2007/08, and to seek approval of these documents.

**2. Financial and Staffing Implications**

The financial implications of this report are contained within the body of the report.

**3. Legal Implications**

The Local Government Act 2003, requires the Council to “have regard to” the Prudential Code, the Treasury Management Code of Practice, both issued by CIPFA, and the Guidance on Local Authority Investments (issued by the ODPM, as was). The Prudential Code requires local authorities to set prudential indicators for the next three years to ensure that their capital spending plans are affordable, prudent and sustainable. The Prudential Code has as one of its indicators, the requirement to comply with the Treasury Management Code of Practice (The Code). In addition, the Prudential Code requires all local authorities to set Operational and Authorised Borrowing Limits.

The Code requires the Council to set and approve its Treasury Management Policy Statement annually, and in advance of the following financial year. In addition, the Guidance on Local Authority Investment requires the Council to set an Annual Investment Strategy that gives priority to security and liquidity of investments.

The documents appended to this report, ensure that the Council fulfil these requirements.

## 4. Risk Implications

There is inevitably an element of risk associated with the investment of the Council's surplus capital and revenue reserves. However, the adoption of requirements of the Treasury Management Code of Practice and Guidance on Local Authority Investments both ensure that this risk is minimised. The adoption of the Treasury Management Policy Statement and Annual Investment Strategy ensure that the Council has actively managed its risk in this area.

Specific treasury management risks are identified in the Council's approved Treasury Management Practices, as part of the Treasury Management Policy Statement. These risks include:

- Liquidity Risk (adequate cash resources);
- Market or Interest Rate Risk (Fluctuations in the value of investments);
- Inflation Risks (Exposure to inflation);
- Credit and Counterparty Risk (Security of Investments);
- Refinancing Risks (Impact of debt maturing in future years);
- Legal and Regulatory Risk (Compliance with statutory and regulatory requirements)

## 5. Background

Treasury Management is defined as "*The Management of the organisation's 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*".

The Treasury Management Code of Practice<sup>1</sup> sets out the proper practice to be followed by local authorities in the management of its treasury management functions. This document requires local authorities to create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies and objectives of its treasury management activities;
- Suitable treasury management practices, 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.

The format of the document is prescribed in the Code of Practice.

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<sup>1</sup> Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, published by CIPFA 2001

## **6. Treasury Management Policy Statement**

There have been no changes to the Treasury Management Policy Statement since the document was approved by the Resources Executive Committee in March 2006.

During the year, it has been necessary to withdraw funds from the funds managed by Invesco, the Council's fund manager, to cover cash flow requirements. £1.5m was withdrawn from the fund in January 2007, and a further £1m will be withdrawn in March 2007. This has led to a minimal technical breach of the Treasury Management Policy Statement, as some of the remaining investments within the fund have breached the 10% counter-party limit because the total value of the fund has reduced. Given that the breach has been minimal and is the result of the Council withdrawing funds, it has been agreed that immediate corrective action need not be taken, as this may have a detrimental effect on the return of the fund.

The Council's fund manager has requested that the counterparty limit be reviewed to allow either 10% of the value of the fund, or £1.75m, whichever is the greater, to be invested with any one counter-party (subject to the other limits applying to Gilts etc). The officers have considered this request and it is recommended that the Treasury Management Policy Statement be amended to reflect this change. The Treasury Management Policy Statement appended has been amended to reflect this change.

## **7. Annual Investment Strategy**

It is a requirement of the Treasury Management Code of Practice and Guidance on Local Government Investments issued under section 15(1)(a) of the Local Government Act 2003, that the Council set an Annual Investment Strategy for the coming year prior to the commencement of that financial year. This document is attached as Appendix A to the Treasury Management Policy Statement and Practices.

## **8. Interest Rate Predictions**

The Council currently takes advice from its Fund Managers, Invesco, on the outlook for interest rates. It is currently anticipated that interest rates are at or close to their peak. If there is another interest rate increase, this is likely to be in April or May 2007. Inflationary pressures should then start to reduce later in 2007 in response to recent interest rate increases. It is anticipated that interest rates will start to move downwards late in 2007, however the markets will begin to price in these reductions slightly earlier. As a result, Invesco are forecasting returns for 2007/08 of 5.75%.

## **9. Overview & Scrutiny Task Group Review**

The Council's Treasury Management arrangements are currently being reviewed by a Task Group of the Overview and Scrutiny Management Board. The Task Group has yet to issue its final report and a further report will be brought to this committee, as appropriate.

However, the Task Group has considered the performance target set for the Council's Fund Manager, Invesco. This has highlighted that the target may no longer be appropriate and should be reviewed at this time.

The target, set at 0.5% above the Local Authority 7 Day Rate, was first set in 1995 when the Council first appointed fund managers. The Local Authority 7 Day Rate was selected as the benchmark for the Council's fund, as a whole. The benchmark is an important reflection of the Council's attitude to risk. The Council's investment strategy has been a low risk strategy, and the 7 day rate is reflective of this attitude. This is appropriate as the Council is dependent on its investment income to support its revenue budget. Other benchmarks can be adopted, for example gilt or composite benchmarks, but they reflect different attitudes not only to risk but also volatility. With this in mind, the Local Authority 7 Day Rate is still considered to be appropriate.

However, it is questionable whether the 0.5% target above this benchmark is still appropriate. This fixed, absolute level of 0.5% was set when prevailing interest rates were higher. As prevailing interest rates have fallen, the target has become harder to achieve whilst the risk strategy of the Council has remained unchanged. Therefore, it is arguable that the target has become unrealistic. It is important that the Council sets SMART targets that are achievable and realistic. Therefore, it is recommended that the target set for Invesco should be changed to be the same as that set for the Cash Managers, Tradition, at 10% above the Local Authority 7 Day Rate. This target is relative to the interest rate and therefore as interest rates increase the target also increases.

## **10. Conclusions**

An updated version of Treasury Management Policy Statement and Annual Investment Strategy for 2007/2008 is presented to Members for approval.

## **11. Recommendations**

**IT IS THEREFORE RECOMMENDED THAT** the committee

- (1) Adopt the revised Treasury Management Policy Statement and Treasury Management Practices (Appendix A), with the following amendments included:
  - a. The counter-party limit for Invesco be amended to read 10% or £1.75m of the fund, whichever is greater;
  - b. The performance target for Invesco to amended to be 10% above the Local Authority 7 Day Rate
  
- (2) Adopt the Annual Investment Strategy for 2007/2008 (Appendix A of Treasury Management Policy Statement)

March 2007