

# REPORT FOR DECISION

<b>DECISION OF:</b>	<b>OVERVIEW &amp; SCRUTINY COMMITTEE CABINET COUNCIL</b>
<b>DATE:</b>	<b>14 FEBRUARY 2018 21 FEBRUARY 2018 21 FEBRUARY 2018</b>
<b>SUBJECT:</b>	<b>TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS 2018/19</b>
<b>REPORT FROM:</b>	<b>CABINET MEMBER FOR FINANCE &amp; HOUSING</b>
<b>CONTACT OFFICER:</b>	<b>STEPHEN KENYON, INTERIM EXECUTIVE DIRECTOR OF RESOURCES AND REGULATION</b>
<b>TYPE OF DECISION:</b>	<b>COUNCIL</b>
<b>FREEDOM OF INFORMATION/STATUS:</b>	The report is for publication
<b>SUMMARY:</b>	<p>The report sets out the suggested Strategy for 2018/19 in respect of the following aspects of the Treasury Management function. It is based upon the Treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor. The Strategy covers:</p> <ul style="list-style-type: none"> <li>• Capital plans and prudential indicators;</li> <li>• the minimum revenue provision policy;</li> <li>• the current treasury position;</li> <li>• treasury limits in force which will limit the treasury risk and activities of the Council;</li> <li>• prospects for interest rates;</li> <li>• the borrowing strategy;</li> <li>• policy on borrowing in advance of need</li> <li>• debt rescheduling;</li> <li>• the investment strategy;</li> </ul>

	<ul style="list-style-type: none"> <li>• creditworthiness policy; and</li> <li>• policy on use of external service providers</li> </ul> <p>The primary objective of the Council's treasury management function will continue to be the minimisation of financing costs whilst ensuring the stability of the Authority's long term financial position by borrowing at the lowest rates of interest and by investing surplus cash to earn maximum interest, all at an acceptable level of risk.</p> <p>The overall strategy for 2018/19 will be to finance capital expenditure by running down cash/investment balances and using short term temporary borrowing rather than more expensive longer term loans. The taking out of longer term loans (1 to 10 years) to finance capital spending will only then be considered if required by the Council's underlying cash flow needs. Some long term loans (over 10 years) may be undertaken to replace debt which matures in the year. With the reduction of cash balances the level of short term investments will fall. Given that investment returns are likely to remain low (say) 0.50% for the financial year 2018/19, then savings will be made from running down investments rather than taking out more expensive long term loans.</p> <p>All prospects for rescheduling debt will be considered, in order to generate savings by switching from high costing long term debt to lower costing shorter term debt.</p>
<b>OPTIONS &amp; RECOMMENDED OPTION</b>	<p>It is recommended that Overview and Scrutiny Committee notes the report;</p> <p>It is recommended that Cabinet approves, for onward submission to Council, the:</p> <ul style="list-style-type: none"> <li>• Prudential Indicators forecast for 3 years</li> <li>• Treasury Management Strategy for 2018/19</li> <li>• Schemes of Delegation and Responsibility attached at Appendices 2 and 6</li> </ul> <p>It is recommended that Council approves the report.</p> <p>Reasons for the Decision:</p> <p>It is a requirement of the CIPFA Code that the Council receives an annual treasury management strategy report.</p>
<b>IMPLICATIONS:</b>	
<b>Corporate Aims/Policy Framework:</b>	Do the proposals accord with the Policy

	Framework? Yes
<b>Statement by the S151 Officer: Financial Implications and Risk Considerations:</b>	Treasury Management is an integral part of the Council's financial framework and it is essential that the correct strategy is adopted in order to ensure that best value is obtained from the Council's resources and that assets are safeguarded.
<b>Statement by Executive Director of Resources &amp; Regulation:</b>	There are no additional resource implications.
<b>Health &amp; Safety implications:</b>	There are no direct Health & Safety implications
<b>Equality/Diversity implications:</b>	No
<b>Considered by Monitoring Officer:</b>	Yes
<b>Wards Affected:</b>	All
<b>Scrutiny Interest:</b>	Overview & Scrutiny Committee

**TRACKING/PROCESS  
KENYON**

**EXECUTIVE DIRECTOR: STEVE**

Chief Executive/ Senior Leadership Team	Cabinet Member/Chair	Ward Members	Partners
	Leader / Finance		
Scrutiny Committee		Committee	Council
Overview & Scrutiny 14/2/18		Cabinet 21/2/18	Council 21/2/18

## 1.0 BACKGROUND

- 1.1 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 adequate liquidity initially before considering investment return.
- 1.2 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 occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.3 CIPFA defines treasury management 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."*

## 1.4 Reporting requirements

- 1.4.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

**Prudential and treasury indicators and treasury strategy** (this report) – the first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**A mid year treasury management report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

- 1.4.2 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Overview and Scrutiny Committee.

