Rother District Council **Agenda Item: 7.3**

Report to	-	Cabinet
Date	-	12 February 2018
Report of the	-	Executive Director of Resources
Subject	-	Treasury Management Strategy Statement and Annual Investment Strategy

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Recommendation to COUNCIL: That:

1) the Council adopt both the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition and the Prudential Code for Capital Finance in Local Authorities – 2017 Edition;

2) the revised Treasury Management Practices as set out in Appendix B (8) be approved;

3) the Treasury Management Strategy as set out at Appendix A be approved;

4) the Annual Investment Strategy as set out at Appendix B be approved;

5) the Minimum Revenue Provision Policy Statement 2018/19 be approved; and

6) the Prudential and Treasury Indicators as set out in Appendix A be approved.

7) That the authorised limits in this report be approved.

Service Manager: Robin Vennard
Lead Cabinet Member: Councillor Lord Ampthill

Introduction

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 for, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's 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. 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."

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.

   a. **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 (TMS; 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).

   b. A **Mid-Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the initial strategy or whether any policies require revision.

   c. 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.

5. **Scrutiny** – The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Cabinet and Audit and Standards Committee.

6. **Capital Strategy** – In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:

   - a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
   - an overview of how the associated risk is managed
   - the implications for future financial sustainability

   The aim of this report is to ensure that all elected Members fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

7. The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all Members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

Treasury Management Strategy for 2018/19

8. The Strategy for 2018/19 covers two main areas:

   a. **Capital issues**
      - the capital expenditure plans;
      - the prudential indicators; and
      - the minimum revenue provision (MRP) policy.

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

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

10. CIPFA have recently revised both the TM Code and Prudential Code and these were published over the 2017 Christmas period. Full adoption of these revised codes is recommended and the recommendations to this report have been drafted accordingly. Due to the timing of the issuing of these revised codes and the confusions contained within them, CIPFA have recognised that the requirements “may not be able to be fully implemented until 2019/20 financial year” but recommend “that the requirements of both Codes are implemented as soon as possible”. Officers have prepared this report based on their understanding of this new guidance. However, Members need to be made aware that there could be further amendments during the next six months as solutions to some of the requirements are fully understood.

11. The Ministry of Housing, Communities and Local Government (MHCLG) have also revised their Investment Guidance (last revised in March 2010) and the MRP Guidance (last revised in 2012). The 2010 Guidance was very focussed on investments in financial institutions, and now authorities are increasingly investing in non-financial assets, they need to be brought in the scope of the Guidance. The Guidance retains the requirement for an Investment Strategy to be prepared at least annually and approved by Full Council.

12. Key changes to the MHCLG guidance are expected to be:

    - Increased transparency and democratic accountability;
    - Disclosure of the contribution that investment activities make to the Council’s core funds (e.g. how much reliance on investment property income);
    - Additional indicators to assess total risk exposure;
    - The extension of the Security, Liquidity and Yield principle to non-financial investments;

- The introduction of proportionality to avoid over-reliance on any one income source;
- Changes to guidance for MRP; and
- Introduction of a maximum economic life of assets for MRP purposes.

13. All the above proposals have been discussed and/or incorporated in this report and the appropriate Council Strategies to which they relate.

14. The Capital and Prudential indicators are set out in Appendix A.

Training

15. The CIPFA Code requires that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutinising the application of the strategy. A training session on the 5 July 2017 by Link Asset Services (formerly Capita Asset Services) was provided, and further training will be arranged as required.

16. The training needs of treasury management officers are periodically reviewed.

Treasury Management Consultants

17. The Council uses Link 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.

Future Capital Investment Plans

20. Members will be aware through the report to Overview and Scrutiny Committee (Minute OSC17/28 refers) in October 2017 that as part of the Rother 2020 programme a specific target of delivering an additional £900,000 of income annually has been agreed. This will mostly be delivered through Rother's Property Investment Strategy. The Council's focus will be on the acquisition of property both within and possibly outside the District with a view to meeting two main needs; stimulating economic activity for the benefit of residents and generating income to support the revenue budget. This means that any investment made must be assessed as making a positive return to be affordable. Initially the investment strategy adopted by Cabinet considered searching for and acquiring commercial industrial and residential property within a maximum 90 minutes driving distance of Bexhill as this is seen as a reasonable travel to work catchment area. This was seen as necessary to increase the size of the pool of available properties and create a more diverse portfolio of localities and commercial sectors. However, recent advice suggests we move away from this approach and initially only seek to acquire within our own boundary or immediately adjacent to.

