Council

20 March 2018

Treasury Management Strategy 2018/19

Recommendations from Cabinet

1) That the Treasury Management Strategy and Investment Strategy for 2018/19 be approved and its provisions have immediate effect in the current financial year 2017/18.

2) That the Prudential Indicators (see **Appendix A**) are noted.

3) That the County Council requires the Head of Finance to ensure that gross borrowing does not exceed the prudential level as specified in **Appendix A**, taking into account current commitments, existing plans, and the proposals in the budget report.

4) That the County Council delegates authority to the Head of Finance to undertake all the activities listed in **Appendix G** of this report, subject to the use of any new financial instruments being approved by Cabinet.

5) That the County Council requires the Head of Finance to implement the Minimum Revenue Provision Policy as specified in **Appendix H**.

1 Introduction

Background

1.1 Treasury management is defined as:

"The management of the local authority'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."

1.2 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing security of capital and sufficient liquidity initially before considering investment return.

1.3 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasions, debt previously drawn may be restructured to meet Council risk or cost objectives.

Statutory Requirements

1.4 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.5 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in section 7 of this report). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

CIPFA Requirements

1.7 The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.
2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.
3. Receipt by the full Council of an annual Treasury Management Strategy Statement, to include the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual (stewardship) Report covering activities during the previous year. The authority has a Capital Strategy for which full council maintains overall responsibility.
4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is Resources and Fire & Rescue Overview and Scrutiny Committee.

Treasury Management Strategy for 2018/19

1.8 The proposed strategy for 2018/19 is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Link Asset Services (Formerly known as Capita).

1.9 The strategy covers:

- Treasury limits for 2018/19 to 2020/21
- Prudential Indicators
- Prospects for Interest Rates
- Borrowing Strategy
- Debt Rescheduling
- Annual Investment Strategy
- Minimum Revenue Provision Strategy

Balanced Budget Requirement

1.10 Under Section 42B of the Local Government Finance Act 1992, it is a statutory requirement for the Council to produce a balanced budget. In particular, Section 42A states a local authority must include the revenue costs that flow from capital financing decisions in its budget requirement for each financial year. Therefore increases in capital expenditure must be limited to a level whereby charges to revenue derived from increases in interest charges (caused by increased borrowing to finance additional capital expenditure and any increases in running costs from new capital projects) are limited.

MiFID II

1.11 The Markets in Financial Instruments Directive ('MiFID') was introduced due to increasing complexity of financial products and issues related to the 2008 financial crisis. It has now been revised (as MiFID II) to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. MiFID II came into effect in January 2018 which re-classifies investors into 'professional' or 'retail' clients.

1.12 Officers have demonstrated with all appropriate providers that we have suitably qualified staff with the necessary skills, training and experience to fulfil the role of "professional client". This has enabled the current treasury asset allocation to continue without disruption.

2 Treasury Limits for 2018/19 to 2020/1

2.1 It is a statutory duty under Section 3 of the Act and supporting regulations for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales, the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and the impact upon its future council tax is 'acceptable'.

2.3 Whilst termed an “Affordable Borrowing Limit”, the capital to be considered for inclusion in corporate financing is both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in **Appendix A** of this report. Explanations of the terminology employed in the Appendix can be found in **Appendix B.**

3 Prudential Indicators for 2018/19 to 2020/21

3.1 Prudential and Treasury Indicators (**Appendix A** to this report) are relevant for the purposes of setting an integrated Treasury Management Strategy.

3.2 Council will approve the Prudential Indicators as part of the budget resolution in February 2017. These indicators will be revised, if necessary, for the Council approved capital programme.

3.3 The Prudential Indicators are relevant for the purposes of setting an integrated Treasury Management Strategy. The indicators are provisional and based on the current agreed capital programme.

4 Prospects for Interest Rates

4.1 The Council has appointed Link as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. The table below sets out Link’s view on the future Bank Rate.

