

Scrutiny of the Treasury Management Strategy and Policies – Questions and Answers (Overview and Scrutiny Committee 9 January 2017)

The following questions and answers will help to demonstrate that the Council's Treasury Management Strategy and Policies were subject to robust member scrutiny and demonstrate compliance with the CIPFA Code of Practice for Treasury Management.

First some questions on the day to day process.

Question No. 1

On a daily basis, how do you work out whether we need to borrow money or have spare cash available that we can lend out?

Cash flow projections are prepared annually and daily. The annual cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an ongoing basis by information received on new or revised amounts to be paid or received as and when they are known and the Council downloads data from its bank on a daily basis.

Question No. 2

If I have understood this correctly, in essence you are estimating what you expect the end of day position to be at the bank when all the pending transactions, including payments to suppliers and the clearance of cheques or direct debits into our account, have been processed – what happens therefore if you get it wrong?

This does happen on occasions and we monitor the end of day balance to improve our understanding with a view to ensuring that it happens infrequently. An example of where we had more in our account was in June this year when an investment was not made before the submission cut off which resulted in an underinvestment of funds overnight. There has been one occasion within the last year where we have had substantially less than predicted in our account, and this was due to an incorrect value being entered on the bank transfer which resulted in an overdrawn balance, this was corrected the following day.

From 1 September 2011, and following a cost/benefit analysis, we took a decision to cease the formal overdraft facility. The formal overdraft facility used to cost the Council £2,000 plus 1% over the base rate for overdrawn net balances over £500,000. The new arrangement now incurs charges at 4% over the current base rate for net overdrawn balances with no annual arrangement fee. There were two instances when the Council's net bank account position was overdrawn during the first six months of 2016/17.

Question No. 3

Is there one person who does the day to day dealing and what happens if they are away on leave?

Within the Treasury Management Policy Statement and Practices that is approved annually by Council in April there is a list of all the different functions and a table showing which officers can do what. For example, the day to day dealing can be done by, either of the three Senior Account Managers (Penny Jones, Julie Woods and Joanne McCaffery) and either of the two Account Managers (Louisa White or Louise Rowland). Authorisation of short term borrowing or investing falls to the Head of Finance (Clare James), the Deputy Head of Finance (Paul Harrison), the Senior Accountant (Serena Armstrong), the Head of the Contact Centre (Peter Mason), the Head of Governance (Joanne Billington), the Head of Business Support (Liesl Hadgraft) or the Senior Solicitor (Mary Grimshaw).

Question No. 4

So what do you have to do if you want to invest some money?

The Treasury Management Policy Statement and Practices states that the Council applies the creditworthiness service provided by Capita Asset Services who are our Treasury Management Consultants. This service employs a sophisticated modelling approach combining credit ratings, credit watches and credit outlooks (see Appendix 1) in a weighted scoring system which is then combined with an overlay of CDS (Credit Default Swaps) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. They provide us with this weekly credit list and supplement it with emails for any changes to counterparty credit ratings. Lending is only made to counterparties within the Council defined colour bands according to the colour coded creditworthiness list.

In addition, the Practices say that the Council will also look at other market information in order to establish a full investment strategy; such as up to date market information, which includes Sovereign and individual counterparty ratings, together with a wide range of relevant economic data. In reality, other than day to day news headlines/reports, no further challenges are made to the treasury advisors guidance.

If we are using the Council's bank, the NatWest, for investments in the Liquidity account we make an inter-account transfer on the Nat West website. If we are using the Money Market Funds then this is entered on to the SunGard System and an email is sent prompting the authorising officer to agree the transfer. All transactions on the SunGard System must be

authorised before, either 1pm, 1.30pm or 2pm dependent on the fund, in order for them to be actioned that day

If we are using the Bank of Scotland or Nationwide we ring up to obtain the rate for the amount and length of time we want to invest and using this information we complete a temporary lending form detailing the amount to be invested, the interest rate and the term. Once this form is authorised we phone the Bank of Scotland or Nationwide back to confirm the deal and give notice if necessary and a bank transfer is made from the Council's banks. If we are using Svenska Handelsbanken or Santander again a temporary lending form is completed and once authorised a bank transfer is made from the Council's bank.

