

TREASURY MANAGEMENT STRATEGY 2018/19

Finance Advisory Committee - 30 January 2018

Report of the: Chief Finance Officer

Status: For Decision

Also considered by: Cabinet - 6 February 2018
Council - 20 February 2018

Key Decision: No

Executive Summary: The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

This report supports the Key Aim of efficient management of the Council's resources.

Portfolio Holder Cllr. John Scholey

Contact Officers Roy Parsons, Principal Accountant, Ext 7204

Adrian Rowbotham, Chief Finance Officer, Ext 7153

Recommendation to Finance Advisory Committee: That the recommendation to Cabinet be approved.

Recommendation to Cabinet: That, subject to the views of the Finance Advisory Committee, Cabinet recommend that Council approve the Treasury Management Strategy for 2018/19.

Recommendation to Council: That the Treasury Management Strategy for 2018/19 be approved.

Reason for recommendations: To ensure that an appropriate and effective annual Treasury Management Strategy is drawn up in advance of the forthcoming financial

year, which meets both legislative and best practice requirements.

Background

- 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.
- 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 3 The Chartered Institute of Public Finance and Accountancy (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."

Introduction

Reporting requirements

- 4 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. These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Finance Advisory Committee.
- 5 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).
- 6 A Mid Year Treasury Management Report - This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.
 - 7 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.

Treasury Management Strategy for 2018/19

- 8 The strategy for 2018/19 covers two main areas:

Capital issues

- the capital plans and the prudential indicators; and
- the Minimum Revenue Provision (MRP) policy.

Treasury management issues

- the current treasury position;
 - treasury indicators which will 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
 - policy on the use of external service providers.
- 9 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the Department of Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.
 - 10 CIPFA has conducted a review of the Prudential Code and the Treasury Management Code of Practice and issued its guidance on 21 December 2017. The review is particularly focused on the risks associated with 'non-treasury' investments, especially the purchase of investment property and other commercial activities that aim to generate income, but which may require

external borrowing (or the use of existing cash balances) to finance such activities.

- 11 Whilst the codes apply to the 2018/19 financial year, given the timing of their release, CIPFA's Treasury and Capital Management Panel recommends that the requirements of both codes be 'implemented as soon as possible' and acknowledges that they may not be fully implemented until the 2019/20 financial year. This Treasury Management Strategy Statement (TMSS) has largely been prepared in accordance with the current Codes of Practice. To ensure that the Council's TMSS remains compliant with the new CIPFA codes, any necessary changes will be reported to Members during 2018/19.

MiFID II

- 12 The Financial Conduct Authority (FCA) implemented the European Union's second Markets in Financial Instruments Directive (known as MiFID II) on 3 January 2018. The directive impacts on the way investors, including local authorities, access financial services provided by banks, brokers, advisors and fund managers.
- 13 Under MiFID II, all local authorities are by default classified as retail clients (i.e. the same as a private individual). Those authorities meeting certain quantitative and qualitative criteria are able to opt up to a professional client. Retail and professional clients have differing access to financial products and services and are afforded differing degrees of protection.
- 14 Professional status has been obtained with our treasury management advisor, brokers, Money Market Funds and some banks and building societies, where necessary.

Training

- 15 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny.
- 16 The training needs of treasury management officers are reviewed periodically.

Treasury management consultants

- 17 The Council uses Link Asset Services, Treasury Solutions (formerly known as Capita Asset Services, Treasury Solutions) as its external treasury management advisors.
- 18 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.
- 19 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.

The Capital Prudential Indicators 2018/19 - 2020/21

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

Capital Expenditure

- 21 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. Members are asked to note the capital expenditure forecasts:

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Capital Expenditure	15,372	9,432	35,595	1,566	1,452

- 22 Other long term liabilities. The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.
- 23 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Capital Expenditure	15,372	9,432	35,595	1,566	1,452
Financed by:					
Capital receipts	630	4,186	7,039	128	0
Capital grants	0	675	889	889	889

Capital reserves	9,430	645	25,746	549	563
Revenue - contribution to capital reserve	0	0	561	0	0
Net financing need for the year	5,312	3,926	1,360	0	0

The Council's Borrowing Need (the Capital Financing Requirement)

- 24 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 indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 25 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 asset's life, and so charges the economic consumption of capital assets as they are used.
- 26 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 by the lease provider and so the Council is not required to separately borrow for these schemes.
- 27 The Council is asked to note the CFR projections below:

