Treasury Management Strategy Report 2018/19

Summary
To consider and recommend to the Council the Treasury Strategy for 2018/19

Portfolio - Finance
Date Portfolio Holder signed off report: 24 January 2018

Wards Affected All

Recommendation

The Executive is advised to RECOMMEND to Full Council to adopt

(i) the Treasury Management Strategy for 2018/19;

(ii) the Treasury Management Indicators for 2018/19, as set out at Annex C to this report; and

(iii) the Minimum Revenue Provision policy statement and estimated minimum revenue provision payment table, as set out at Annex F to this report.

Resource Implications

1. £160,000 has been budgeted for Investment Income for 2018/19 calculated as a average return of 1.1% on a £14.5m portfolio. £2.2m has been budgeted for interest payments calculated as average cost of 2% on a debt of £111m. These figures are influenced by changes to interest rates, levels of debt and investment funds.

2. The proposed corporate capital programme for 2018/19 – 2019/20 will need to be funded by borrowing or out of revenue due as the Council does not hold any capital receipts.

3. Any changes required to the approved treasury management indicators and strategy, say because of changes in economic conditions, will be reflected future reports for Executive and Council to consider.

Key Issues

4. Treasury Management is “the management of the Council’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”.

5. The Council's investment portfolio comprises of funds available for longer-term investment, and short term investments sufficient to meet cash flow requirements.

6. On 22nd February 2013 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017 and the amendments were published in late December 2017, however, due to the committee timetable, the amendments have not been reflected in this report.

7. In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Council Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year. CLG consulted on changes to its guidance in 2017 but has yet to publish any updated guidance.

8. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

9. The Council invests and borrows large sums of money and is therefore exposed to financial risks which include the revenue impact of changing interest rates and the loss of part or all invested funds. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

10. In accordance with the CLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance. The updated Treasury Guidance when issues may also require a revised report to be submitted for approval.

Options

11. The Executive can receive or amend the report, or ask for further information.

12. The Executive can approve or amend the proposed recommendations to Council.

Proposals

13. The Executive is asked to approve and recommend to Council the adoption of:

a) The Treasury Management Strategy for 2018/19.
b) The Treasury Management Indicators for 2018/19 at Annex C.
c) The Minimum Revenue Provision (MRP) policy statement at Annex F

Supporting Information

National and International Factors which influence the Council's Treasury Strategy

14. The Council's treasury management advisors, Arlingclose Limited, have given us their assessment of the wider external factors that the Council's investment strategy needs to take in to account in terms of the economy, interest rates and credit outlook. This is set out below:

Economic background:

15. The major external influence on the Council's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the 2016 referendum, but there are indications that uncertainty over the future is now reducing growth. Transitional arrangements may prevent a cliff-edge, but could also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain low throughout 2018/19.

16. Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates again.

17. In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some growing confidence in the Eurozone economy.

Credit outlook:

18. High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Low growth in the economy and fines for pre-crisis behaviour continue to depress bank profits and this may be exacerbated if the economy slows down further.

19. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ring-fence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

20. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; In addition returns from cash deposits however remain very low.

Interest rate forecast:

21. The UK Bank Rate increased to 0.50% in November 2017 from 0.25%. The Bank of England emphasized that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

22. Longer-term interest rates have risen in the past year, reflecting the possibility of increasing short-term rates. Arlingclose forecasts these to remain broadly constant during 2018/19, but with some volatility as interest rate expectations wax and wane with press reports on the progress of EU exit negotiations.

23. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

24. For the purpose of setting the budget, it has been assumed that no new investments will be made and that new long-term loans will be borrowed at an average rate of 2%.

Local Context

25. The Council currently has £111m of external borrowing and £14 million of investments (as at 31st December 2017) as set out in Annex E.

26. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, subject to holding a minimum of £5million. However the Council will continue to borrow externally if there is a sound business case for doing so.

27. The Council has a falling CFR due to repayments of debt however this would increase if further capital investment through borrowing is undertaken.

28. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2018/19.