Link Bank Rate Forecast

Period	Bank Rate %
Jan 2018 to Dec 2018	0.50
Jan 2019 to Dec 2019	0.75
Jan 2020 to Dec 2020	1.00
Jan 2021 onwards	1.25

4.2 A detailed view of the current economic background is contained within **Appendix C** to this report.

5 Borrowing Strategy

5.1 The Council is currently maintaining an over borrowed position. This means there is no current need for capital borrowing (the Capital Financing Requirement). Based on the estimates of medium term capital expenditure, the Council’s gross borrowing covers the Capital Financing Requirement until 2020/21.

5.2 The borrowing strategy is consistent with the County Council’s Capital Strategy. This document describes the Council’s capital programme, how the capital programme is financed and how it contributes to the

Council's priorities. This strategy is also updated annually and forms part of the Budget resolution process. Full Treasury management implications are built within this strategy.

5.3 The Treasury Team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Any decisions will be reported to the Resources and Fire & Rescue Overview and Scrutiny Committee at the next opportunity.

5.4 The Link forecast for the PWLB new borrowing rate is as follows:

Annual Average %	**PWLB Borrowing Rates % (including certainty rate adjustment)**		
	5 year	**25 year**	**50 year**
Mar-18	1.60	2.90	2.60
Jun-18	1.60	3.00	2.70
Sep-18	1.70	3.00	2.80
Dec-18	1.80	3.10	2.90
Mar-19	1.80	3.10	2.90
Jun-19	1.90	3.20	3.00
Sep-19	1.90	3.20	3.00
Dec-19	2.00	3.30	3.10
Mar-20	2.10	3.40	3.20
Jun-20	2.10	3.50	3.30
Sep-20	2.20	3.50	3.30
Dec-20	2.30	3.60	3.40

5.5 In view of the above forecast, the Council's borrowing strategy will be based upon the following:

- The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates.
- Internal borrowing will be weighed against potential long term costs that will be incurred if market loans at long term rates are higher in future years.
- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintain an appropriate balance between PWLB and market debt in the debt portfolio.
- PWLB borrowing for periods under ten years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a current concentration in longer dated debt.

5.6 Against this background and the risks within the economic forecast, caution will be adopted within the treasury operations in 2018/19. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, for example:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings may be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast in world economic activity or a sudden increase in inflation risks, then the portfolio position will be reappraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years

5.7 **Appendix I** sets out a graph of the existing Councils existing PWLB debt portfolio and how that debt will mature over the life of the underlying loans (assuming no further re-structuring takes place).

Policy on borrowing in advance of need

5.8 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

5.9 In determining whether borrowing will be undertaken in advance of need, the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to fund in advance of need;
- ensure the ongoing revenue liabilities created, and the implications on future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate time periods and repayment profiles;
- consider the impact on temporarily (until required to finance capital expenditure) increasing cash balances and the consequent increase in exposure to counterparty and other risks in light of the residual level of such risks given the controls in place to manage them.

Scheme of Delegation

5.10 The scheme of delegation in terms of financing options and decisions to be taken by the Head of Finance is shown in **Appendix G.**

6 Debt Rescheduling

6.1 As short term borrowing rates will be considerably cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of debt repayments.

6.2 The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the strategy
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility).

6.3 Consideration will also be given to identify if there is any potential for making savings by running down investment balances in order to repay debt prematurely as short term interest received on investments is likely to be lower than interest paid on current debt.

6.4 The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce the difference between its gross and net debt position. However, the premium that would be incurred by doing so means there would need to be careful analysis of the cost and benefit from such early repayment. The Municipal Bonds Agency is offering loans to local authorities. It is envisaged that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority is a founder member and would consider the agency alongside the PWLB in the event that borrowing was required.

7 Annual Investment Strategy

Investment Policy

7.1 The Council will have regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

7.2 The Council's investment priorities will be security first, liquidity second and then return.

7.3 In accordance with the above, and in order to minimise the risk to investments, the Council has stipulated in **Appendix E**, the minimum acceptable credit quality of counterparties for inclusion on the lending list.