(Scenario)

Question No. 5

What about if you need to borrow money – what happens then?

The Treasury Management Policy Statement and Practices clearly states that the Council must access temporary loans through approved brokers on the London money market. The approved borrowing limit for short term debt has been set at £13.743m in 2016/17.

In essence, we telephone the brokers and ask them to find somebody who can lend us the amount we need and for the required term, for example, are we happy for the money to be called back at any time or do we want to fix it to a particular date. We aren't fussy about who lends us the money and the brokers currently charge commission at 1% of interest due. There is no commission charge for undertaking investment transactions via the brokers.

The last time we borrowed via the brokers was back in 2009/10.

Question No. 6

So what guarantees do we have that somebody in the finance team isn't going to disappear to the Caribbean with a significant amount of the Council's money – presumably there are sufficient checks and balances?

Firstly, I'm not good in places with extreme temperatures but on a more serious note, there are a number of controls in place including;

- ✓ All lending is only made to institutions on the Capita Creditworthiness Weekly List.
- ✓ All loans raised and repayments made go directly to and from the institutions bank account.
- ✓ Authorisation limits are set for every institution.
- ✓ Brokers have a list of named officials authorised to perform loan transactions.
- ✓ There is adequate insurance cover for employees involved in loan management and accounting.
- ✓ The control totals for borrowing and lending are regularly reconciled with the ledger balance sheet codes by the Financial Services team.
- ✓ There is a separation of duties in the Section between the processing and authorisation of transactions.

- ✓ The Council's bank holds a list of Council officials who are authorised signatories.
- ✓ No member of the Treasury Management team responsible for borrowing and lending is an authorised signatory.

A key aim of the Treasury Management Policy Statement is that the Council 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.

And if you are still worried, then it is worth noting that the Council has 'Fidelity' insurance cover with Zurich Municipal (ZM). This covers the loss of cash by fraud or dishonesty of employees. This cover is limited per transaction as follows:

- ✓ 14 designated officers (Head of Finance, Head of Contact Centre, Head of Governance, Head of Business Support, Senior Solicitor, Deputy Head of Finance, 2 x Senior Accountant (systems x 1, non-systems x 1), Senior Account Manager x 3, Systems Administrator/Customer Focus Officer and Account Manager x 2 are indemnified for £3m.
- ✓ All other employees are indemnified for £250,000.

Question No. 7

How do you know if you are doing a good job – what measures do you use to assess your performance?

We do an annual report in June each year showing the overall position and activities for the previous year. The report includes the following issues, where relevant:

- ✓ total debt and investments at the beginning and end of the financial year and average interest rates;
- ✓ borrowing strategy for the year compared to actual strategy, including interest paid;
- ✓ investment strategy for the year compared to actual strategy, including interest received;
- ✓ explanations for variance between original strategies;
- ✓ debt rescheduling done in the year;
- ✓ actual borrowing and investment rates achieved through the year;
- ✓ comparison of return on investments to the benchmark 7-day LIBID rate (London Interbank Bid Rate); and
- ✓ compliance with Prudential and Treasury Indicators.

We also complete a half yearly Report on Treasury Management which is submitted to Council in December which reviews the performance of the debt and investment portfolios. This report contains the same information as the annual report but only includes information for the first 6 months of the year.

Last year investments earned an average return of 0.53% against a benchmark LIBID (London Interbank Bid Rate) 7-day average of 0.36% whilst the Bank of England base rate remained at 0.5%.

In the six months to 30 September 2016 investments have achieved an average return of 0.51% against a benchmark LIBID 7-day average of 0.27%.

And now just a couple of other questions concerning the wider Treasury Management arrangements

Question No. 8

I understand that we are with the NatWest bank and have been for some time – do we ever consider switching?