	2016/17 Actual £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Capital Financing Requirement					
Total CFR	5,392	9,085	10,062	9,641	9,239
Movement in CFR	(21)	(233)	(382)	(422)	(402)

Movement in CFR represented by:					
Net financing need for the year (above)	5,312	3,926	1,360	0	0

<u>Less</u> MRP/VRP and other financing movements	(5,291)	(3,693)	(978)	(422)	(402)
Movement in CFR	(21)	(233)	(382)	(422)	(402)

Note:- The MRP / VRP includes finance lease annual principal payments

Core Funds and Expected Investment Balances

28 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an on-going impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
Fund balances / reserves	23,914	17,974	18,922	19,345	20,360
Capital receipts	143	276	5,660	11,110	10
Provisions	409	409	409	409	409
Other	0	0	0	0	0
Total core funds	24,466	18,659	24,991	30,864	20,779
Working capital*	10,814	10,914	11,014	11,114	11,214
Under/over borrowing	(4,561)	(3,004)	(3,981)	(3,560)	(3,158)
Expected investments	30,719	26,569	32,024	38,418	28,835

*Working capital balances shown are estimated year end; these may be higher mid year

The Borrowing and Repayment Strategy

29 The capital expenditure plans set out above 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 relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. 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.

Current portfolio position

- 30 The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations) against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
	£000	£000	£000	£000	£000
External debt					
Debt at 1 April	0	0	5,250	5,250	5,250
Expected change in Debt	0	5,250	0	0	0
Other long-term liabilities (OLTL)	702	831	831	831	831
Expected change in OLTL	129	0	0	0	0
Actual gross debt at 31 March	831	6,081	6,081	6,081	6,081
The Capital Financing Requirement (CFR)	5,392	9,085	10,062	9,641	9,239
Under / (over) borrowing	4,561	3,004	3,981	3,560	3,158

Borrowing Strategy

- 31 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement or CFR)

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 considered a prudent one as investment returns are low and counterparty risk is relatively high.

- 32 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Chief Finance Officer 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.*
- 33 Any decisions will be reported to the appropriate decision making body at the next available opportunity.
- 34 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 35 The Chief Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: Limits to Borrowing Activity

The operational boundary

- 36 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
Debt	10,000	30,000	30,000	30,000
Other long term liabilities	831	831	831	831
Total	10,831	30,831	30,831	30,831

The authorised limit for external debt

- 37 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.
- 38 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.
- 39 The Council is asked to note the following Authorised Limit:

Authorised limit	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Debt	10,000	35,000	35,000	35,000
Other long term liabilities	831	831	831	831
Total	10,831	35,831	35,831	35,831

Prospects for interest rates

- 40 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.

	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	Mar-21
Bank Rate	0.50%	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	1.50%	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 View	2.10%	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 View	2.80%	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	2.50%	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%

- 41 Appendix A draws together a number of current City forecasts for short term and longer fixed interest rates. Appendix B contains Link Asset Services' latest economic background report.

Policy on borrowing in advance of need

- 42 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.
- 43 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Debt rescheduling

- 44 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).
- 45 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;
 - enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 46 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.
- 47 All rescheduling will be reported to Cabinet at the earliest meeting following its action.

Municipal Bonds Agency

- 48 It is possible that the Municipal Bonds Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

Minimum Revenue Provision (MRP) Policy Statement

- 49 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).
- 50 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:
- 51 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be based on CFR.
- 52 This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- 53 From 1 April 2008 for all unsupported borrowing (including PFI and finance leases), the MRP policy will be either:
- Asset life method - MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction); or
 - Depreciation method - MRP will follow standard depreciation accounting procedures.

These options provide for a reduction in the borrowing need over approximately the asset's life. Repayments included in annual PFI or finance leases are applied as MRP.

- 54 It is proposed to use the 'Asset life method' in the calculation of the Council's MRP. In choosing to do so, there are two options available:
- Equal instalments - where the principal repayment made is the same in each year; or
 - Annuity - where the principal repayments increase over the life of the asset.