7.4 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which the institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to monitor market pricing such as Credit Default Swaps and overlay that information on top of the credit ratings.

7.5 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny of the suitability of potential investment counterparties. The aim of the strategy is to generate a list of highly creditworthy counterparties which will enable diversification and therefore avoid concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

7.6 Investment instruments identified for use in the financial year are listed in **Appendix E** under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices Schedules.

7.7 The Council on occasion will hold long term investments or provide loans for operational policy reasons, for example, to our local authority traded companies. Operational loans and investments will be assessed and approval sought from members on a case-by-case basis. This will include a full assessment of the risk, including credit risk and how this will be managed.

Creditworthiness Policy

7.8 The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that it maintains a policy covering both the categories and types of investment that It will invest in and the criteria for choosing investment counterparties with adequate security and the monitoring of their security. This is set out in the specified and non-specified investment sections in **Appendix E**. Also that It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

7.9 The Head of Finance will maintain a counterparty list in compliance with the criteria and will revise and submit the criteria to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

7.10 The Council will ensure that it maintains its policy covering both the categories and types of investment, the criteria for choosing investment counterparties with adequate security, and the monitoring of that security. Moreover, it will ensure it has sufficient liquidity in its investments. For this purpose, it will follow procedures for determining the maximum periods for which funds may be committed according to future cash flow requirements. The Head of Finance will maintain a list of counterparties in compliance with the stated criteria, providing a high quality pool of counterparties which the Council may use.

7.11 Credit rating information is supplied by Link, our treasury consultants, on all counterparties that comply with the stated criteria. Any counterparty failing to meet the criteria will be deleted from the counterparty lending list. Any rating changes, watches (notification of a likely change), or outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.

Country Limits

7.12 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or an equivalent rating from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria at the current time are shown in **Appendix F**. This list will be amended by officers as and when ratings change in accordance with this policy.

Investment Strategy

7.13 The Council has in-house managed funds that are mainly cash flow derived and a core balance available for investment over a maximum one year period. Investments will be made with regard to the core balance, cash flow requirements and the outlook for short term interest rates.

7.14 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, money market funds, and short dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of Year Investment Report

7.15 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Outturn Report.

External Fund Managers

7.16 The County Council uses a number of external managers to spread risk and obtain maximum market exposure. The fund managers will use both specified and non-specified investments and must comply with the terms set out in **Appendix E**. External fund managers actively used are listed below.

Fund Manager	Product/Fund Name
CCLA	Public Sector Deposit Fund
CCLA	Local Authority Property Fund
Standard Life	Short Duration Cash Fund
Aberdeen Asset Management	Sterling Liquidity Fund
Federated Investors	Sterling Liquidity Fund
Columbia Threadneedle	UK Social Bond Fund
Aviva Investors	Sterling Core Liquidity Fund

Policy on the Use of External Service Providers

7.17 The Council uses Link as its external treasury management advisers. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed, documented and subject to regular review.

Role of the Section 151 Officer

7.18 Please see **Appendix G**.

Pension Fund Cash

7.19 This Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, implemented 1 January 2010. With effect 1 April 2010, the Council does not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority after 1 April 2010 must comply with the requirements of SI 2009 No 393.

8 Minimum Revenue Provision

8.1 The Council's policy on Minimum Revenue Provision (MRP) is shown in Appendix H.

Background papers

None

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The report was not circulated to members prior to publication for Cabinet.

APPENDICES

A. Prudential and Treasury Indicators

B. Prudential Term Explanations

C. Link Economic Commentary

D. Treasury Management Scheme of Delegation

E. Schedule of Specified and Non Specified Investments

F. Approved Countries for Investments

G. The Treasury Management Role of the S151 (Responsible) Officer: Head of Finance

H. Minimum Revenue Provision