Whilst we have been with NatWest for nearly 30 years, banking services have traditionally been re-tendered or renegotiated every 3 years to ensure that the level of prices reflect efficiency savings achieved by the supplier and current pricing trends. The Council retendered for Banking Services using the Government Framework earlier this year. This resulted with our present providers NatWest being awarded the contract which resulted in considerable savings for the Authority 2016.

Question No. 9

And whilst we are talking about the costs of treasury management – do we have other advisors that we use and how much do they cost?

When the Council lost its debt free status during 2007/08 Capita Asset Services (previously known as Capita Treasury Services) was engaged as the Council's treasury advisor. The initial appointment was for one year and was considered to be value for money having sought other quotations. The service has recently been benchmarked and further benchmarking exercises will be conducted every three years to ensure value for money is maintained. The cost of the service is £7,750 per year.

Question No. 10

I know you've mentioned the half yearly and annual performance reports to Council but are there other reports that we need to produce to ensure compliance with the CIPFA Code of Practice for Treasury Management?

Yes, there are a number of reports that we are required to complete and we probably take more to Council on an annual basis than we need to but find it useful to review the Treasury Management Policy Statement and Treasury Management Practices each year. The specific requirements ask for the following:

- ✓ The Treasury Management Strategy Statement- sets out the specific expected treasury activities for the forthcoming financial year and is submitted to the Cabinet in March and then full Council in April. It involves determining the appropriate borrowing and investment decisions in the light of the anticipated movement in both fixed and shorter-term variable interest rates. For instance, the Council may decide to postpone borrowing if fixed interest rates are expected to fall, or borrow early if fixed interest rates are expected to rise. It covers a number of items including:
 - Prudential and Treasury Indicators

- current Treasury portfolio position
 - borrowing requirement
 - prospects for interest rates
 - borrowing strategy
 - policy on borrowing in advance of need
 - debt rescheduling
 - investment strategy
 - creditworthiness policy
 - policy on the use of external service providers
 - any extraordinary treasury issue
 - the MRP strategy
- ✓ The Annual Investment Strategy – is received at the same time as the Treasury Management Strategy Statement and sets out the following:
- The Council's risk appetite in respect of security, liquidity and optimum performance
 - The definition of 'high credit quality' to determine what are specified investments as distinct from non- specified investments
 - Which specified and non-specified instruments the Council will use
 - Whether they will be used by the in house team, external managers or both (if applicable)
 - The Council's policy on the use of credit ratings and other credit risk analysis techniques to determine creditworthy counterparties for its approved lending list
 - Which credit rating agencies the Council will use
 - How the Council will deal with changes in ratings, rating watches and rating outlooks
 - Limits for individual counterparties and group limits
 - Country limits
 - Cash balances
 - Interest rate outlook
 - Budgeted investment return
 - Use of a cash fund manager (if applicable)
 - Policy on the use of external service providers (if applicable)
- ✓ The Annual Minimum Revenue Provision Statement - is received at the same time as the Treasury Management Strategy Statement and sets out how the Council will make revenue provision for repayment of its borrowing using the four options for so doing. Our adopted policy is that all expenditure reflected within the debt liability at 31 March 2008 will under delegated powers be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method (Asset Life Method).
- ✓ Policy on Prudential and Treasury Indicators – the limits are approved by Council before the beginning of each financial year and, in addition to being presented with the Revenue and Capital Estimates in March, are incorporated into the Annual Treasury Management Strategy.

Question No. 11

I'm interested in what our advisors said about the prospects for interest rates?

The advisors indicated for the Annual Investment Strategy that the base rate would not rise from its position of 0.5% until March 2017 when it would rise to 0.75%, increasing to 1% in September 2017 and 1.25% in March 2018. The most recent September 16 update indicates

that the base rate would fall to 0.10% in December 2016 and only increasing to 0.25% in June 2018.

