

## **REDDITCH BOROUGH COUNCIL**

**AUDIT, STANDARDS & GOVERNANCE COMMITTEE 1<sup>st</sup> February 2018**

### **TREASURY MANAGEMENT STRATEGY 2018/19**

Relevant Portfolio Holder	Councillor John Fisher
Portfolio Holder Consulted	-
Relevant Head of Service	Jayne Pickering
Wards Affected	All
Ward Councillor Consulted	None specific
Non-Key Decision	

#### **1. SUMMARY OF PROPOSALS**

Members are asked to approve the strategy statement for treasury management and investments in order to comply with the Local Government Act 2003.

#### **2. RECOMMENDATIONS**

The Committee is asked to **RECOMMEND** that

- 1) the Strategy and Prudential Indicators at Appendix 1 to the report be approved; and
- 2) the Treasury Management Policy at Appendix 2 to the report be approved.

#### **3. KEY ISSUES**

##### **Financial Implications**

3.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public services (the CIPFA TM Code) and the Prudential Code require local authorities to set the Treasury Management Strategy Statement (TMSS) and Prudential Indicators each financial year. The TMSS also incorporates the Investment Strategy as required under the CLG's Investment Guidance.

3.2 CIPFA has defined Treasury Management as:

*"the management of the organisation's investments, 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."*

- 3.3 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Treasury management risks are identified in the Council's approved Treasury Management Practices and include:
- Liquidity Risk (Adequate cash resources)
  - Market or Interest Rate Risk (Fluctuations in the value of investments)
  - Inflation Risks (Exposure to inflation)
  - Credit and Counterparty Risk (Security of Investments)
  - Refinancing Risks (Impact of debt maturing in future years)
  - Legal & Regulatory Risk (Compliance with statutory and regulatory requirements)
- 3.4 In addition, the Local Government Act 2003 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'.
- 3.5 The revised CLG guidance issued in November 2011 makes it clear that investment priorities should be security and liquidity, rather than yield and that authorities should not rely just on credit ratings, but consider other information on risk.
- 3.6 The guidance requires investment strategies to comment on the use of treasury management consultants and on the investment of money borrowed in advance of spending needs.
- 3.7 In formulating the Treasury Management Strategy and the setting of the Prudential Indicators, the Council adopts the Treasury Management Framework and Policy recommended by CIPFA.

#### **Legal Implications**

- 3.8 This is a statutory report under the Local Government Act 2003.

#### **Service/Operational Implications**

- 3.9 None as a direct result of this report.

#### **Customer / Equalities and Diversity Implications**

- 3.7 None as a direct result of this report.

#### **4. RISK MANAGEMENT**

Failure to manage the Treasury Management function effectively to ensure the delivery of maximum return within a secure environment. Controls in place to mitigate these risks are as follows:

- Regular monitoring of the status of the organisations we invest with
- Daily monitoring by internal officers of banking arrangements and cash flow implications.

### **AUTHOR OF REPORT**

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# Appendix 1

## Treasury Management Strategy Statement 2018/19

### Redditch Borough Council

#### Introduction

On the 17<sup>th</sup> March 2010, the Authority 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 Authority to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017, but as yet have not published a revised Code.

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year. A copy of the Authority's Treasury Management Policy Statement is attached in Appendix 2.

The purpose of this Treasury Management Strategy Statement (TMSS) is, therefore, to approve:

- Treasury Management Strategy for 2018/19
- Annual Investment Strategy for 2018/19
- Prudential Indicators for 2018/19, 2019/20 and 2020/21
- MRP Statement

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

The Authority has borrowed substantial sums of money, primarily for the HRA subsidy settlement in 2012, and from time to time has surplus operational cash balances and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

**Revised strategy:** In accordance with the CLG Guidance, the Authority will be asked to approve a revised TMSS should the assumptions on which this report is based change significantly. Examples of which could include a large unexpected change in; interest rates, in the Authority's capital programme or in the level of its investment balance.

