

Rother District Council

Report to	-	Cabinet
Date	-	3 June 2019
Report of the	-	Executive Directors
Subject	-	Treasury Management Update

Recommendation to COUNCIL: That the revised authorised limit and operational boundary for external debt contained in the Treasury Management Strategy be approved.

Head of Service: Assistant Director Resources: Robin Vennard
Lead Cabinet Member: Councillor Doug Oliver

Introduction

1. Cabinet approved the Council's 2019/20 Treasury Management Strategy Statement and Annual Investment Strategy in February this year (Appendix A). In managing its treasury management activities, the Council follows the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised 2017).
2. By way of explanation, the Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.
3. The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
4. The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund.

Review of Treasury Indicators – Authorised Limit and Operational Boundary

5. Part of the Treasury Strategy sets the external debt (borrowing) limits for the Council. This takes account of the Council's long term borrowing and any short term cash flow borrowing needs. The Council's capital expenditure plans are the key driver for setting these limits. The capital expenditure plans are reflected in the prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans. There are two limits that the Council sets;
6. **The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the Capital Financing Requirement (CFR), but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.
7. **The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal 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.
8. 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.
9. Following a review of the capital expenditure plans, particularly in relation to the property investment strategy and the likely timing of investments, Members are asked to recommend to full Council to increase the limits previously agreed (Appendix A paragraph 28) to the following:

	2018/19 Forecast £ (000)	2019/20 Budget £ (000)	2020/21 Budget £ (000)	2021/22 Budget £ (000)	2022/23 Budget £ (000)	2023/24 Budget £ (000)
Authorised Limit	40,900	57,400	67,300	67,300	67,300	67,300
Operational boundary	37,000	52,000	61,000	61,000	61,000	61,000

Conclusion

10. The above changes ensure the Council's treasury management and investment strategies remain robust in managing the Council's cash funds and borrowing.

Malcolm Johnston
Executive Director

Dr Anthony Leonard
Executive Director

Risk Assessment Statement

There are no direct risks arising from this report.

Treasury Management Strategy for 2019/20 – Approved by Full Council 25 February 2019

1. The strategy for 2019/20 covers two main areas:
 - a. **Capital issues**
 - the capital expenditure plans and the associated prudential indicators;
 - 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
 - the policy on use of external service providers.
2. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Ministry of Housing, Communities and Local Government (MHCLG) Minimum Revenue Provision (MRP) Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

Training

3. The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny of the treasury management function. Training has been undertaken by Members in June 2018 on the legislation and treasury activities of the Council and further training will be arranged after the election of a new Council in May 2019. The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

4. The Council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.
5. 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 the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
6. 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.

7. The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties in support of its Property Investment Strategy. The commercial type investments require specialist advisers, and the Council uses appropriately qualified companies in relation to this activity.

The Capital Prudential Indicators

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

Capital expenditure

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

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
General Fund Services	4,614	7,447	535	238	238	238
Regeneration Investments	2,512	12,488	20,000	0	0	0
TOTAL	7,126	19,935	20,535	238	238	238

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

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2023/24 budget
External Sources	1,429	3,497	0	0	0
Own Resources	3,138	3,950	535	238	238
Borrowing	2,559	12,488	20,000	0	0
TOTAL	7,126	19,935	20,535	238	238

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

11. The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.
12. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the

indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

13. The CFR includes any 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 by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently does not have any such schemes within the CFR.

14. The CFR projections are shown below:

	31.3.19 forecast	31.3.20 budget	31.3.21 budget	31.3.22 budget	31.3.23 budget	31.3.24 budget
General Fund Services#	1,138	1,136	1,134	1,132	1,130	1,128
Regen Investments	2,512	15,000	34,844	34,553	34,038	33,511
TOTAL	3,650	16,136	35,978	35,685	35,168	34,639

#including adjustment "A" £1.091m

Movement in CFR

	31.3.19 forecast	31.3.20 budget	31.3.21 budget	31.3.22 budget	31.3.23 budget	31.3.24 budget
Net financing need for the year (above)	3,650	16,136	35,978	35,685	35,168	34,639
Less MRP/VRP and other financing movements	0	156	291	515	527	540
Movement in CFR	3,650	15,980	35,687	35,170	34,641	34,099

15. A key aspect of the regulatory and professional guidance is that elected Members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in above and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

Affordability Prudential Indicator

16. 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 indicator:

Ratio of Financing Costs to Net Revenue Stream

17. 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.