21. Recent changes to investment regulations mean that it is expected that most of the property investment will be funded by borrowing which is expected to peak at approximately £35m by 2021. In Appendix B it is explained the Council needs to maintain £10m cash balances to be MIFID II compliant thereby retaining professional investor status. Without this status, the Council would be treated as a retail investor and would lose access to the majority of financial investment instruments currently used. Estimated cash balances at Appendix A paragraph 10 shows that core cash funds drop to £12.266m in 20/21. Consequently if £7m of cash resources are released for property investment then balances would fall below £10m and the Council could not maintain compliance with MIFID II.

Expected Investment Returns 2018/19

22. As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

23. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. From time to time, gilt yields – and therefore PWLB rates – can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

24. Overall returns for the treasury activity in 2018/19 for the Council are expected to generated £362,083, with £245,000 from Property Funds and £17,083 from the UK Gilt and £100,000 from cash deposits.

Conclusion

25. There were many consultations out at the end of 2017, the CIPFA Treasury Management and Prudential codes, IFRS9 and the CLG Minimum Revenue Provision (MRP) Guidance and Investment Guidance.

26. Whilst there are a number of contradictions and inconsistencies in the various proposals, the common theme seems to be to address the perceived issues of non-treasury investments being carried out by local authorities i.e. commercial property purchases.

27. CIPFA have concluded their review of the Treasury Management (TM) Code of Practice and the Prudential Code these were published after Christmas 2017. CIPFA have indicated that these codes will be effective for the 2018/19 financial year. However, they "recognise that the requirement included in the Prudential Code to produce a Capital Strategy may require a longer lead-in period. Therefore the CIPFA Treasury and Capital Management Panel recognise that this requirement may not be able to be fully implemented until 2019/20 financial year. They do however recommend that the requirements of both Codes are implemented as soon as possible".

28. These changes to the regulations have an effect on the Council's TMPs (Treasury Management Practices). These have therefore been amended in accordance with the changes set out in this report and are set out in Appendix 8 for approval.

29. Aside from the raft of new guidance, we remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. As a consequence, authorities are not getting much of a return from deposits.

30. The strategies proposed in this report, together with the interest rates forecast, are in line with the assumptions made when preparing the 2018/19 Revenue Budget. The costs of treasury operations are contained within the 2018/19 draft Revenue Budget reported elsewhere on this agenda.

Malcolm Johnston
Executive Director of Resources

Risk Assessment Statement
Failure to produce a Treasury Management Strategy Statement would mean that the Council would not be complying with the CIPFA Treasury Management and Prudential Codes of Practice and may, therefore, be at risk of making inappropriate investments – leading to a potential major loss of resources – or setting capital expenditure targets that would not be affordable for the Council.

THE ANNUAL TREASURY MANAGEMENT STRATEGY

Capital Prudential Indicators 2018/19 – 2020/21

1. The Council's Prudential Indicators include capital expenditure plans, capital financing requirement and indicators of affordability.

2. 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 the prudence, sustainability and affordability of capital expenditure plans.

Capital Expenditure

3. The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need.

4. There are a number of projects contained in the Corporate Plan that have no funding identified. The current policy is that schemes that are unfunded will not be released until funding is agreed. For this reason, at the time of writing this report, no shortfall of funding is shown.

Capital Expenditure £m	**2016/17** **Actual** **£'000**	**2017/18** **Estimate** **£'000**	**2018/19** **Estimate** **£'000**	**2019/20** **Estimate** **£'000**	**2020/21** **Estimate** **£'000**
Total Capital Expenditure	2,619	2,276	10,262	10,143	20,130
Financed by:					
Capital receipts	30	0	3,057	0	0
Capital grants	2589	1,376	0	0	0
Revenue	0	900	2,360	143	130
Net financing need for the year	**Nil**	**0**	**4,845**	**10,000**	**20,000**

Council's Borrowing Need (the Capital Financing Requirement)

5. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

6. 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.

7. The CFR opening balance of £1.091 million represents an "Item A" adjustment dating back to 2004: this is the agreed historic amount on which it is not necessary to provide the annual Minimum Revenue Provision (MRP) for repayment of debt. MRP would be payable for any capital expenditure financed from loan in the future.

8. The CFR also includes "other long term liabilities" (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently does not have any "other long-term liabilities" within its CFR.

9. The Council's CFR projections are shown in the table below:

£m	**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	1,091	1,091	5,937	15,937	35,816
Movement in CFR		0	4,845	9,879	19,129

Movement in CFR represented by					
Net financing need for the year (above)	Nil	0	4,845	10,000	20,000
Less MRP/VRP and other financing movements	Nil	0	0	121	871
Movement in CFR	Nil	0	4,845	9,879	19,129

MRP has been calculated on the straight line asset life basis for the purposes of this report.

