Gateshead Council

REPORT TO CABINET
13 September 2016

Title of report:	**Amendment to the Treasury Policy Statement and Treasury Strategy 2016/17 to 2018/19**
Report of:	**Darren Collins – Strategic Director, Corporate Resources**

Purpose of the Report

1. This report asks Cabinet to review and to recommend to Council a proposed amendment to the Treasury Policy Statement and Treasury Strategy for 2016/17 to 2018/19. The proposal was presented for the views of Audit and Standards Committee on the 25th July 2016.

Background

2. To provide a framework for the Strategic Director, Corporate Resources to exercise his delegated powers, the Council agrees a three year Treasury Management Policy and Treasury Strategy which is reviewed at the start of each financial year.

3. The current Strategy was approved by Cabinet on the 15 March 2016 and the Strategy states that any in year changes have to be reported and agreed by Cabinet on an exception basis. This report is to consider an in year change.

4 The current strategy requires that all countries in which the Council invests monies have a minimum country sovereign rating of AA+ and this includes the UK. However the relevance of this sovereign rating for the UK has been weakened due to the evolution of financial market regulations that has seen the link between sovereigns and their respective banks materially weakened.

5 This report proposes that the Treasury Strategy be amended to exclude the UK from the requirement to have a sovereign rating of AA+ for investment purposes.

6 Failure to adopt this amendment could mean that the Council is in a position where no deposits can be made with UK Banks.

7 The proposal was presented for the views of Audit and Standards Committee on the 25 July 2016 and the content of the report was recommended to Cabinet.

Proposals

8 Cabinet is asked to consider the amendment to the Treasury Strategy in Appendix 2 reflecting the removal of the UK from the requirement to have AA+ sovereign rating for investment purposes.

Recommendation

9 Cabinet is asked to recommend Council to approve the changes to the Treasury Strategy as follows:

- Section 6. Investment Strategy 2016/17 to 2018/19 to change to reflect the exclusion of the UK from the requirement to have a sovereign rating of AA+ as shown in appendix 2.

For the following reason:

- To ensure that UK banks are assessed using their individual credit ratings and not against a sovereign rating that is no longer applicable.

- To ensure that the Council fully complies with the requirements of good practice as recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) in its Code of Practice on Treasury Management and Prudential Code for Capital and the Department for Communities and Local Government (CLG), Guidance on Local Government Investments.

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Appendix 1

Policy Context

1. The proposals in this report are consistent with the Council's vision and medium term priorities as set out in Vision 2030 and the Council Plan and in particular they ensure that effective use is made of the Council's resources to ensure a sustainable financial position.

Background

2. Part 1 of the Local Government Act 2003 specifies the powers of a local authority to borrow for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. Borrowing is linked to the CIPFA Prudential Code for Capital which sets out a range of prudential and treasury indicators that must be calculated to ensure borrowing is affordable, prudent and sustainable. The Prudential Code refers to the need for a clear and integrated treasury strategy.

3. In addition, under Section 15 of the Local Government Act 2003, authorities are required to have regard to the CLG's guidance on Local Government Investments. This document stipulates the requirement for an annual investment strategy to be integrated into the Council's Treasury Strategy.

4. CIPFA has produced the Code of Practice on Treasury Management 2011 (the Code) which represents best practice. The Council fully complies with the Code and this contributes towards achieving good practice.

5. Under Part 4 of the Council's Constitution the Strategic Director, Corporate Resources will produce a Treasury Policy Statement annually, setting out the general policies and objectives of the Council's treasury management function.

Treasury Policy

6. 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 the risk implications for the Council.

7. The Council 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 comprehensive performance measurement techniques, within the context of effective risk management.

8. CIPFA's Code requires the setting out of responsibilities and duties of councillors and officers to allow a framework for reporting and decision making on all aspects of treasury management. To achieve this CIPFA has recommended the adoption of 12 treasury management practices (TMPs).

9. These principles are intended to provide a working document that forms a detailed framework for treasury management activities. The policy fully encompasses CIPFA's Code of Practice. In addition the policy fully takes account of the requirements of the Prudential Code for Capital Finance in Local Authorities and the guidance issued by the CLG supporting Part 1 of the Local Government Act 2003 in respect of local authority investments.