Borrowing Strategy

29. The Council currently holds £111 million of loans, a decrease of £19 million on the previous year, which it is using to fund it's property acquisitions. Borrowing reduced over the year as investments were sold to repay debt. The Council may borrow in advance to pre-fund future years' requirements, providing this does not

exceed the authorised limit for borrowing, however the Council will incur a cost of carry until the funds are applied. This is because generally borrowing rates are higher than investment returns.

Objectives:

30. The Council's main objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy:

31. Given the significant cuts to public expenditure and in particular to local government funding, the council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The Council has currently borrowed most of its debt short in order to take advantage of low rates however it is in the process of fixing some of its borrowing for the longer term to give certainty of cost in the future and reduce risk. However there is still a risk of exposure to increased variable interest rates on the Council's short term borrowing.

32. By selling its investments and repaying borrowing, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

33. The Council is seeking to arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved in the future whilst taking advantage of low rates in the short term.

34. In addition, the Council may borrow further short-term loans to cover unplanned cash flow shortages.

Sources:

35. The approved sources of long-term and short-term borrowing are:
    - Public Works Loan Board (PWLB) and any successor body
    - Any institution approved for investments (see below)
    - Any other bank or building society authorised to operate in the UK
    - UK public and private sector pension funds (except Surrey County Council Pension Fund)
    - UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues
    - Local Enterprise Partnerships

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Operating and finance leases
- Hire purchase
- Private Finance Initiative
- Sale and leaseback

36. The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local Council loans and bank loans that may be available at more favourable rates. Short term borrowing has allm been from other Public Bodies. As at 31st December 2017, the Council has borrowed £16.1m from the PWLB, £0.8m from the M3 LEP and £94.5m from local authorities.

Municipal Bond Agency:

37. UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Hence at the moment the UKMBA does not compare favourably with other sources of finance. Any decision to borrow from the Agency will require the approval of Council and therefore a separate report would be required.

Short-term and Variable Rate loans:

38. These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt Rescheduling:

39. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Annual Minimum Revenue Provision (MRP) Statement

40. When a Council borrows, it is required to indicate how it intends to fulfil its duty to make prudent provision for the repayment of the capital borrowed from revenue. This provision is called the Minimum Revenue Payment or MRP. Best practice guidance recommends that Councils prepare a statement of policy on making MRP in respect of the forthcoming financial year. The Council's MRP statement will be recommended to Council by the Executive on 6th February 2018 as part of the Capital Budget for 2018/19.

41. The recommended policy is attached in Annex F and the forecast MRP is shown in the table below:

	2018/19	2019/20	2020/21
	£m	£m	£m
Forecast MRP	1.4	1.4	1.5

Investment Strategy

42. The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £6million and £34million. Average levels of £12m are expected in 2018/19.

Objectives:

43. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

Strategy:

44. Given the increasing risk and falling returns from short-term unsecured bank investments, the Council aims to remain diversified into higher yielding asset classes during 2018/19, particularly for investments held for the longer term. Shorter term investments will be invested in short-term unsecured bank deposits, lent to other public bodies Councils and money market funds. No changes are proposed to the 2018/19 investment strategy from that adopted in 2017/18.

Approved Counterparties:

45. The Council's Treasury advisors have advised that the Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Building Societies	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£2m 5 years	£3m 10 years	£2m 3 years	n/a	£2m 20 years	£2m 20 years
AA+	£2m 5 years	£3m 10 years	£2m 3 years	n/a	£2m 10 years	£2m 10 years
AA	£2m 4 years	£3m 5 years	£2m 3 years	n/a	£2m 5 years	£2m 10 years
AA-	£2m 3 years	£3m 4 years	£2m 3 years	n/a	£2m 4 years	£2m 10 years
A+	£2m 2 years	£3m 3 years	£2m 2 years	n/a	£2m 3 years	£2m 5 years
A	£2m 13 months	£3m 2 years	£2m 12 months	n/a	£1m 2 years	£2m 5 years
A-	£2m 6 months	£3m 13 months	£1m 6 months	n/a	£1m 13 months	£2m 5 years
BBB+	£3m next day only	£3m 6 months	£1m 100 days	n/a	n/a	£1m 2 years
None	£1m 6 months	n/a	£1m 6 months	n/a	n/a	n/a
Pooled funds	£2m per fund					
Supranational Banks	£3m for up to 5 years where rated A or above					
UK Local Authorities	£2m per authority for up to 5 years					