Core funds and expected investment balances

10. 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 (e.g. capital receipts from 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 Actual £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Fund balances / reserves	16,032	16,332	13,660	12,675	11,865
Capital receipts	2,950	3,050	1,128	65	65
Other	1,022	946	946	336	336
Total core funds	**20,004**	**20,328**	**15,734**	**13,076**	**12,266**
Working capital*	2,159	2,159	2,159	2,159	2,159
Under/over borrowing	Nil	Nil	Nil	Nil	Nil
Expected investments	**22,163**	**22,487**	**17,893**	**15,235**	**14,425**

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

Borrowing

11. The capital expenditure plans set out earlier 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 programme. 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.

12. 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 Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£m	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
External Debt					
Debt at 1 April	-	-	-	4,845	14,845
Expected change in Debt			4,845	10,000	20,000
Other long-term liabilities (OLTL)					
Expected change in OLTL					
Actual gross debt at 31 March			**4,845**	**14,845**	**34,845**
The Capital Financing Requirement	**1,091**	**1,091**	**5,937**	**15,937**	**35,816**
Under / (over) borrowing	**1,091**	**1,091**	**1,092**	**1,092**	**971**

13. The Council's strategy for long term borrowing is as follows:

Sources of borrowing
The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board (PWLB)
- any institution approved for investments
- any other bank or building society approved by the Financial Conduct Authority
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable joint local authority bond issues.

Debt instruments
Borrowing will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest, subject to the limits in the treasury management indicator, below
- bonds

14. Any proposed borrowing will only be undertaken on a phased basis in accordance with agreed plans and requirements at that time. The borrowing of money purely to invest or lend-on to make a return is unlawful.

15. 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.

16. The Chief Finance Officer (Service Manager - Finance & Welfare) 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.

Minimum Revenue Provision (MRP) Policy Statement

17. When a Council funds capital expenditure by borrowing, the costs are charged to the Council Tax payer in future years, reflecting the long-term use of the assets. The interest on borrowing is charged in the year it is payable.

18. To reflect this, the Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement – 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).

19. The MRP exists as a charge to revenue each year in order to have sufficient monies set aside to meet the future repayment of principle on any borrowing undertaken. There is not an earmarked reserve for MRP, it is represented in the accounts as increased cash.

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20. MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. The aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is commensurate with that over which the capital expenditure provides benefits. The guidance recommends 4 options for calculating a prudent MRP as follows:

    1. Regulatory Method
    2. CFR Method
    3. Asset Life Method (repayment over the useful life of the asset on an asset life basis)
    4. Depreciation Method (cost less estimated residual value)

21. Options 1 and 2 should normally only be used for Government-supported borrowing with options 3 and 4 being used for self-financed borrowing.

22. The MHCLG consultation paper on MRP issued at the end of 2017 suggested four changes to the regulations. These relate to the definition of prudent provision, the meaning of a charge to the revenue account, the impact of changing methods of calculating MRP and the introduction of a maximum economic useful life of assets. It is this last item that has proved the most controversial.

23. Initially the proposals seemed to suggest that the maximum life of a building would be set at 40 years and land at 50 years. Since its original, seemingly hard line approach, subsequent clarifications have suggested that this is guidance which the MHCLG would expect to be followed unless there is a good need or reason to vary from the procedures.

24. The proposals do not seem to be retrospective or a requirement to change previously approved prudent policies.

25. The Council will use the asset life method as its main method for calculating MRP. In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, a MRP provision will be set aside from the date that the asset becomes operational and/or revenue income is generated.

Current Portfolio Position

26. The Council held £33 million of investments as at 31 December 2017 (£28 million at 31 December 2016) and the investment portfolio yield to 31 December 2017 is £251,826. The average rate of return is 1.15%.

Treasury Management

27. The capital expenditure plans set out earlier 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. This will involve both the management of short and long-term cashflows and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

28. One of the key changes to the Prudential and Treasury Managment Codes is the requirement to develop a Capital Strategy to link both codes. There is a requirement for this to be effective for the 2018/19 financial year. However CIPFA "recognise that the requirement included in the Prudential Code to produce a Capital Strategy may require a longer lead-in period. Therefore the CIPFA Treasury and Capital Management Panel recognise that this requirement may not be able to be fully implemented until 2019/20 financial year".

29. Therefore, the Capital Programme for 2018/19 to 2022/23 forms the basis of the information that generates the Prudential and Treasury Management Indicators.

30. In setting or revising their prudential indicators, local authorities must have regard to:

    a. Service objectives e.g. strategic planning for the authority
    b. Stewardship of assets e.g. asset management planning
    c. Value for money e.g. option appraisal
    d. Prudence and sustainability e.g. implications for external borrowing
    e. Affordability e.g. implications for Council Tax and balances
    f. Practicality e.g. achievability of the forward plan

31. To demonstrate that these objectives are being fulfilled the Prudential Code operates through the provision of prudential indicators which highlight particular aspects of capital expenditure planning. Each indicator is annually updated as part of the budget process and projected forward for the next three years. The Code requires that the Council approves as a minimum certain mandatory prudential indicators.