Treasury Strategy

10. The Treasury Strategy for 2016/17 to 2018/19 covers the specific activities proposed for 2016/17 to 2018/19 in relation to both borrowing and investments and ensures a wide range of advice is taken to maintain and preserve all principal sums, whilst obtaining a reasonable rate of return, and that the most appropriate borrowing is undertaken. The primary objective of the investment strategy is to maintain the security of investments at all times.

11. The Council has produced the Treasury Strategy to comply with the requirements of the Code, the Prudential Code for Capital Finance in Local Authorities and Part 1 of the Local Government Act 2003. The Council considers that compliance with the above ensures that best practice is followed.

12 Following on from the recent vote to leave the EU, Capita, the Council's Treasury Advisers produced a note providing an update on recent action taken by credit ratings agencies on the UK sovereign rating. This was to ensure that Local Authorities who have sovereign criteria in their strategy review their policy and remove the UK from this criteria.

13 The current strategy requires that all countries in which the Council invests monies have a minimum country sovereign rating of AA+ and this includes the UK. However the relevance of this sovereign rating for the UK has been weakened due to the evolution of financial market regulations that has seen the link between sovereigns and their respective banks materially weakened.

14 The result of the breakage of the link has meant that there is little or no "sovereign uplift" to any major bank ratings in the UK and beyond.

15 The Council's Treasury Advisers, Capita have advised that the UK sovereign rating is currently not a constraining factor for any UK bank ratings and while there are negative implications for the UK, its economy and financial institutions as a result of Brexit, financial markets and the operators therein are materially stronger, in terms of capital and liquidity than they were ahead of the financial crisis.

16 The Governor of the Bank of England has stated "…the capital requirements of our largest banks are now ten times higher than before the crisis. The Bank of England has stress tested them against scenarios more severe than the Country currently faces. As a result of these actions, UK banks have raised over £130bn of capital, and now have more than £600bn of high quality liquid assets."

17 The impact of Brexit may filter through to the individual bank ratings that the credit rating agencies supply. These ratings are regularly reviewed to ensure compliance with the current strategy. We will continue to review the UK banks in line with the current strategy and advice from our Treasury advisers.

18 The proposed change is the removal of the UK from the requirement to have AA+ sovereign rating.

Consultation

19. Consultation on the amendment to the Treasury Strategy for 2016/17 to 2018/19, has taken place with the Council's treasury advisers (Capita Asset Services, Treasury Solutions). The outcome of the consultation process, has informed the format and content of the policy and strategy statements.

Alternative Options

20. There are no alternative options proposed.

Implications of recommended options

21. **Resources:**

a) Financial Implications - The Strategic Director, Corporate Resources confirms that the financial implications are set out in this report. There are no additional financial implications associated with the report itself.

b) Human Resources Implications - There are no human resources implications arising from this report.

c) Property Implications – There are no property implications arising from this report.

22. **Risk Management Implications**

The Treasury Policy and Treasury Strategy which informs activity in this area was prepared with the primary aim of minimising risk to ensure that the Council's principal sums are safeguarded. Maximising income is considered secondary to this main aim.

23. **Equality and Diversity Implications**

There are no equality and diversity implications arising from this report.

24. **Crime and Disorder Implications**

There are no crime and disorder implications arising from this report.

25. **Sustainability Implications**

There are no sustainability implications arising from this report.

26. **Human Rights Implications**

There are no human rights implications arising from this report.

27. **Area and Ward Implications**

There are no direct area and ward implications arising from this report.

28. **Background Information:**

The following documents have been used in preparation of the report:

- Local Government Act 2003
- CLG Guidance on Local Government Investments
- CIPFA’s Prudential Code for Capital
- CIPFA’s Code of Practice on Treasury Management
- Council’s approved Treasury Management Practice Statements

6.12 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. While this authority understands the changes that have taken place, it will continue to specify a minimum sovereign rating of AA+ to all banks outside the UK. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background, will still have an influence on the ratings of a financial institution.

Creditworthiness Policy

6.14 The Council uses the creditworthiness service provided by Capita Asset Services to assess the creditworthiness of counterparties. The service provided by Capita Asset Services uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following information as overlays which are combined in a weighted scoring system:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap spreads, financial agreements that compensate the buyer in the event of a default, which give an early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries outside the UK.