	2018/19 forecast	2019/20 budget	2020/21 budget	2021/22 budget	2022/23 budget	2023/24 budget
Financing costs (£000)	64	376	1,163	1,380	1,379	1,379
Proportion of net revenue stream	0.5%	2.5%	8.6%	10.5%	10.4%	10.3%

18. The table shows that the proportion of the Council's net revenue stream (Council Tax, share of business rates and grants) at risk increases to over 10% due to the investments made under the Property Investment Strategy.

Core Funds and Expected Investment Balances

19. 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 ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

Year End Resources £m	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
Fund balances / reserves	-14,781	-11,670	-9,756	-8,520	-7,552	-6,902
Capital receipts	-2,725	-845	-895	-945	-995	-1,045
Provisions	-700	-700	-700	-700	-700	-700
Total core funds	-18,206	-13,215	-11,351	-10,165	-9,247	-8,647
Working capital	-1,800	-1,800	-1,800	-1,800	-1,800	-1,800
Expected investments	-20,006	-15,015	-13,151	-11,965	-11,047	-10,447

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

Minimum Revenue Provision (MRP) Policy Statement

20. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
21. MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:
22. From 1 April 2008 for all unsupported borrowing (including PFI and finance leases if entered into) the MRP policy will be:

Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations; this provides for a reduction in the borrowing need over approximately the assets' life. Note that for the Council's commercial type investments in support of the Council's Property Investment Strategy MRP will be based on an annuity based method over the assets life.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance made allowance for any charges made over the statutory minimum

revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, to be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 the total VRP overpayments were nil.

Borrowing

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

	Actual £'000 31.3.18	Actual % 31.3.18	Actual £'000 15.1.19	Actual % 15.1.19
Treasury Investments				
Nat West	5,018	30.3%	2,000	8.4%
Lloyds Bank Plc.	6,242	37.7%	3,500	14.7%
Bank of Scotland	5,300	32.0%	5,300	22.3%
Santander UK plc.	2	0.0%	4,951	20.8%
Barclays Bank	1	0.0%	1	0.0%
TOTAL managed funds in-house	16,563	100.0%	15,752	66.3%
Property Funds	0	0.0%	8,000	33.7%
TOTAL treasury investments	16,563	100.0%	23,752	100.0%
Treasury External Borrowing				
PWLB	0	0%	900	100%
NET Treasury investments	16,563		22,852	

24. The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	31.3.19 forecast	31.3.20 budget	31.3.21 budget	31.3.22 budget	31.3.23 budget	31.3.24 budget
Gross Debt	2,559	14,846	35,648	35,135	34,610	34,072
Capital Financing Requirement	3,650	15,982	36,782	36,267	35,740	35,200

25. Within the above figures the level of debt relating to commercial activities / non-financial investment is:

	31.3.19 forecast	31.3.20 budget	31.3.21 budget	31.3.22 budget	31.3.23 budget	31.3.24 budget
External Debt for commercial activities / non-financial investments						
Actual debt at 31 March £m	2,512	14,846	35,648	35,135	34,610	34,072
Percentage of total external debt %	99%	100%	100%	100%	100%	100%

26. Within the range of 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 2019/20 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.
27. The Assistant Director, Resources (Chief Finance Officer) reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Treasury Indicators: limits to borrowing activity

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

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Commercial activities/ non-financial investments	6,000	20,000	41,000	40,000	40,000	40,000
GF Services	10,000	10,000	10,000	10,000	10,000	10,000
Authorised limit – total external debt	16,000	30,000	51,000	50,000	50,000	50,000

29. The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal 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.
30. 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.
31. The Council is asked to approve the following authorised limit:

	2018/19 limit	2019/20 limit	2020/21 limit	2021/22 limit	2022/23 limit	2023/24 limit
Commercial activities/ non-financial investments	6,000	20,000	41,000	40,000	40,000	40,000
GF Services	15,000	15,000	15,000	15,000	15,000	15,000
Authorised limit – total external debt	21,000	35,000	56,000	55,000	55,000	55,000

Prospects for interest rates

32. 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 our central view.