32. Prudential Indicators are designed to support and record local decision making. They are not performance indicators and are not comparable between authorities, all of whom will have differing policies and debt positions. In addition the indicators should not be taken individually; the benefit from monitoring will arise from following the movement in indicators and the year on year changes over time.

33. 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 purposes.

34. 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.

Affordability Prudential Indicators

35. 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. The Council is asked to approve the following indicators:

Ratio of financing costs to net revenue stream

36. 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 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund	1.04%	2.70%	1.85%	-0.44%	-9.53%

37. The estimates of financing costs include current commitments and the proposals in the Revenue Budget report.

Incremental impact of capital investment decisions on the Band D council tax

38. This local indicator identifies the revenue costs associated with proposed changes to the capital programme recommended in the Budget report compared to the Council's existing approved commitments and current plans.

%	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Council Tax- Band D	£ -	£ -	£ 0.13	£ 0.26	£ 0.49

Treasury Indicators: limits to borrowing activity

39. **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed, but it may be marginally lower or higher depending on day to day cashflow and in-year funding requirements.

Operational boundary	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Debt	22,000	24,000	32,000	51,000
Other long term liabilities	0	0	0	0
Total	**22,000**	**24,000**	**32,000**	**51,000**

40. **The authorised limit for external debt.** A further key prudential indicator, this represents a control on the maximum level of borrowing that may be undertaken in total. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It

reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

- The Council is asked to approve the following authorised limit:

Authorised limit	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000	2020/21 Estimate £'000
Debt	24,400	26,600	35,400	56,300
Other long term liabilities	0	0	0	0
Total	**24,400**	**26,600**	**35,400**	**56,300**

Prospects for Interest Rates

41. 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%

42. A more detailed interest rate view and economic commentary is at Appendix 2.

Policy on borrowing in advance of need

43. 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. 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.

ANNUAL INVESTMENT STRATEGY

1. The Council's investment policy has regard to the MHCLG Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, then return.

2. In accordance with the above guidance from the MHCLGand 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.

3. As well as the changes to the CIPFA Codes and MHCLG guidance, a further impact on the Council next year will be the full adoption of a new International Financial Reporting Standard dealing with Financial Instruments (IFRS9). One of the key impacts of IFRS 9 will be that, whilst many loans and investments will continue to be held at amortised cost, gains and losses arising from changes in the fair value of some categories of investments will have to be recognised in authorities' revenue accounts. This means that from 2018/19 changes in the value of certain investments will have a consequent impact on the General Fund. This may have an impact on the level of local authority reserves being held to manage risk.

4. At the time of writing both the MHCLG and CIPFA, whilst having some sympathy for the view that some form of statutory override might be appropriate, have only stated that they will be willing to consider representations from local authorities in this area informed by evidence.

5. The Council's current strategy allows it to invest in several classes of pooled funds that would fall under the remit of IFRS9, for example pooled bond, equity and property funds that offer enhanced returns over the longer term but are potentially more volatile over the shorter term.

6. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. The Council has invested a principal sum of £5m in the CCLA Property Fund which would be caught by this change. The net asset value of this investment was £4,913,296 as at 31 December 2017. This represent a notional (unrealised) loss of £86,704, a provision for this would need to be made in the 2017/18 accounts to mitigate the impact of IFRS9. There would be no cash loss as long as the Council did not withdraw its funds.

7. Under the European Markets in Financial Instrument Directive 2014/65 ("MiFID II") from 3 January 2018, local authorities would lose the automatic right to be categorised as professional clients. In order for the Council to be able to "opt-up" to professional status, the Council is required to state the knowledge and skills of key staff involved in the treasury decision making – this is a mandatory criterion. Financial institutions decide whether the Council can opt-up, and there is comfort in that were the Council is accepted as a

professional client, we have the required level of skills and knowledge expected by the financial institutions of key treasury staff.

8. The new regulations place an additional administrative burden on the Council and officers will need to continually review its options and advise all counterparties of any changes in the Council's circumstances. The Treasury Management Code also requires the Council to set out a list of those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client. The current list is set out at Appendix 7.

9. The Council plans to preserve cash balances at £10m which is another factor which allows the Council to elect to be a professional client for MIFID II.

10. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

11. 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.

12. Investment instruments identified for use in the financial year are listed in Appendix 3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

Creditworthiness Policy

13. This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utlilising credit ratings from the three main credit rating agencies – Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings; and
- sovereign ratings to select counterparties from only the most creditworthy countries.