This table must be read in conjunction with the notes below:

Credit Rating:

46. Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks Unsecured:

47. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Banks Secured:

48. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The

combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government:

49. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities. These investments are not subject to bail-in, and there is a low risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates:

50. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers:

51. Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds:

52. Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

53. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Operational Bank Accounts

54. In addition the Council may incur operational exposures, for example though bank current accounts, collection accounts and merchant acquiring services, to UK banks with a credit ratings of at least BBB- and with assets greater than £25

billion. These exposures are not classed as investments but are still subject to the risk of a bank bail-in, thereby putting these operational deposits at risk. The Council's current accounts, together with a Business Reserve account are held with NatWest Bank who are currently rated BBB+. Deposits with the Council's current account are restricted to overnight deposits.

Supranational Banks

55. Loans bonds and bills issued or guaranteed by Supranational Banks such as the European Investment Bank, European central bank etc. These investments are not subject to bail-in, and there is an insignificant risk of insolvency.

UK Local & Regional Authorities

56. Loans to UK local and regional authorities and bodies created by statute whether credit rated or not.

Risk Assessment and Credit Ratings:

57. Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

58. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments:

59. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

60. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to

maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments:

61. The CLG Guidance defines specified investments as those:
- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local Council, parish council or community council, or
    - a body or investment scheme of "high credit quality".

62. The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments:

63. Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in the table below.

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£10m
Total investments without credit ratings or rated below A- Except Local Authorities	£7m
Total investments (except pooled funds) with institutions domiciled in foreign countries	£7m
Total non-specified investments	**£24m**

Investment Limits:

64. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £3 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£3m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£3m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£2m per country
Registered Providers	£5m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£2m in total
Money Market Funds	£10m in total

Liquidity Management:

65. The Council uses purpose-built cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed.

Non-Treasury Investments:

66. Although not classed as treasury management activities at the moment and therefore not covered by the CIPFA Code or the CLG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example as loans to local businesses and landlords, or as equity investments and loans to the Council's subsidiaries.

67. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. This situation may change when the revised guidance is released by Government later this year – see below.

Other Items

68. There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its treasury management strategy. These are shown in Annex B.

Potential Legislative and Accounting Changes which could impact the Treasury Strategy

69. At the time of writing this report there are changes proposed to the Treasury Management and Prudential Code, DCLG Investment Guidance as well as a new International Financial Reporting Standard (IFRS) on Financial Instruments. As the impact of these is not known at the moment nor the final guidance published this report has been written on the basis of the 2009 and 2011 Code. Once the changes are agreed and published a new report may be required for Council to consider. For information the impact of the potential changes is outlined below.

IFRS9 – Accounting Standard for Financial Instruments

70. Although not applicable to the Treasury Strategy, this standard will apply to the Local Government accounts from 2018/19 and will impact the Council's General Fund in two areas:

- Movement in the market value of some loans and investments will all charged to the General Fund. At the moment only realised movements are taken to the General Fund with unrealised losses being placed in a reserve. The impact of this change will depend on CIPFA's final guidance on which instruments are affected, investment holdings and financial market conditions on Friday, 29th March 2019 when the standard is introduced.
- A provision will have to be made for potential losses on loans to subsidiaries and third parties, deposits, financial guarantees and trade and lease receivables resulting in a charge to the General Fund. The size of the charge will depend on the size of the Council's exposure and credit standing of its borrowers, counterparties and customers in March 2019. This will particularly impact those authorities that have lent money by way of equity or loan to wholly owned subsidiary companies.

71. The possible impact of the adoption of IFRS9 is not reflected in this report and a statutory override of IFRS9 has been requested to mitigate the impact. A decision by DCLG on this is awaited.

Potential Changes in the 2017 CIPFA Treasury Management Code

72. The definition of Investments may be widened to include non-financial investments such as property and so these would then all fall under the code. The Council would need to demonstrate that there were robust due diligence procedures for external investment, transparent decision making and reporting, and that potential risks have been considered.