Question No. 12

And if we wanted to borrow to fund some of the capital works that are currently being assessed, what would the costs be?

If we borrowed £2m in March 2017 the interest rate is currently projected to be 2.3% and if we used the money to fund assets with lives of 25 years then the cost for principal and interest repayments would be £126,000pa.

We currently have debt of £1.552m and incur debt charges of £164,389 – this isn't expected to fall until 2024/25 when the assets with a 15 year life span drop out of the MRP calculation.

The Prudential Code for Capital Finance aims to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. The Code sets out indicators that must be used and requires local authorities to set relevant limits and ratios. As the Council is currently projecting a gap between expenditure and income of £2.2m in 2019/20 further borrowing is not considered to be affordable, prudent or sustainable.

And finally, if there are any burning issues that we haven't addressed or any further questions, please feel free to do so now.

Treasury Management Definitions

Credit Rating – Credit ratings are assigned to counterparties by Credit Rating Agencies, the main ones being Standard and Poor's, Moody's and Fitch's. Their ratings are based on detailed analysis and result in lettered ratings from A to C. Higher grades such as AAA represent a lower probability of default.

Credit Watches – These are lists used by rating agencies to signal that they may downgrade a company's credit rating because of a declining business environment characterised by declining sales, profits or increased competition.

Credit Outlook – These indicate the potential direction of a rating over the intermediate term, typically 6 months to 2 years. When determining a credit outlook, consideration is given to any changes in the economic and/or fundamental business conditions.

Credit Default Swap – This is a financial instrument for swapping the risk of debt default. The price of a CDS for a particular company is often used to measure the creditworthiness of a company, since the price of the CDS will vary quickly in response to the market's assessment of the company's creditworthiness; by contrast, changes in credit ratings issued by credit rating companies, such as Moody's or Standard & Poor's, can take weeks or months.

Treasury Management Investment Scenario Question

Which option/s would you choose to provide the best investment on **£7m** for the Council taking account of the below interest rates and the guidance provided below taken from the Treasury Management Strategy? Assume the monies will be invested for the full 6 month period.

<u>Institution</u>	<u>Interest Rate %</u>	<u>Credit Rating Colour</u>
NatWest Liquidity	0.25	0-6 months (red)
NatWest 95 day notice	0.22	0-6 months (red)
Santander 60 day notice	0.50	0-100 days (green)
Co-operative Bank 95 day notice	0.62	No colour
Prime-rate MMF	0.32	AAA
Goldman Sachs IB 6 month fixed	0.60	0-100 days (green)
Standard Chartered 6 month fixed	0.52	0-6 months (red)

Treasury Management Strategy Extract

Maximum maturity periods, credit colour ratings and maximum amounts to be placed in different types of institutions are as follows:-

	<u>Colour Credit Rating</u>	<u>Money Limit</u>	<u>Maturity Period</u>
Banks and Building Societies	purple	£6m	2yr
Banks - part nationalised	blue	£6m	1 yr
Banks and Building Societies	orange	£6m	1 yr
Banks and Building Societies	red	£6m	6 mths
Banks and Building Societies	green	£6m	100 days
Limit 3 category – Council’s banker	blue	£6m	1 yr
Local authorities	yellow	£6m	5yrs
Money market funds	AAA	£6m	liquid

The Council will not invest in a counterparty with no colour rating other than money market funds which have to be AAA rated.

Treasury Management Investment Scenario – Answer

£7m cannot be invested in one institution as TM limit is £6m.

Despite the best interest rate we cannot invest in Co-operative Bank 95 day notice as it has no colour coded credit rating

Despite offering a good interest rate (due to the length of investment), we cannot invest for more than 100 days with Goldman Sachs International Bank.

The investment I would choose would be £6m in the Standard Chartered 6 month fixed.

For the remaining £1m you could chose to invest for the full 6 months with Prime-rate MMF or if you were flexible about investing for a shorter period then you could invest £1m in the Santander 60 day notice account.