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

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

	Colour	£limit or % of Fund Limit	Time Limit
Banks and Building Societies – part nationalised	Blue	30%	1 yr
Banks and Building Societies	Red	50%	6 months
Banks and Building Societies	Green	50%	100 days
Banks and Building Societies	No colour	Not to be used	N/A
Council's banker	Not applicable	Unlimited/ 100%	1 day

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

16. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

17. All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

18. In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

20. There may be occasions that the Council has invested in a counterparty that subsequently falls below the minimum ratings required. For fixed term deposits it is likely that the Council will allow the investment to mature and will not withdraw its funding unless there are extreme circumstances. In all situations the Section 151 Officer and Executive Director of Resources will take the best course of action to protect the value of the investment based on advice received from the Council's treasury advisors. This is a sensible and practical way to manage the Council's investments at a difficult economic time.

Country limits

21. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

22. The Council's available funds will be spread among different counterparties in order to minimise the risk of loss.

Investment Strategy
In-house funds

23. 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).

Investment returns expectations

24. 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%

25. The draft revenue budget includes a gross return on treasury activities of £362,000 including the return on property funds. The Investment Strategy will be reviewed and updated to take account of these decisions. Link Asset Services suggest the following returns should be achievable in subsequent financial years on investments placed for 3 months:

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

26. 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.

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

28. The Council is asked to approve the treasury indicator and limit:

Maximum principal sums invested > 364 days			
	2018/19	**2019/20**	**2020/21**
Principal sums invested > 364 days	10,000,000	10,000,000	10,000,000

29. For 2018/19, the Council has budgeted for an investment return of approximately 1.15% based on current performance.

30. For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, 15 and 30 day notice accounts, money market funds and short-dated deposits (overnight to three, six and nine months) in order to benefit from the compounding of interest.

Investment risk benchmarking

31. This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 1, 3, 6 or 12 month LIBID compounded / uncompounded.

End of year investment report

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

Policy on the use of external service providers

33. The Council uses Link Asset Services as its external treasury management advisors.

34. 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.

35. 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.

Scheme of delegation

36. Please see Appendix 5.

Role of the Section 151 Officer

37. Please see Appendix 6.

Appendices

1. Interest Rate Forecasts
2. Economic Background
3. Treasury Management Practice – Credit and Counterparty Risk
4. Approved Countries for Investments
5. Treasury Management Scheme of Delegation
6. The Treasury Management Role of the Section 151 Officer
7. Markets in Financial Instruments Directive 2014
8. Rother District Council Treasury Management Practices

Interest Rate Forecasts **Appendix 1**

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

Appendix 2

Economic Background

1. GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

2. In addition, **inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution**.

3. KEY RISKS - central bank monetary policy measures. Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

4. The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial

markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks**.

5. There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income**, which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

6. A further question that has come to the fore is whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

    - Some economists favour a shift to **a lower inflation target of 1%** to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply 'look through' tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
    - However, other economists would argue for a **shift UP in the inflation target to 3%** in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
    - In addition, there is a strong argument that central banks should **target financial market stability**. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
    - Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

7. **UK**. After the UK surprised on the upside with strong economic **growth in 2016, growth in 2017** has been disappointingly weak; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was

+0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

8. While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

9. At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

10. However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

11. It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 by **two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was because the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

12. One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

13. Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

14. **EZ**. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

15. **USA**. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

16. **CHINA**. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

17. **JAPAN**. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

Treasury Management Practice – Credit and Counterparty Risk

Specified Investments:

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

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

	Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	**100%**	**6 months**
UK Government gilts	UK sovereign rating	50%	1 year subject to guidance
UK Government Treasury bills	UK sovereign rating	20%	1 year subject to guidance
Bonds issued by multilateral development banks	AAA	20%	1 year subject to guidance
Money Market Funds CNAV	AAA	20%	Liquid
Money Market Funds LVAV	AAA	20%	Liquid
Money Market Funds VNAV	AAA	20%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	20%	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	20%	Liquid
Local authorities	N/A	50%/ £2M	12 months
UK Banks and building societies	Refer to Creditworthiness Policy	100%, Unlimited with Council's own banker, £5m limit in UK banks and building societies other than the Council's subsidiaries where is £10 m	1 year
Term deposits with banks and building societies	Refer to Creditworthiness Policy	100%, £5m limit in UK banks and building societies other than the Council's own banker. £10 m in the Council's own bank and its subsidiaries, £2m in foreign banks	1 year
CDs or corporate bonds with banks and building societies	Refer to Creditworthiness Policy	20%	1 year

