SURREY
COUNTY COUNCIL

REPORT TO COUNCIL

REVISED TREASURY MANAGEMENT STRATEGY 2016/17

KEY ISSUE/DECISION:

To approve changes to the treasury management strategy 2016/17, specifically in relation to the borrowing strategy.

BACKGROUND:

REVISED TREASURY MANAGEMENT AND BORROWING STRATEGY

1. Historically, the Council has used its internal resources (such as reserves and working capital) to fund capital expenditure in order to limit the immediate need for external borrowing. This strategy has reduced the interest payable on external borrowing costs and in periods of historically low interest rates reduced the cost of carry[1] in an environment when the cost of borrowing far exceeds cash investment interest.

2. For a number of years, the council has set itself a minimum working cash investment target of £47m. It is recommended that this minimum level be amended. In order to enable the Council to optimise the benefits of the internal borrowing strategy and take further advantage of a low interest rate environment, this would mean the Council aiming to keep its cash balances above zero.

3. This change also has the benefit of reducing the recently increased counterparty risk to which the Council is exposed as result of the new 'bail in'[2] regulations in relation to short term investments in banks.

4. Interest rates on short term borrowing are significantly lower than long term borrowing rates and, while the current environment is expected to continue, it is recommended that the Council extends its internal borrowing policy by maintaining cash balances above zero and managing fluctuations in cash balances by borrowing on a short term basis.

[1] The difference between the cost and financial benefit of holding cash for a specified period

[2] Where depositors are required to prop up a failing financial institution as opposed to the state (bail out)

5. The Director of Finance will continue to review the need to borrow, taking into account expected interest rate changes, new capital expenditure, refinancing of maturing debt, the cost of carry and economic forecasts. Markets will continue to be carefully monitored and the Council will adopt a pragmatic approach to changing circumstances in relation to its borrowing strategy.

6. The Director of Finance has delegated power to authorise additional borrowing if it is considered that interest rates and timing are appropriate within the overall strategy. Future borrowing decisions will continue to be managed in this way.

7. The revised borrowing strategy section of the Treasury Management Strategy 2016/17 is shown as Annex 1. There are no changes required to the other areas of the Treasury Management Strategy, the Prudential Indicators or the Minimum Revenue Provision policy statement.

SECTION 151 OFFICER COMMENTARY

8. The revised Treasury Management Strategy has come about as a result of changes in the economic environment, specifically the combination of increased counterparty risk (less security arising from new bail in regulations) and a longer than predicted lower interest rate environment. This has resulted in consideration of a more focused strategy of internal borrowing over the short term, combining a move away from long term borrowing towards short term borrowing to maintain cash balances above zero. The medium term financial plan will be updated accordingly in due course.

9. Such a strategy will require monitoring to ensure that the Council can act responsively in the event of a sustained change in the economic forecast.

LEGAL IMPLICATIONS – MONITORING OFFICER

10. Approval of a treasury management strategy is a function of the full Council. Councillors have a fiduciary duty to Surrey taxpayers and should therefore assure themselves that the proposed new arrangements are prudent and maintain a proper balance of risk and benefit.

RISK MANAGEMENT

11. The main risk with this strategy refresh is that the anticipated “lower for longer” scenario surrounding interest rates dissipates far sooner than envisaged and a recovery in the markets and economic climate bring about an appetite from the Bank of England’s Monetary Policy Committee (MPC) to start increasing rates. However, following the result of the referendum on the withdrawal of the UK from the EU, this scenario seems some way off and, indeed, there is a degree of anticipation in the markets that the MPC will reduce the bank base rate to 0.25% or even zero in the near future.

12. However, the Governor of the Bank of England has stressed that the Bank will assess economic conditions as well as considering additional policy responses over the next couple of weeks, a veiled reference to the possibility of future changes to monetary policy, possibly to support a weakening pound. However, many economists expect that

monetary policy will be loosened in response to the weaker economic outlook and to support consumer and business sentiment.

FINANCIAL IMPLICATIONS

13. The strategy change will result in significant savings to the Council whilst the current interest rate environment exists. Short term borrowing in 2016/17 is forecast to cost the Council £40,000 in comparison with the £1.97m that exists in the medium term financial plan (MTFP) in relation to the interest cost for new borrowing. The equivalent figures for 2017/18 are £230,000 cost and £3.35m in the MTFP.

EQUALITIES AND DIVERSITY

14. There are no equality or diversity issues arising from revising the Council's Treasury Management Strategy.

WHAT HAPPENS NEXT

15. The revised treasury management strategy will have immediate effect on approval from the Council. Decisions will continue to be reported to the Audit and Governance Committee as necessary.

RECOMMENDATIONS

It is recommended that County Council approve with immediate effect the:

1. Changes to the Council's Treasury Management Strategy for 2016-21 (shown as Annex 1), which include:
    - the revised borrowing strategy for long term capital funding;
    - the revision of the Council's minimum cash balance to above zero.

REASON FOR RECOMMENDATIONS

Changes that have developed over the medium term to the economic and financial environment in which the Council operates has led to a review of the existing borrowing strategy. An increased opportunity in relation to an expectation that interest rates will remain lower for longer than initially anticipated and investment security have resulted in a proposal to amend the Council's borrowing strategy with immediate effect to ensure it reacts appropriately and with flexibility to these changes in conditions.

Lead/Contact Officers:
Phil Triggs, Strategic Finance Manager.
Tel: 020 8541 9894

Sources/background papers:
CIPFA Treasury Management in the Public Services: Code of Practice

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