Potential changes to the CIPFA Treasury Management Cross-sectoral Guidance Notes

73. Any decision to invest in a non-financial investment, e.g. property must set out the risks clearly and any impact this may have on financial sustainability. There will also be a requirement for greater disclosure over debt, and in particular the key risks in servicing future debt requirements.

Potential Changes to the Prudential Code

74. Capital expenditure and Investment plans may need to consider the longer term implications and risk to the Council. This includes the arrangements for repayment of debt and the impact on financial sustainability over the longer term. This may include a requirement to report on the affordability of the capital strategy. Affordability should only consider those funds available for the servicing of debt and not include ring fenced amounts. It is likely that a “Capital Strategy” may be required setting out the Council’s risk parameters which would then be applied to any non-treasury investment.

DCLG Proposed changes on Investment & MRP Guidance

75. The definition of investments may be widened to include non-financial assets held for generating income returns such as investment properties and loans. Physical assets held as non-financial investments must be valued at fair value, and the investment strategy must state whether the fair value is sufficient to provide against loss and the liquidity of non-financial investments should be assessed as part of the Strategy. Where the Council relies on investment income to achieve a balanced budget and fund core services the extent of this may have to be disclosed together with contingency plans should yields on investments fall. In addition Councillors and Officers may need to be adequately trained to make informed investment decisions

Minimum Revenue Provision (MRP)

76. The definition of MRP may be updated to cover the gap between the Capital Financing Requirement (CFR) and grant income/capital receipts (CFR measures an Council's underlying need to borrow or finance by other long-term liabilities for a capital purpose). Any planned overpayments in MRP should be recorded clearly as a separate section in the MRP Statement and could be used to offset charges in future years. However a change in MRP policy which leads to an overpayment of MRP may not be taken to the General Fund – it must be offset against future MRP payments. The Government may set maximum MRP lengths of 40 years with 50 years applicable to freehold land.

Treasury Management Indicators

77. The Council measures and manages its exposures to treasury management risks using a range of indicators which members are asked to approve. These are set out at Annex C.

Corporate Objectives and Key Priorities

78. The Treasury Management supports the Council's Key Priority 2.

Policy Framework

79. The Council fully complies with the requirements of the CIPFA Code of Practice on Treasury Management. The current relevant criteria and constraints incorporated into the Treasury Management Policy Statement are:
    - New borrowing is to be contained within the limits approved by the Council, in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities, and the Council's prudential indicators.
    - Investments to be made in accordance with the CLG guidance on Local Council Investments, on the basis of Fitch, Moody's and Standard & Poors credit ratings for rated institutions and as detailed in the Treasury Management Policy statement and approved schedules and practices.
    - Sufficient funds to be available to meet the Council's estimated outgoings for any day.
    - Investment objectives are to maximise the return to the Council, subject to the overriding need to protect the capital sum.
    - The Council's response to interest rate changes is to minimise the net interest rate burden on borrowing and maximise returns from investments, subject to (a-d) above.

Legal Issues

80. These are addressed in the report and relate to a requirement to set and agree both a treasury management strategy and prudential indicators.

Governance Issues

81. The recommendations address best practice and are required as part of the CIPFA code.

Sustainability

82. None

Risk Management

83. Poor returns on investments could lead to a reduction in income required to support the revenue budget. However, low returns on investments should mean low rates for borrowing which could offset any potential loss. There is a risk that variable interest rates on short term borrowing could rise faster than expected leading to an increase in costs and therefore needing savings elsewhere in the Council's budget.

84. The limits proposed in this report in respect to counterparties and investments are the overall limits for agreement by Council. However from time to time these may be tightened temporarily by the Executive Head of Finance in consultation

with the portfolio holder for Resources to reflect increased uncertainty and increase in perceived risk in financial institutions and the economy. This will usually be at the cost of lower returns.

85. The investments ratings provided by credit ratings agencies are only a guide and do not give 100% security. There is always a risk that an institution may be unable to repay its loans whatever the credit rating thereby putting the Council's investments at risk.