#### External Context

**Economic background:** The major external influence on the Authority'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 weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

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 confidence in the Eurozone economy.

**Credit outlook:** High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

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 ringfence 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.

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

**Interest rate forecast:** The Authority's treasury adviser Arlingclose's central case is for the UK Bank Rate to remain at 0.5% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to not rise significantly above current levels.

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. The risks to Arlingclose's 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.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.35%, and that new long-term loans will be borrowed at an average rate of 3.5%.

## **Local Context**

On 31st December 2017, the Authority held £104m in long-term debt, £1m in short-term borrowing and £1m in short-term investments. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

**Table 1: Balance sheet summary and forecast**

	<b>31.3.17 Actual £m</b>	<b>31.3.18 Estimate £m</b>	<b>31.3.19 Forecast £m</b>	<b>31.3.20 Forecast £m</b>	<b>31.3.21 Forecast £m</b>
General Fund CFR	15.8	17.4	18.1	17.8	18.8
HRA CFR	122.2	122.2	122.2	122.2	122.2
<b>Total CFR</b>	<b>138.0</b>	<b>139.6</b>	<b>140.3</b>	<b>140.0</b>	<b>141.0</b>
Less: External borrowing *	-106.9	-103.9	-103.9	-103.9	-103.9
<b>Internal (over) borrowing</b>	<b>31.1</b>	<b>35.7</b>	<b>36.4</b>	<b>36.1</b>	<b>37.1</b>
Less: Usable reserves	-30.2	-29.7	-29.0	-28.3	-27.6
Less: Working capital	-0.8	-0.9	-0.9	-0.9	-0.9
<b>Investments (or New borrowing requirement)</b>	<b>(0.9)</b>	<b>(6.0)</b>	<b>(7.4)</b>	<b>(7.8)</b>	<b>(9.5)</b>

\* Includes £98.9m borrowing undertaken in March 2012 for the HRA subsidy reform settlement. This row only profiles external borrowing to which the Authority is already committed to and excludes new borrowing/refinancing.

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 Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has an increasing CFR due to the capital programme, but minimal investments and will therefore be required to borrow up to £9.5m over the forecast period.

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

### **Borrowing Strategy**

On 31<sup>st</sup> December 2017, the Authority held £1m in short-term borrowing and £104m in long-term borrowing; the level of long-term borrowing is unchanged from 31<sup>st</sup> March 2017.

The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £7.4m by the end of 2018/19. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £150 million.

**Objectives:** The Authority's chief 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 Authority's long-term

plans change is a secondary objective. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;
- Borrowing source and flexibility

**Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregoing investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose Ltd will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may 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 without suffering a cost of carry in the intervening period.

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

**Sources of borrowing:** 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 in Table 2)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Worcestershire County Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates but without compromising flexibility.

**Short-term and variable rate loans:** These loans leave the Authority 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:** The PWLB allows authorities to repay loans before maturity and either pay a premium (i.e. an amount over and above the principal outstanding) or receive a discount according to a set formula based on current interest rates. The Authority 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.

The Authority's PWLB loans were borrowed at a one-off preferential rate for HRA self-financing settlement. As at 2<sup>nd</sup> January 2018, a premium would be incurred if the Authority were to prematurely repay any loan in its portfolio.

### Investment Strategy

In the past 12 months, the Authority's investment balance has ranged between nil and £5 million; higher levels are expected in the forthcoming year.

**Objectives:** Both the CIPFA Code and the CLG Guidance require the Authority 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 Authority'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.

**Negative interest rates:** If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

**Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding asset classes during 2018/19. All of the Authority's surplus cash is currently invested in call accounts or term deposits with banks and building societies which, by their nature, are unsecured.

The Authority will also consider investment of surplus monies in pooled Money Market Funds which provide much greater diversification of credit risk as well as high liquidity (same day access to the investment).

**Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 2 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	Government	Corporates
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a
AAA	£2m 5 years	£2m 20 years	£2m 50 years	£2m 5 years
AA+	£2m 5 years	£2m 10 years	£2m 25 years	£2m 5 years
AA	£2m 4 years	£2m 5 years	£2m 15 years	£2m 5 years
AA-	£2m 3 years	£2m 4 years	£2 m 10 years	£2m 3 years
A+	£2m	£2m	£2m	£2m



	2 years	3 years	5 years	2 years
A	£2m 13 months	£2m 2 years	£2m 5 years	£2m 2 years
A-	£2m 6 months	£2m 13 months	£2 m 5 years	£2m 13 months
None	£0.5m 6 months	n/a	£3m 25 years	£500k 1 year
<b>Pooled funds</b>	£2m per fund			

**Credit rating:** 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. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development 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. See below for arrangements relating to operational bank accounts.

**Banks secured:** 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:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

**Corporates:** 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 following an external credit assessment as part of a diversified pool in order to spread the risk widely.

**Pooled funds:** Shares in diversified investment vehicles consisting of the 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.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

**Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, 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.

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:** The Authority 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.

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 Authority 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 Authority'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:** 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 authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. 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:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority 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 table 3 below.

Table 3: Non-specified investment limits

	Cash limit
Total long-term investments	£1.5m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£0.5m
Total non-specified investments	£2m

**Investment limits:** The Authority’s revenue reserves available to cover investment losses are forecast to be £29.7 million on 31st March 2018. In order that no more than 13.5% 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 £4 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 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.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£2m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£2m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker’s nominee account	£5m per broker
Unsecured investments with building societies	£2m in total
Money Market Funds	£11m in total

**Liquidity management:** The Authority uses purpose-built cash flow forecasting tools to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium term financial plan and cash flow forecast.

### Non-Treasury Investments

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

Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

The Authority's existing non-treasury investments are listed in Appendix B.

### Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. 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. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit score	<i>6.0 which is equivalent to a credit rating of A</i>

**Liquidity:** The Authority 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	£3m

**Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

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.

**Maturity structure of borrowing:** This indicator is set to control the Authority'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	15%*	0%
12 months and within 24 months	15%	0%
24 months and within 5 years	35%	0%
5 years and within 10 years	100%	0%
10 years and above	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.

**Principal sums invested for periods longer than 364 days:** The purpose of this indicator is to control the Authority'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	£1.5m	£1.5m	£1.5m

### Other Items

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

**Policy on the use of financial derivatives:** Local authorities 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).

The Authority 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 Authority 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.

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.

**Policy on apportioning interest to the HRA:** On 1st April 2012, the existing long-term loans were notionally moved into the HRA pool. In the future, any new long-term loans will be assigned in their entirety to the relevant pool, whether it be General Fund or HRA and interest and costs charged/credited to the respective revenue account. The General Fund uses surplus HRA funds as a means of internal borrowing. Interest is calculated using the Authority's average rate on investments and transferred to the HRA from the General Fund.

**Investment training:** The needs of the Authority's treasury management staff for training in investment management are assessed every three months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

**Investment advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

**Investment of money borrowed in advance of need:** The Authority 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 Authority 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 Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £150 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

### Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. It is considered 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
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## Prudential Indicators 2018/19 - 2020/21

**Background:** There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. The objectives of the Prudential Code are to ensure that the capital investment plans are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

**Estimates of Capital Expenditure:** The Authority's planned capital expenditure and financing may be summarised as follows. Further detail is provided in the Budget report.

Capital Expenditure and Financing	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Forecast £m
General Fund	3.2	4.7	2.6
HRA	9.0	10.7	6.0
<b>Total Expenditure</b>	<b>12.2</b>	<b>15.4</b>	<b>8.6</b>
Capital Receipts	2.1	0.3	0.6
Government Grants	0.8	1.2	0.1
Reserves	6.1	9.3	4.6
Revenue	1.2	1.2	0.8
Borrowing	2.0	3.4	2.5
<b>Total Financing</b>	<b>12.2</b>	<b>15.4</b>	<b>8.6</b>

**Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

	31.3.17 Actual £m	31.3.18 Estimate £m	31.3.19 Forecast £m	31.3.20 Forecast £m	31.3.21 Forecast £m
General Fund CFR	15.8	17.4	18.1	17.8	18.8
HRA CFR	122.2	122.2	122.2	122.2	122.2
<b>Total CFR</b>	<b>138.0</b>	<b>139.6</b>	<b>140.3</b>	<b>140.0</b>	<b>141.0</b>

**Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	31.3.17 Revised £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m
Borrowing	125.4	131.4	132.8	133.2
<b>Total Debt</b>	<b>125.4</b>	<b>131.4</b>	<b>132.8</b>	<b>133.2</b>

Total debt is expected to remain below the CFR during the forecast period.

**Actual External Debt:** This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2017	31.3.17 Actual £m
Borrowing	106.9
Other Long-term Liabilities	0
<b>Total</b>	<b>106.9</b>

**Authorised Limit and Operational Boundary for External Debt:** The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). This limit includes all HRA debt, including that borrowing taken for HRA self-financing in 2012.



<b>Authorised Limit for External Debt</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
Borrowing	150,000	150,000	150,000
Other Long-term Liabilities	0	0	0
<b>Total</b>	<b>150,000</b>	<b>150,000</b>	<b>150,000</b>

The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

The Executive Director of Finance and Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of Executive.

<b>Operational Boundary for External Debt</b>	<b>2018/19 Estimate £'000</b>	<b>2019/20 Estimate £'000</b>	<b>2020/21 Estimate £'000</b>
Borrowing	140,000	140,000	140,000
Other Long-term Liabilities	0	0	0
<b>Total</b>	<b>140,000</b>	<b>140,000</b>	<b>140,000</b>

**Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the net revenue budget required to meet financing costs, net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2017/18 Estimate %</b>	<b>2018/19 Estimate %</b>
General Fund	16.5	21.0
HRA	11.6	11.9

**Adoption of the CIPFA Code of Practice:** The indicator below demonstrates that the Council has adopted the principles of best practice.

<b>Adoption of the CIPFA Code of Practice in Treasury Management</b>
The Council approved the adoption of the CIPFA Treasury Management Code at its meeting on 18 <sup>th</sup> May 2005 and updated 2011 Treasury Management Code on 15 <sup>th</sup> January 2017

The Council has incorporated the changes from the revised 2011 CIPFA Code of Practice into its treasury policies, procedures and practices.

## Appendix A - Arlingclose Economic & Interest Rate Forecast November 2017

### 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 at 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.

### Forecast:

- 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.

	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
<b>Official Bank Rate</b>														
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
<b>3-month LIBID rate</b>														
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
<b>1-yr LIBID rate</b>														
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	-0.30	-0.15	-0.26
<b>5-yr gilt yield</b>														
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
<b>10-yr gilt yield</b>														
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
<b>20-yr gilt yield</b>														
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
<b>50-yr gilt yield</b>														
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

## Appendix B - Existing Investment & Debt Portfolio Position

	31.12.17 Actual Portfolio £m	31.12.17 Average Rate %
<b>External borrowing:</b>		
Public Works Loan Board	98.9	3.31
Local authorities	1.0	0.45
Other loans	5.0	4.71
<b>Total external borrowing</b>	<b>104.9</b>	<b>3.07</b>
<b>Treasury investments:</b>		
Government (incl. local authorities)	1.0	0.1

## Appendix 2

# TREASURY MANAGEMENT POLICY STATEMENT

### 1. INTRODUCTION AND BACKGROUND

- 1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.
- 1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-
  - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.
- 1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Executive and for the execution and administration of treasury management decisions to Executive Director of Finance and Resources, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
- 1.5 The Council nominates Executive to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policies.

### 2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

- 2.1 The Council defines its treasury management activities as:

"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."

- 2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will

focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

- 2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.”
- 2.4 The Council’s borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk.
- 2.5 The Council’s primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority’s investments followed by the yield earned on investments remain important but are secondary considerations.