## 1.5 In Year Monitoring Arrangements

- 1.5.1 Budget monitoring reports are produced on a monthly basis, together with quarterly reporting to Cabinet and the Overview and Scrutiny Committee.

1.5.2 In 2017/18 the average rate of return on investments is 0.26% as at 31<sup>st</sup> December 2017.

## **1.6 Treasury Management Strategy for 2018/19**

1.6.1 The strategy for 2018/19 covers two main areas:

### **Capital issues**

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) strategy.

### **Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers.

1.6.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

## **1.7 Treasury Management consultants**

1.7.1 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

1.7.2 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.

1.7.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## **2.0 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21**

2.1 The Council's capital expenditure plans are the key driver of treasury management activity. The outputs of the capital expenditure plans are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans.

### **2.2 Capital expenditure**

2.2.1 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

<b>Capital Expenditure</b>	<b>2016/17 Actual £'000</b>	<b>2017/18 Estimate £'000</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
<b>Non-HRA</b>	22,700	27,779	14,688	14,309	1,156
<b>HRA</b>	10,704	8,772	9,830	9,830	9,830
<b>Total</b>	<b>33,404</b>	<b>36,551</b>	<b>24,518</b>	<b>24,139</b>	<b>10,986</b>

## 2.3 The Council's borrowing need (the Capital Financing Requirement)

- 2.3.1 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.3.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.
- 2.3.3 The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

<b>Capital Financing Requirement</b>	<b>2016/17 Actual £'000</b>	<b>2017/18 Estimate £'000</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
<b>CFR – non HRA</b>	126,936	123,876	124,704	124,276	120,685
<b>CFR – HRA existing</b>	40,531	40,531	40,531	40,531	40,531
<b>Housing Reform Settlement</b>	78,253	78,253	78,253	78,253	78,253
<b>Total CFR</b>	<b>245,720</b>	<b>242,660</b>	<b>243,488</b>	<b>243,060</b>	<b>239,469</b>

## 2.4 Minimum revenue provision (MRP) policy statement

- 2.4.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
- 2.4.2 CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. The Council is recommended to approve the following MRP Statement for the year 2017/18:-
- MRP for supported borrowing will be calculated using 2% over 50 years in equal annual instalments as a variation on the 'Regulatory Method' of calculating MRP.
  - The Asset Life method of calculating repayment provision will be used for unsupported borrowing.

- The Interim Executive Director of Resources and Regulation may from time to time and when it is beneficial to the efficient financial administration of the Council, vary the amounts charged as MRP in the year by making additional and voluntary payments of MRP. In these circumstances, the amount paid would not prejudice the existing strategy or be counter to the regulatory intent of that strategy.

## **2.5 Affordability prudential indicators**

- 2.5.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

## **2.6 Ratio of financing costs to net revenue stream.**

- 2.6.1 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

<b>%</b>	<b>2016/17 Actual</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
Non-HRA	3.10%	3.01%	2.94%	2.87%	2.78%
HRA	14.47%	14.47%	14.47%	14.47%	14.47%

- 2.6.2 The estimates of financing costs include current commitments and the proposals in this budget report.

## **3.0 BORROWING**

- 3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### **3.2 Current portfolio position**

- 3.2.1 To assist Members in agreeing a strategy for 2018/19 the Council's current treasury portfolio position (at nominal value) is detailed below:

		31st March 2017			Forecast 31st March 2018		
		Principal		Avg. Rate	Principal		Avg. Rate
		£0	£0		£0	£0	
Fixed rate funding							
	PWLB Bury	131,453			131,453		
	PWLB Airport	1,726			553		
	Market Bury	62,500	195,679		60,500	192,506	
Variable rate funding							
	PWLB Bury	0			0		
	Market Bury	0	0		0	0	
Temporary Loans / Bonds		3	3		3	3	
Total Debt		195,682	3.95%		192,509	3.95%	
Total Investment Properties		8,313	4.24%		8,313	4.87%	
Total Cash Investments		18,550	0.58%		2,900	0.26%	