- 55 Of the two options, the annuity method seems to be the most suitable for the Council at this time, particularly for assets that generate income. It matches the repayment profile to how the benefits of the asset financed by borrowing are consumed over its useful life (i.e. it reflects the fact that asset deterioration is slower in the early years of an asset and accelerates towards the latter years). Interest will be greater at the beginning of the loan, at which time all of the principal is outstanding, so the amount of principal repayment is lower in the initial years. The schedule of charges produced by the annuity method results in a consistent charge of principal and interest over an asset’s life, taking into account the real value of the annual charges when they fall due.
- 56 MRP commences in the financial year following that in which the expenditure is incurred, or in the year following that in which the relevant asset becomes operational. This enables an MRP “holiday” to be taken in relation to assets which take more than one year to be completed before they become operational.

Affordability prudential indicators

- 57 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. Members are asked to note the following indicators:

Ratio of financing costs to net revenue stream

- 58 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.

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
Ratio (%)	(2%)	0%	1%	0%	0%

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

Treasury indicators for debt

- 59 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 and/or 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.

60 Members are asked to note the following treasury indicators and limits:

	2018/19	2019/20	2020/21
	%	%	%
Interest rate exposures			
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100	100	100
Limits on variable interest rates based on net debt	50	50	50
Maturity structure of fixed interest rate borrowing 2018/19			
		Lower	Upper
Under 12 months		0	100
12 months to 2 years		0	100
2 years to 5 years		0	100
5 years to 10 years		0	100
10 years and above		0	100
Maturity structure of variable interest rate borrowing 2018/19			
		Lower	Upper

Under 12 months	0	100
12 months to 2 years	0	100
2 years to 5 years	0	100
5 years to 10 years	0	100
10 years and above	0	100

Annual Investment Strategy

Current investment portfolio position

- 61 The Council's treasury portfolio position at 31 December 2017 appears in Appendix C.

Loans to other organisations

- 62 The Council has loaned money to other organisations. Details appear in Appendix C. A further loan has been agreed of £600,000 to Sevenoaks Leisure Limited at 6% p.a. payable in tranches during the latter part of 2017/18.

Investment policy

- 63 The Council's investment policy has regard to the Department of Communities and Local Government (CLG) Guidance on Local Government Investments ("the Guidance") and the 2011 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, then return.
- 64 In accordance with the above guidance from the CLG 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.
- 65 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 this end the Council will engage with its advisors to maintain a monitor on market

pricing such as “credit default swaps” (CDS) and overlay that information on top of the credit ratings.

- 66 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.
- 67 Investment instruments identified for use in the financial year are listed in Appendix D under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set below.

Creditworthiness policy

- 68 Following a review of counterparties and limits, as agreed with the Portfolio Holder, rather than using the Link Asset Services colour coded creditworthiness service, the policy is now based on credit ratings and our own view of suitable creditworthy counterparties.
- 69 The primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
 - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.
- 70 The Chief Finance Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.
- 71 Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum

Council criteria will be suspended from use, with all others being reviewed in light of market conditions

- 72 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:
- Banks 1 (Good credit quality). UK banks having, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where rated):
 - i. Short Term - F1
 - ii. Long Term - A-
 - Banks 2 (Good credit quality). Non-UK banks domiciled in a country which has a minimum sovereign Long Term rating of AA- and having, as a minimum, the following Fitch, Moody's and Standard & Poor's credit ratings (where appropriate):
 - i. Short Term - F1
 - ii. Long Term - A-
 - Banks 3 (Part nationalised UK Bank - Royal Bank of Scotland). This bank can be included provided it continues to be part nationalised or it meets the rating requirements in Banks 1 above.
 - Banks 4 (The Council's own banker for transactional purposes, if it falls below the above criteria). Balances will be minimised in both monetary size and time invested.
 - Bank subsidiary and treasury operation. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
 - Building societies. The Council will use all societies which:
 - i. Meet the ratings for banks outlined above; or
 - ii. Have assets in excess of £3bn;or meet both criteria.
 - Money Market Funds (MMFs). Minimum AAA credit rating from at least two of the three rating agencies and with a fund size in excess of £1bn. New EU regulations to be implemented in 2018/19 will change fund valuation methodology from Constant Net Asset Valuation (CNAV) to either Low Volatility Net Asset Valuation (LVNAV) or CNAV. As a consequence, the Council approves the use of Money Market Funds that operate under CNAV (those that invest exclusively in government securities) or operate under LVNAV (all other liquidity funds)
 - UK Government (including gilts, Treasury Bills and the DMADF)
 - Local authorities, parish councils etc.