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

33. The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.
34. The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic

growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

35. 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, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
36. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

37. Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years. Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Borrowing Strategy

38. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.
39. Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Assistant Director,

Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.*

40. Any decisions will be reported to Cabinet and the Audit and Standards Committee at the next available opportunity.

Policy on borrowing in advance of need

41. 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.

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

Debt rescheduling

43. As short-term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long-term debt to short-term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

44. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

45. Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. All rescheduling will be reported to Cabinet and the Audit and Standards Committee at the earliest meeting following its

action. At present this is not required as the Council has only recently entered into its only loan with PWLB.

ANNUAL INVESTMENT STRATEGY

Investment policy – management of risk

1. The Ministry of Housing, Communities and Local Government (MHCLG) and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).
2. The Council’s investment policy has regard to the following:
 - MHCLG’s Guidance on Local Government Investments (“the Guidance”)
 - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
 - CIPFA Treasury Management Guidance Notes 2018
3. The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).
4. The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -
 - a. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
 - b. **Other information:** 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.
 - c. **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.
 - d. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 1 under the categories of ‘specified’ and ‘non-specified’ investments.
 - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
 - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex

instruments which require greater consideration by members and officers before being authorised for use.

- e. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as shown in Appendix 1,
 - f. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table below
 - g. **Transaction limits** are set for each type of investment.
 - h. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**.
 - i. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**.
 - j. This authority has engaged **external consultants**, to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
 - k. All investments will be denominated in **sterling**.
 - l. As a result of the change in accounting standards for 2018/19 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)
5. However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Creditworthiness policy

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

7. This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:
- Yellow 5 years
 - Dark pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
 - Light pink 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
 - Purple 2 years
 - Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
 - Orange 1 year
 - Red 6 months
 - Green 100 days
 - No colour not to be used
8. 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.
9. 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.
10. All credit ratings are monitored regularly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service. If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list. 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.

	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

UK banks – ring fencing

11. The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
12. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.
13. While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Country limits

14. 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 2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
15. The Council’s available funds will be spread among different counterparties in order to minimise the risk of loss.

Use of additional information other than credit ratings

16. Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Investment Strategy

17. 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). Greater returns are usually obtainable by investing for longer periods. While part of the cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable. Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

Investment returns expectations

18. Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

19. The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	Now
2018/19	0.75%
2019/20	0.75% to 1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

20. The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.
21. **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

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

Maximum principal sums invested > 365 days			
	2018/19	2019/20	2020/21
Principal sums invested > 365 days	£10,000,000	£10,000,000	£10,000,000

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

Investment risk benchmarking

23. This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day rate for cash deposit investments.

End of year investment report

24. 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

25. The Council uses Link Asset Services as its external treasury management advisors.
26. 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.
27. 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

28. Please see Appendix 3.

Role of the Section 151 Officer

29. Please see Appendix 4.

TREASURY MANAGEMENT PRACTICE – CREDIT AND COUNTERPARTY RISK

Specified Investments:

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

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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 below:

	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 £10m	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.	<p>Supranational bonds greater than 1 year to maturity</p> <p>(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.).</p> <p>(b) A financial institution that is guaranteed by the United Kingdom Government (e.g. National Rail, the Guaranteed Export Finance Company [GEFCO])</p> <p>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.</p>	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.

APPROVED COUNTRIES FOR INVESTMENTS

Based on lowest available rating

AAA

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

AA+

- Finland
- U.S.A.

AA

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

AA-

- Belgium
- Qatar

AS AT 21.1.19

Treasury Management Scheme of Delegation

1. Full Council

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

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

3. 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.

4. Executive Directors, and Assistant Director, Resources (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 Directors 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 Directors will take the best course of action to protect the value of the investment based on advice received from the Council's treasury advisors.

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
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:
 - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
 - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
 - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
 - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken; and
 - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.