- 3.2.2 The forecast accumulated capital financing requirement at the end of 2017/18 is £242.7m. The forecast borrowing at the end of 2017/18 is £192.5m meaning that the Authority is under borrowed by £50.2m.
- 3.2.3 The cash investment portfolio after the Capital Programme has been spent during 2017/18 is estimated to be around £8.5m. In preference to taking out long term borrowing, the Authority is taking temporary loans and running down investments to finance capital expenditure because investment returns are low at the present time. The estimated rate of interest on investments for 2017/18 is 0.26% against the 3 month LIBID investment benchmark of 0.27%.
- 3.2.4 The Council is also investing in properties that deliver a sustainable rental yield; under its "Property Investment Strategy"

### 3.3 Treasury Indicators: limits to borrowing activity

- 3.3.1 **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
<b>Borrowing</b>	242,700	243,500	243,100	239,500
<b>Other long term liabilities</b>	5,000	5,000	5,000	5,000
<b>Total</b>	<b>247,700</b>	<b>248,500</b>	<b>248,100</b>	<b>244,500</b>

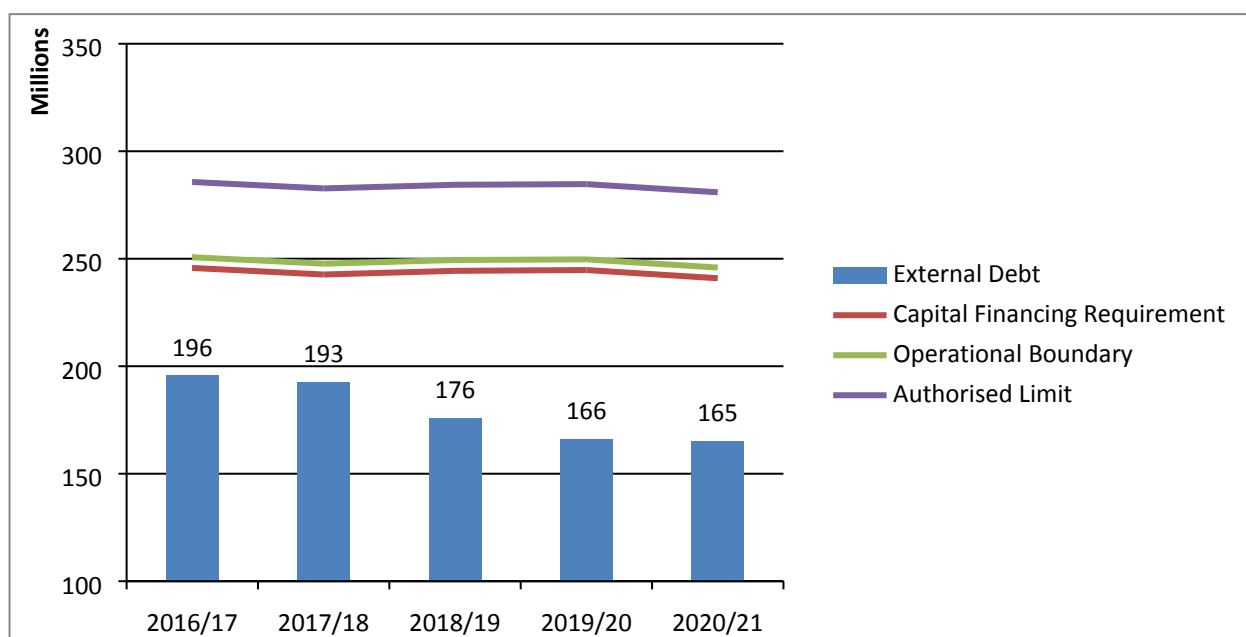
- 3.3.2 **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all



councils' plans, or those of a specific council, although this power has not yet been exercised.

<b>Authorised limit</b>	<b>2017/18 Estimate £'000</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
<b>Borrowing</b>	277,700	278,500	278,100	274,500
<b>Other long term liabilities</b>	5,000	5,000	5,000	5,000
<b>Total</b>	<b>282,700</b>	<b>283,500</b>	<b>283,100</b>	<b>279,500</b>



### 3.4 Prospects for interest rates

3.4.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

3.4.2 The Monetary Policy Committee, (MPC), increased Bank Rate from 0.25% to 0.50% on 2nd November, reversing the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

3.4.3 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led

to a rise in equity values as investors searched for higher returns and took on riskier assets.