Non-specified investments: – are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	**Limit (£ or %)**
a.	Supranational bonds greater than 1 year to maturity (a) Multilateral development bank bonds – these are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and Development Bank etc.). (b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, the Guaranteed Export Finance Company [GEFCO]) The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.	AAA long term ratings (or other of your choice)
b.	The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.	
c.	Certificates of deposit issued by banks and building societies. Refer to Creditworthiness Policy	£3m – 10% of fund
d.	Property funds – the use of these instruments can be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	Specific authorisation required from Members
e.	Property purchases. The criteria for any purchase of property for investment purposes will meet the following broad criteria in the approved Property Investment Strategy (PIS). Appropriate due diligence will also be undertaken before investment of this type is undertaken.	In accordance with the PIS governance arrangements

NOTE 1: The Council will seek further advice on the appropriateness and associated risks with investments in these categories.

Appendix 4

Approved Countries for Investments

Based on lowest available rating at 15.1.2018

AAA

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

AA+

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

AA

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

AA-

- Belgium
- Qatar

Treasury Management Scheme of Delegation

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities; and

- approval of annual strategy.

(ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;

- budget consideration and approval;

- approval of the division of responsibilities;

- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit and Standards Committee

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

- receiving and reviewing regular monitoring reports and acting on recommendations.

(iv) Executive Director of Resources, Executive Director of Business Operations and Service Manager - Finance and Welfare (Section 151 Officer)

- In the event that a counterparty, subsequent to an investment being made, falls below the minimum ratings required the following action is delegated to the Executive Director of Resources, Executive Director of Business Operations or in his absence the Section 151 Officer;

- Fixed term deposits – allow the investment to mature and not withdraw its funding unless advised otherwise by the Council's treasury advisors; and

- In all situations the Section 151 Officer, Executive Director of Business Operations and Executive Director of Resources will take the best course of action to protect the value of the investment based on advice received from the Council's treasury advisors.

Appendix 6

The Treasury Management Role of the Section 151 Officer

The S151 (responsible) officer duties include:

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

Appendix 7

Markets in Financial Instruments Directive 2014 (MIFID II)

As a result of the implementation of the Markets in Financial Instruments Directive (MIFID II), on the 3 January 2018, the Council put a request to some financial institutions, with which it deals, to elect up from retail to professional status. This is in order to continue to access the markets and opportunities which have been available to it in the past, including maintaining access to regulated financial services firms including banks, brokers, advisers, fund managers and custodians with who we have dealings regarding investment products.

The Council has reviewed its classification with financial institutions under MIFID II and the following is a list of those organisations with which it is registered as a professional client and those which it has an application outstanding to register as a professional client.

<u>Professional Client Status agreed</u>

CCLA
Link Asset services (Treasury advisors)

<u>Professional Client Status outstanding</u>

Lloyds bank
King and Shaxson

Appendix 8

ROTHER DISTRICT COUNCIL TREASURY MANAGEMENT PRACTICES

TMP 1	Treasury risk management
TMP 2	Performance measurement
TMP 3	Decision–making and analysis
TMP 4	Approved instruments, methods and techniques
TMP 5	Organisation, clarity and segregation of responsibilities, and dealing arrangements
TMP 6	Reporting requirements and management information arrangements
TMP 7	Budgeting, accounting and audit arrangements
TMP 8	Cash and cash flow management
TMP 9	Money laundering
TMP 10	Training and qualifications
TMP 11	Use of external service providers
TMP 12	Corporate governance

TMP1 TREASURY RISK MANAGEMENT

1. The Chief Finance Officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 Reporting Requirements and Management Information Arrangements.

2. The investment and risk management criteria for any material non-treasury investments will be set out in the Property Investment Strategy as appropriate.

3. In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out below.

Credit and Counterparty Risk Management

4. Credit and counter-party risk is the risk of failure by counterparty to meet its contractual obligations to the organisation under an investment, borrowing, capital project or partnership financing, particularly as a result of the counterparty's diminished creditworthiness, and the resulting detrimental effect on the Council's capital or current (revenue) resources.

5. This Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 Approved Instruments Methods and Techniques and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

Liquidity Risk Management

6. This is the risk that cash will not be available when it is needed, that ineffective management of liquidity creates additional unbudgeted costs, and that the organisation's business/service objectives will be thereby compromised.

7. This organisation will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

8. This organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

Interest Rate Risk Management

9. The risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

10. This organisation will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 Reporting requirements and management information arrangements.

11. It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.

Exchange Rate Risk Management

12. The risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the Council's finances, against which the organisation has failed to protect itself adequately.

13. It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

Refinancing Risk Management

14. The risk that maturing borrowings, capital, project or partnership financings cannot be refinanced on terms that reflect the provisions made by the Council for those refinancing, both capital and current (revenue), and/or that the terms are inconsistent with prevailing market conditions at the time.