Consultation

86. The Council's treasury advisors have been consulted and advised on the treasury strategy.

Officer Comments

87. Treasury Management, in particular the management of debt, is becoming an increasingly important area for the Council. This can lead to financial benefits but also carries risks which need to be clearly understood.

Annexes	Annex A – Arlingclose Economic and Interest Rate Forecast September 2017 Annex B – 2018/19 Other Items - Treasury Management Strategy Annex C – 2018/19 Treasury Management Indicators Annex D – Investments as at 31 December 2017 Annex E – Existing Investment and Debt Portfolio Annex F – Minimum Revenue Policy (MRP) Statement
Background Papers	CIPFA Code of Practice: Treasury Management in the Public Services – 2011 Edition
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Head of Service	Kelvin Menon - Executive Head of Finance

Consultations, Implications and Issues Addressed

Resources	**Required**	**Consulted**
Revenue	✓	
Capital		
Human Resources		
Asset Management		
IT		
Other Issues	**Required**	**Consulted**
Corporate Objectives & Key Priorities	✓	
Policy Framework		
Legal		
Governance		

Sustainability		
Risk Management		
Equalities Impact Assessment		
Community Safety		
Human Rights		
Consultation		
P R & Marketing		

Annex A

Economic & Interest Rate Forecast November 2017

The Council's Treasury Advisors Arlingclose has provided there prediction of interest rates over the next 3 years. This is shown in the table below together with their underlying assumptions and predictions.

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be a gradual pace and to a limited extent.

- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Predictions:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

Predicted Interest Rate Table

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.19**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.15**
3-month LIBID rate														
Upside risk	0.10	0.10	0.10	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.22**
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**
Downside risk	-0.10	-0.10	-0.15	-0.15	-0.15	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	**-0.20**
1-yr LIBID rate														
Upside risk	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.27**
Arlingclose Central Case	**0.70**	**0.70**	**0.70**	**0.70**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.80**	**0.77**
Downside risk	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.15	-0.15	**-0.26**
5-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**0.75**	**0.75**	**0.80**	**0.80**	**0.80**	**0.85**	**0.90**	**0.90**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**0.89**
Downside risk	-0.20	-0.20	-0.25	-0.25	-0.25	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
10-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.25**	**1.25**	**1.25**	**1.25**	**1.25**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.55**	**1.36**
Downside risk	-0.20	-0.25	-0.25	-0.25	-0.25	-0.30	-0.35	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	**-0.33**
20-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.85**	**1.85**	**1.85**	**1.85**	**1.85**	**1.90**	**1.90**	**1.95**	**1.95**	**2.00**	**2.05**	**2.05**	**2.05**	**1.93**
Downside risk	-0.20	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.38**
50-yr gilt yield														
Upside risk	0.20	0.25	0.25	0.25	0.30	0.35	0.35	0.35	0.35	0.35	0.35	0.35	0.40	**0.32**
Arlingclose Central Case	**1.70**	**1.70**	**1.70**	**1.70**	**1.70**	**1.75**	**1.80**	**1.85**	**1.90**	**1.95**	**1.95**	**1.95**	**1.95**	**1.82**
Downside risk	-0.30	-0.30	-0.25	-0.25	-0.30	-0.35	-0.40	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	**-0.39**

Annex B

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

1. **Policy on Use of Financial Derivatives:** Local authorities, but not Surrey Heath, have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

2. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

3. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

4. **Investment Training:** The needs of the Council's treasury management staff for training in investment management are assessed as part of the staff appraisal process, and when the responsibilities of individual members of staff change. Staff attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

5. **Investment Advisors:** The Council has appointed Arlingclose Limited as treasury management advisors and receives specific advice on investment, debt and capital finance issues. This is monitored by holding regular meetings with the advisors to ensure that they continue to meets the Council's treasury management objectives. In addition, the Council's tender process for treasury management advice ensures value for money.

6. **Investment of Money Borrowed in Advance of Need**: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may

change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £190 million. The maximum period between borrowing and expenditure is not expected to exceed two years, although the Council is not required to link particular loans with particular items of expenditure. At the moment there are no plans to borrow in advance.

7. Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Executive Head of Finance, having consulted the Portfolio Member, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex C

Treasury Management Indicators for 2018/19

1. The Council measures its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators:

2. Security: average credit rating

   The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	Target
Portfolio average credit rating	A+

   This is calculated by applying a score to each investment (AAA = 1, AA+=2, etc.) and taking the arithmetic average weighted by the size of each investment.

3. Liquidity: cash available within three months

   The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£5m

4. Interest Rate Exposures:
   This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as an amount of net principal borrowed will be:

	2018/19	**2019/20**	**2020/21**
Upper limit on fixed interest rate exposure	£190m	£190m	£190m
Upper limit on variable interest rate exposure	£190m	£190m	£190m

   Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate. Setting the limits the same gives maximum flexibility to achieve the best interest rate outcome for the Council.

5. Maturity Structure of Borrowing**:**

   This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
Over 40 years	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

6. Principal Sums Invested for Periods Longer than 364 days**:**

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£17m	£17m	£17m

Annex D

INVESTMENTS as at 31st December 2017

	£
Lloyds Bank Call Account	3,000,000
Total Banks	**3,000,000**
Glasgow City Council	2,000,000
Total Local Authorities	**2,000,000**
AAA Rated MM Fund - Blackrock	1,700,000
AAA Rated MM Fund - CCLA Public Sector Deposit Fund	1,000,000
AAA Rated MM Fund - Legal and General	3,000,000
AAA Rated MM Fund - Standard Life (Ignis)	3,000,000
Total Money Market Funds	**8,700,000**
CCLA Property Fund	2,140,500
Total Longer Term Investments	**2,140,500**
Total Invested (excluding the NatWest Business Reserve)	**15,840,500**
NatWest Business Reserve	1,000,000
Total Invested (including NatWest Business Reserve)	**£16,840,500**

Annex E

Existing Investment & Debt Portfolio Position

	31-Dec-17 Actual Portfolio £m	31-Dec-17 Average Rate %
External Borrowing:		
Public Works Loan Board - Long Term	**(16)**	2.9%
Local authorities - Short Term	**(95)**	0.5%
Total Gross External Debt	**(111)**	**1.3%**
Investments:		
Banks & Building societies	4	0.4%
Government (incl. local authorities)	2	1.3%
Money Market Funds	9	0.3%
Other Pooled Funds	2	4.7%
Total Treasury Investments	**17**	**1.7%**
Net Debt	**(95)**	**0.4%**

Non-treasury Investments: Investments in Property Trust***	105	2.0%
Total non-treasury Investments	**105**	**2.0%**
Total Investments	**122**	**1.8%**

*** Represents ownership of The Square, Camberley and associated property

Annex F

Minimum Revenue Policy (MRP) Statement

1. The Secretary of State under section 21(1A) of the Local Government Act 2003 issued guidance on the calculation of MRP in February 2012 with 2012 being the first year of operation. The Council has assessed its method of MRP and is satisfied that the guidelines for its annual amount of MRP set out within this policy statement will result in its making the prudent provision that is required by the guidance.

2. For capital expenditure incurred and funded through borrowing the Council will calculate MRP using the asset life method as summarised in the table below. MRP will be based on the estimated life of the assets purchased by unsupported borrowing.

Estimated economic lives of assets Asset Class	**Estimated economic life**
Land and heritage assets	50 years
Buildings for services	40 years
Vehicles and Plant	10 years
IT equipment and software	5 years
Investment property	50 years
Property for regeneration	0% until development complete

3. The Council will aim to minimise the impact of MRP on the General Fund by funding assets with a longer economic life from borrowing in the first instance.

4. In accordance with provisions in the guidance MRP will be charged starting in the year following the date an asset becomes operational.

5. The forecast MRP is shown in the table below:

	2018/19	2019/20	2020/21
	£m	£m	£m
Forecast MRP	1.4	1.4	1.5

Note: The Council may need to amend to MRP policy dependent on Guidance from DCLG. If this is the case it will be submitted to members again for approval at later date