- 3.4.4 Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.
- 3.4.5 From time to time, gilt yields – and therefore PWLB rates – can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.
- 3.4.6 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.
- 3.4.7 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.
- 3.4.8 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:
- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
  - Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
  - A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
  - Weak capitalisation of some European banks.
  - Germany is still without an effective government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March. Hungary will hold a general election in April 2018.
  - A sharp Chinese downturn and its impact on emerging market countries
- 3.4.9 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within

the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

### **3.5 Investment and borrowing rates**

- 3.5.1 Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- 3.5.2 Borrowing interest rates increased after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectation for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid borrowing to finance capital expenditure and/or the refinancing of maturing debt.
- 3.5.3 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### **3.6 Borrowing strategy**

- 3.6.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
- 3.6.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Interim Executive Director of Resources & Regulation will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- *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 will 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*, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in

inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

- 3.6.3 Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### 3.7 Treasury management limits on activity

- 3.7.1 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

<b>Interest rate exposures</b>	<b>2017/18 Upper</b>	<b>2018/19 Upper</b>	<b>2019/20 Upper</b>
<b>Limits for fixed interest rates based on net debt</b>	113%	117%	118%
<b>Limits for variable interest rates based on net debt</b>	-13%	-17%	-18%
<b>Maturity structure of new fixed rate borrowing 2017/18</b>			
	<b>Upper</b>	<b>Lower</b>	
Under 12 months	40%	0%	
12 months and within 24 months	35%	0%	
24 months and within 5 years	40%	0%	
5 years and within 10 years	50%	0%	
10 years and above	90%	0%	

### 3.8 Policy on borrowing in advance of need

- 3.8.1 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 within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

- 3.8.2 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 take funding in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets, have been considered

- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

### 3.9 Borrowing Requirement

3.9.1 Based on a current forecast for the Capital Financing Requirement plus the replacement of existing debt, less the minimum revenue provision (MRP) and the voluntary revenue provision (VRP), the net borrowing requirement for the current year and the next three years is estimated to be as follows.

	<b>2017/18 Estimate £'000</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
<b>Alternative financing</b>	9,645	3,500	3,000	0
<b>Replacement borrowing</b>	2,427	16,503	10,000	1,000
<b>Borrowing Requirement</b>	<b>12,073</b>	<b>20,003</b>	<b>13,000</b>	<b>1,000</b>

3.9.2 Alternative financing is a combination of running down cash balances and investments and temporary borrowing.

3.9.3 The plan is to use a combination of internal borrowing (i.e. running down cash balances/investments) and temporary borrowing to finance some of the replacement borrowing. The rest will be financed by long term borrowing (over 10 years) as required by the Council's underlying cash flow needs.

### 3.10 Debt rescheduling

3.10.1 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential 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 the current treasury position and the size of the cost of debt repayment (premiums incurred).

3.10.2 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 treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

3.10.3 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

3.10.4 All rescheduling will be reported to the Council, at the earliest meeting following its action.

## **4.0 ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment policy**

- 4.1.1 The Council's investment policy has 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"). The Council's investment priorities will be security first, liquidity second and then return.
- 4.1.2 In accordance with guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties, which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.
- 4.1.3 Ratings will not be the sole determinant of the quality of an institution; 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 institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings..
- 4.1.4 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 process on the suitability of potential investment counterparties.
- 4.1.5 Investment instruments identified for use in the financial year are listed in appendix 2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.
- 4.1.6 In light of low investment returns, the Interim Executive Director of Resources & Regulation has obtained Cabinet approval to investigate alternative forms of investment; primarily property, which will yield a sustainable rental income at a higher rate than can be obtained via UK high street banks.

### **4.2 Creditworthiness policy**

- 4.2.1 This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:
- credit watches and credit outlooks from credit rating agencies;
  - CDS spreads to give early warning of likely changes in credit ratings;
  - sovereign ratings to select counterparties from only the most creditworthy countries.

4.2.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years
- Dark Pink 5 years for Ultra Short Dated Bond Funds with a credit score of 1.25
- Light Pink 5 years for Ultra Short Dated Bond Funds with a credit score of 1.5
- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

4.2.3 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

4.2.4 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

4.2.5 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

### 4.3 Country limits

4.3.1 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 equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 3, although the Council's current approach is to use UK High Street Banks and other public bodies. The list of counterparties will be added to, or deducted from, by officers should ratings change in accordance with this policy.