- 73 A limit of 50% will be applied to the use of non-specified investments.
- 74 Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.
- 75 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating (or equivalent)	Money and/or % Limit	Time Limit
Banks 1	A-	£7m	2 years
Banks 2	A-	£5m	2 years
Banks 3	N/A	£7m	2 years
Banks 4	N/A	£7m	1 day
Bank subsidiaries	A-	£7m	2 years
Rated building societies (assets over £3bn)	N/A	£5m	2 years
Unrated building societies (assets over £3bn)	N/A	£3m	1 year
UK Government DMADF	UK sovereign rating	£5m	6 months
Local authorities	N/A	£5m (each)	2 years
Money Market Funds (CNAV)	AAA	£5m (per Fund)	Liquid
Money Market Funds (LVNAV)	AAA	£5m (per Fund)	Liquid

- 76 The proposed criteria for specified and non-specified investments are shown in Appendix D.

- 77 Due care will be taken to consider the country, group and sector exposure of the Council's investments.
- 78 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- 79 In addition:
- no more than 15% of the total fund will be placed with any non-UK country at any time. The only country, other than the UK, currently approved for investment is Sweden;
 - total investment in any single institution, or institutions within a group of companies, is limited to 25% of the total fund at the time an investment is placed;

Investment Strategy

- 80 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).
- 81 Bank Rate is forecast to stay flat at 0.50% 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%
- 82 The suggested budgeted investment earnings rates for returns on investments, placed for periods up to about 3 months, during each financial year are as follows:
- 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%

- 83 The overall balance of risks to these forecasts is currently skewed 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.
- 84 Members are asked to note the following treasury indicator and limit. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for an early sale of an investment. They are based on the availability of funds after each year-end.

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

- 85 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.

Investment risk benchmarking

- 86 The Council will use an investment benchmark to assess the performance of its portfolio. The benchmarks will be 7 day and 3 month LIBID uncompounded.

End of year investment report

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

Scheme of delegation

- 88 The guidance notes accompanying the revised Code also require that a statement of the Council’s scheme of delegation in relation to treasury management is produced as part of the Annual Investment Strategy. This appears at Appendix F.

Role of the Section 151 officer

- 89 As with the scheme of delegation mentioned in the previous paragraph, a statement of the role of the Section 151 officer is also required. This appears at Appendix G.

Key Implications

Financial

The management of the Council's investment portfolio and cash-flow generated balances plays an important part in the financial planning of the authority. The security of its capital and liquidity of its investments is of paramount importance.

Legal Implications and Risk Assessment Statement

Under Section 151 of the Local Government Act 1972, the Section 151 Officer has statutory duties in relation to the financial administration and stewardship of the authority, including securing effective arrangements for treasury management.

This treasury management strategy report fulfils the requirements of The Chartered Institute of Public Finance & Accountancy's Code of Practice on Treasury Management 2009 plus the 2011 update. The 2017 revised Code was published in December 2017 and any changes to ensure compliance will be put in place at the earliest available opportunity.

Treasury management has two main risks:

- Fluctuations in interest rates can result in a reduction in income from investments; and
- A counterparty to which the Council has lent money fails to repay the loan at the required time.

Consideration of risk is integral in our approach to treasury management.

The movement in previous years towards having a restricted lending list of better quality institutions but higher individual limits with those institutions has reduced the chances of a default. But if a default did occur, the potential loss would be greater.

These risks are mitigated by the annual investment strategy which has been prepared on the basis of achieving the optimum return on investments commensurate with proper levels of security and liquidity. However, Members should recognise that in the current economic climate, these remain significant risks and that the strategy needs to be constantly monitored.

Equality Assessment

The decisions recommended through this paper have a remote or low relevance to the substance of the Equality Act. There is no perceived impact on end users.

Conclusions

The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances.

In line with the revised CIPFA Code of Practice on Treasury Management, the Annual Treasury Strategy Statement must be considered by Council and this is planned for its meeting on 20 February 2018. Given the current uncertainties in the banking sector and financial markets, the Council may need to consider amending its strategy during the year.

Appendices:

- Appendix A - Prospects for interest rates
- Appendix B - Economic background report
- Appendix C - Investment portfolio at 31 December 2017
- Appendix D - Specified and non-specified investments
- Appendix E - Approved countries for investments
- Appendix F - Treasury management scheme of delegation
- Appendix G - The treasury management role of the S151 officer

Background Papers:

None

**Adrian Rowbotham
Chief Finance Officer**