15. This Council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the Council as can reasonably be achieved in the light of market conditions prevailing at the time.

16. It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

Legal and Regulatory Risk Management

17. The risk that the Council itself, or an organisation with which it is dealing in its treasury management activities, fails to act in accordance with its legal powers or regulatory requirements, and that the organisation suffers losses accordingly.

18. This Council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1[1] credit and counterparty risk management, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the

transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

19. This Council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the Council.

Fraud, Error and Corruption, and Contingency Management#

20. The risk that a Council fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings, and fails to employ suitable systems and procedures and maintain effective contingency management arrangements to these ends. It includes the area of risk commonly referred to as operational risk.

21. This Council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

Market Risk Management

22. The risk that, through adverse market fluctuations in the value of the principal sums a Council borrows and invests, its stated treasury management policies and objectives are compromised, against which effects it has failed to protect itself adequately.

23. This Council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP 2 PERFORMANCE MEASUREMENT

24. The Council is committed to the pursuit of Value for Money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its Treasury Management Policy Statement.

25. Accordingly, the treasury management function will be the subject of on-going analysis of the value it adds in support of the Council's stated business and service objectives. The performance of the treasury management function will be monitored as detailed below.

26. The methodology and criteria for assessing the performance and success of non-treasury investments will be clearly set out in the Property Investment Strategy.

Evaluation and Review of Treasury Management Decisions

27. The Council has a number of approaches to evaluating treasury management decisions: -
    - Quarterly reviews carried out by the treasury management team
    - reviews with our treasury management consultants
    - annual review after the end of the year as reported to full Council
    - regular monitoring reports to Audit and Standards Committee

TMP 3 DECISION-MAKING AND ANALYSIS

28. The Council will maintain full records of its treasury management decisions, and of processes and practices applied in reaching those decisions, both for the purpose of learning from the past and for demonstrating that all reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at that time.

In respect of borrowing and other funding decisions, the Council will:

- consider the on-going revenue liabilities created, and the implications for the Council's future plans and budgets;
- evaluate the economic and market factors that might influence the manner and timing of any decision to fund;
- consider the merits and demerits of alternative forms of funding, including funding from revenue, leasing and private partnerships;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use and, if relevant, the opportunities for foreign currency funding.

In respect of investment decisions, the Council will:

- Consider the optimum period, in the light of cash flow availability and prevailing market conditions;
- Consider the alternative investment products and techniques available, especially the implications of using any which may expose the Council to changes in the value of its capital;
- Seek advice from its Treasury Advisors before investing in property funds.

TMP 4 APPROVED INSTRUMENTS, METHODS AND TECHNIQUES

Approved Activities of the Treasury Management Operation

- borrowing;
- lending;
- debt repayment and rescheduling;
- consideration, approval and use of new financial instruments and treasury management techniques;
- managing the underlying risk associated with the Council's capital financing and surplus funds activities;
- managing cash flow;
- banking activities;
- the use of external fund managers (other than Pension Fund);
- leasing.

Approved Instruments for Investments

29. The Council will use instruments for investment as detailed in Annual Investment Strategy.

Approved Methods and Sources of Raising Capital Finance

30. Finance will only be raised in accordance with the Local Government Act 2003, and within this limit the Council has a number of approved methods and sources of raising capital finance. These are:

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency *	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Local temporary	●	●
Local Bonds	●	
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Leasing (not operating leases)	●	●

Other Methods of Financing
Government and EC Capital Grants
Lottery monies
Operating leases

Borrowing will only be done in Sterling. All forms of funding will be considered dependent on the prevailing economic climate, regulations and local considerations. The responsible officer has delegated powers in accordance with Financial Regulations, Standing Orders, the Scheme of Delegation to Officers, Policy and the Treasury Management Strategy to take the most appropriate form of borrowing from the approved sources.

Investment Limits

31. The Annual Investment Strategy sets out the limits and the guidelines for use of each type of investment instrument.

Borrowing Limits

32. See the Treasury Management Strategy Statement and Prudential and Treasury Indicators.

TMP 5 ORGANISATION, CLARITY AND SEGREGATION OF RESPONSIBILITIES, AND DEALING ARRANGEMENTS

Allocation of responsibilities

(i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities; and

- approval of annual strategy.

(ii) Cabinet

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;

- budget consideration and approval;

- approval of the division of responsibilities;

- approving the selection of external service providers and agreeing terms of appointment.

(iii) Audit and Standards Committee

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

- receiving and reviewing regular monitoring reports and acting on recommendations.