### 4.4 Investment Strategy

4.4.1 **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

4.4.2 **Investment returns expectations.** Bank Rate is forecast to stay flat at 0.25% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

4.4.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

	Now
2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	1.75%
2023/24	2.00%
Later years	2.75%

4.4.3 The overall balance of risks to these forecasts is currently to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

4.4.5 **Investment treasury indicator and limit** - total principal funds invested for greater than 364/365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

<b>Maximum principal sums invested &gt; 364 &amp; 365 days</b>			
<b>£m</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>
<b>Principal sums invested &gt; 364 &amp; 365 days</b>	£10m	£10m	£10m

(This takes account of the proposed change in the CIPFA Treasury Code from a 364 day limit to 365 days.)

4.4.6 For its cash flow generated balances, the Council will seek to utilise its business reserve, instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

## 4.5 End of year investment report

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

## 5.0 EQUALITY & DIVERSITY



- 5.1 An initial assessment has been undertaken and it is concluded that there will be no negative impact from this report.

**Councillor Eamonn O'Brien**  
**Cabinet Member for Finance and Housing**

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**For further information on the contents of this report, please contact:**

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## APPENDIX 1: Interest Rate Forecasts 2018 – 2021

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
3 Month LIBID	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%

## APPENDIX 2: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

**NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. A maximum of 100% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
<b>DMADF – UK Government</b>	N/A	<b>100%</b>	<b>6 months</b>
UK Government gilts	UK sovereign rating		12 months
UK Government Treasury bills	UK sovereign rating		12 months
Bonds issued by multilateral development banks	AAA (or state your criteria if different)		6 months
Money Market Funds CNAV	AAA	100%	Liquid
Money Market Funds LVAV	AAA		Liquid
Money Market Funds VNAV	AAA		Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	Liquid
Local authorities	N/A	100%	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour		12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating		

### **APPENDIX 3: Approved countries for investments**

*This list is based on those countries which have sovereign ratings of AA- or higher and also, (except - at the time of writing - for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Capita Asset Services credit worthiness service.*

#### AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

#### AA+

- Finland
- Hong Kong
- U.S.A.

#### AA

- Abu Dhabi (UAE)
- France
- U.K.

#### AA-

- Belgium
- Qatar

***(note the Council only invests in the highest rated UK institutions)***

## **APPENDIX 4: DELEGATION AND RESPONSIBILITY**

The following personnel are involved on a regular basis in Treasury Management: -

Interim Executive Director of Resources & Regulation (Steve Kenyon)	Overall supervision of Treasury Management function and cashflow. Regular reviews of Treasury Management Strategy and monitor performance.
Head of Financial Management (Andrew Baldwin)	Deputise for the Interim Executive Director of Resources & Regulation
Principal Accountant (Management Accountancy) (Jane Bunn)	Manage and undertake day to day Treasury Management Activities in accordance with Treasury Strategy and Policy Statement.
Senior Accountant (Joanne McIntyre)	Deputise for Principal Accountant in her duties as required.
Senior Accountant (Angela Sozansky)	Deputise for Principal Accountant in her duties as required.
Senior Accountancy Assistant (Stephen Blake)	Deputise for Principal Accountant in her duties as required.
Accountancy Assistant (Linda Hughes)	Standby for allocation of short term business via brokers.

Please note that the Council's signatories for treasury management transactions are :-

Steve Kenyon	Interim Executive Director of Resources & Regulation
Andrew Baldwin	Head of Financial Management
Kath Pope	Principal Finance Manager
Jane Bunn	Principal Accountant

## **APPENDIX 5: Treasury management scheme of delegation**

### **(i) Full council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### **(ii) Boards/committees/Council/responsible body**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### **(iii) Body/person(s) with responsibility for scrutiny**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## **APPENDIX 6: The treasury management role of the section 151 officer**

### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

***The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). (Officers are recommended to decide whether to extend this section to include the following examples): -***

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities. Please also note that CIPFA has provided advice that it recognises that it may be too late in the current budget round for 2018/19 for many local authorities to produce a capital strategy this year.)
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees (*We are unclear as to whether CIPFA requires this to be implemented in 2018/19. We are concerned that many local authorities could have difficulty in complying fully with this requirement at this late stage in the 2018/19 budget cycle.*)
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following (*TM Code p54*): -
  - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

- *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*
- *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*
- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*
- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*