(iv) Executive Director of Resources, Executive Director of Business Operations and Service Manager for Finance and Welfare (Section 151 Officer)

- In the event that a counterparty, subsequent to an investment being made, falls below the minimum ratings required the following action is delegated to the Executive Director of Resources, Executive Director of Business Operations or in his absence the Section 151 Officer;
- Fixed term deposits – allow the investment to mature and not withdraw its funding unless advised otherwise by the Council's treasury advisors; and
- In all situations the Section 151 Officer, Executive Director of Business Operations and Executive Director of Resources will take the best course of action to protect the value of the investment based on advice received from the Council's treasury advisors

TMP 6 REPORTING REQUIREMENTS AND MANAGEMENT INFORMATION ARRANGEMENTS

Annual programme of reporting

33. Annual reporting requirements before the start of the year: -
    - review of the organisation's approved clauses, treasury management policy statement and practices
    - strategy report on proposed treasury management activities for the year comprising of the treasury management strategy statement, Annual Investment Strategy and Minimum Revenue Provision Policy Statement
    - Mid-year review
    - Annual review report after the end of the year

34. The Audit and Standards Committee will receive regular monitoring reports on treasury management activities and risks.

35. The Overview and Scrutiny Committee will have responsibility for the scrutiny of treasury management policies and practices.

Annual Treasury Management Strategy Statement

36. The Treasury Management Strategy Statement sets out the specific expected treasury activities for the forthcoming financial year. This strategy will be submitted to the Cabinet and then to the full Council for approval before the commencement of each financial year.

The Annual Investment Strategy Statement

37. At the same time as the Council receives the Treasury Management Strategy Statement it will also receive a report on the Annual Investment Strategy.

The Annual Minimum Revenue Provision Statement

38. This statement will set out how the Council will make revenue provision for repayment of its borrowing using the four options for so doing and will be submitted at the same time as the Annual Treasury Management Strategy Statement.

TMP 7 BUDGETING, ACCOUNTING AND AUDIT ARRANGEMENTS

Statutory/Regulatory Requirements

39. The accounts are drawn up in accordance with the Code of Practice on Local Authority Accounting in Great Britain that is recognised by statute as representing proper accounting practices.

40. The Council has also adopted in full the principles set out in CIPFA's 'Treasury Management in the Public Services - Code of Practice' (the 'CIPFA Code'), together with those of its specific recommendations that are relevant to this Council's treasury management activities.

41. The Council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force at that time.

List of Information Requirements of External Auditors.

42. Information will be provided to External Auditors according to the records required listing they provide each year.

TMP 8 CASH AND CASH FLOW MANAGEMENT

Arrangements for Preparing/Submitting Cash Flow Statements

43. Cash flow projections are prepared annually, monthly and daily. The annual and monthly cash flow projections are prepared from the previous years' cash flow records, adjusted for known changes in levels of income and expenditure and also changes in payments and receipts dates. These details are supplemented on an on-going basis by information received of new or revised amounts to be paid or received as and when they are known.

Bank Statements Procedures

44. The Council receives daily bank statements and a daily download of data from its bank. A formal bank reconciliation is undertaken on a monthly basis.

TMP 9 MONEY LAUNDERING

45. The Council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure staff are properly trained.

TMP 10 TRAINING AND QUALIFICATIONS

46. The Council recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

- Treasury management staff employed by the Council
- Members charged with governance of the treasury management function

47. All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council identifies the training requirements of individual members through the staff appraisal system for staff engaged on treasury related activities.

48. Elected Members charged with diligence also have a personal responsibility to ensure that they have the appropriate skills and training for their role.

TMP 11 USE OF EXTERNAL SERVICE PROVIDERS

49. The Council recognises that responsibility for treasury management decisions remains with the Council at all times.

50. This Council will employ the services of other organisations to assist it in the field of treasury management. In particular, it will use external consultants to provide specialist advice in this ever more complex area. However, it will ensure that it fully understands what services are being provided and that they meet the needs of this organisation, especially in terms of being objective and free from conflicts of interest.

51. It will also ensure that the skills of the in house treasury management team are maintained to a high enough level whereby they can provide appropriate challenge to external advice and can avoid undue reliance on such advice.

TMP 12 CORPORATE GOVERNANCE

52. The Council is committed to the principle of openness and transparency in its treasury management function and in all of its functions.

53. It has adopted the CIPFA Code of Practice on Treasury Management and implemented key recommendations on developing Treasury Management Practices, formulating a Treasury Management Policy Statement and implementing the other principles of the Code.

54. The following documents are available for public inspection: -

    Treasury Management Strategy Statement
    Annual Investment Strategy
    Minimum Revenue provision policy statement
    Annual Treasury Review Report
    Treasury Management monitoring reports

    Annual accounts and financial instruments disclosure notes
    Annual budget
    5 Year Capital Plan

    Minutes of Council / Cabinet / Committee meetings