Report reference: SG.090217/11

Wards affected: General

Strategy Group – 9th February 2017

Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018

Resources Issues

1. Purpose of Report

1.1 To advise Strategy Group of the expected activities and appropriate operational parameters of the treasury management function in 2017/2018. To endorse the "Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018"

2. Advice

That it be RECOMMENDED:	That the Council's Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018 be approved.

3. Introduction

3.1 The Council is required to set 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 the cash flow is adequately planned, with cash being available when 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.

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. The management of longer term cash flow may involve arranging long or short term loans, using longer term cash flow surpluses.

Treasury management is defined 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."

3.2 Reporting Requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Treasury Management Strategy Statement, Minimum Revenue Provision Statement and Annual Investment Strategy (This Report) – The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are managed).

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 objectives or whether any policies need revision. In addition, quarterly reports are produced to Portfolios Holders.

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.

3.3 Treasury Management Strategy 2017/2018

The 2017/2018 strategy covers two main areas:

Capital Issues

- the capital plans and prudential indicators;
- the minimum revenue provision (MRP) policy.

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;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service providers.

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.

3.4 Training

The CIPFA code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management.

The training needs of treasury managemnt officers are periodically reviewed.

3.5 Treasury Management Consultants

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

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.

4. Capital Issues

4.1 The Capital Plans Prudential Indicators

The Council's capital expenditure plans are the key driver of treasury management activity.

The table below summarises the capital expenditure and how it is being financed by capital or revenue resources. Any shortfall of resources could result in a borrowing need.

Capital expenditure £m	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Total Capital Expenditure	5.896	24.018	9.963	1.662
Financed by:				
External Funding	1.584	7.037	0.303	0.313
Capital reserves	1.276	15.981	9.660	1.349
Revenue	3.036	1.000	0.000	0.000
Net financing need for the year (CFR)	**0.000**	**0.000**	**0.000**	**0.000**

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

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

The Council, under the current Medium Term Financial Plan and Capital Programme, have no plans to borrow and therefore has a zero CFR.

4.2 Minimum Revenue Provision (MRP) Policy Statement

If the Council was to borrow it would be 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 allowed to undertake additional voluntary payment if required (Voluntary Revenue Provision VRP).

The MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

CLG regulations have been issued which require 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.

From 1 April 2017 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be either*:*

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);

- **Depreciation method** – MRP will follow standard depreciation accounting procedures;

These options provide for a reduction in the borrowing need over approximately the asset’s life.

4.3 Core funds and expected investment balances

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	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Fund balances / reserves	18.302	22.890	25.180	27.734
Capital receipts	14.263	9.601	7.786	10.852
Total core funds	**35.565**	**32.491**	**32.966**	**38.586**
Working capital	-6.636	-6.636	-6.636	-6.636
Expected investments	**25.929**	**25.855**	**26.330**	**31.950**

In addition to the expected investments total from the above table we have a cash element which would include the reciepts of Council Tax and NNDR income prior to the payments being made to the government and precepting authorties. This would increase the level of investments held by the council at any one time.

4.4 Affordability Prudential Indicators

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.

4.4.1 Ratio of financing costs to revenue streams

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. In other words in 2016/17 the interest earnings would be approximately 2.08% of the Council's net revenue spend.

%	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Ratio	-2.08	-1.13	-1.23	-1.24

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

4.4.2 Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council tax - band D	-6.80	-16.95	-31.30	-30.99

5.0 Treasury Management Issues

5.1 Current Treasury Portfolio

The Council's Treasury portfolio as 31/01/2017 comprised:-

Counterparty	Amount (£)	Maturity	Rate %
Standard Chartered Bank	2,000,000	07/02/2017	0.43
Svenska Handelsbanken	4,000,000	20/02/2017	0.25
Santander UK	2,500,000	10/03/2017	0.65
Goldman Sacs International Bank	5,000,000	13/03/2017	0.60
Toronto Dominion Bank	5,000,000	04/04/2017	0.85
Bank of Scotland	3,000,000	28/04/2017	0.65
Lloyds Bank	5,000,000	28/04/2017	0.65
Bank of Scotland	2,000,000	03/05/2017	0.65
Barclays Bank	2,500,000	08/05/2017	0.46
Co-operative Rabobank	5,000,000	11/10/2017	0.57
United Overseas Bank	5,000,000	01/11/2017	0.60
Landesbanken Hessen Thuringen	5,000,000	07/11/2017	0.64
National Bank of Abu Dhabi	5,000,000	05/01/2018	0.70
Qatar National Bank	5,000,000	12/01/2018	0.89
TOTAL	**56,000,000**		

The Council has not previously had to borrow from external funding in the past and as reported in the Medium Term Financial Plan this does not look like changing in the near future. However, looking into the future we need to take into consideration that there may be a need to borrow money 'from itself' from other cash holdings that the Council may have. This would mean that the Council would not hold any 'cash backed' reserves. Any borrowing that may be taken would be in line with the prudential indicators and borrowing strategy outlined in this report.

5.2 Treasury Indicators for 2017/18 – 2019/2020

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. Whilst the council has no plans to borrow an operational boundary is set for occasions where very short term bowing is required for cash flow purposes only.

Operational boundary £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	3.000	3.000	3.000	3.000
Other long term liabilities	0	0	0	0
Total	**3.000**	**3.000**	**3.000**	**3.000**

The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. 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.
2. The Council is asked to approve the following authorised limit:

Authorised limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	5.000	5.000	5.000	5.000
Other long term liabilities	0	0	0	0
Total	5.000	5.000	5.000	5.000

6. Prospects for Interest Rates

Capita Asset Services as part of their service assist the Council to formulate a view on interest rates. The following table gives their central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2016	0.25	1.60	2.90	2.70
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00
Sep 2019	0.50	1.90	3.30	3.10
Dec 2019	0.75	2.00	3.30	3.10
Mar 2020	0.75	2.00	3.40	3.20

Gross Domestic Product (GDP) growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%.

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals. The meeting on the 3 November left the Bank rate and the other monetary policy measure unchanged. This was in line with market expectations, but a major change from the previous inflation report which in its forward guidance showed that another cut was likely in 2016. The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how the economic date evolves in the coming months. The central view from our advisors is that it is unlikely to change in the near future with a first rise in Bank Rate being forecast for quarter 2 of 2019. However forecasting this this far ahead is highly fraught as there are many potential economic headwinds which could blow the UK economy either way.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November.

7. Borrowing Strategy

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Upper limit for fixed interest rate exposure				
Net interest re fixed rate borrowing/investments	100%	100%	100%	100%
Upper limit for variable rate exposure				
Net interest re variable rate borrowing	0%	0%	0%	0%
Net interest re variable rate investments	30%	30%	30%	30%
Upper limit for total principal sums invested for over I Year (per maturity date)	£15m	£15m	£15m	£15m

Maturity structure of fixed rate borrowing during 2017/2018 (if required)	upper limit %	lower limit %
under 12 months	100	0
12 months and within 24 months	100	0
24 months and within 5 years	100	0
5 years and within 10 years	100	0
10 years and above	100	0

Policy on Borrowing in Advance of Need

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 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.

8. Annual Investment Strategy

8.1 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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

Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investments categories.

Specified Investments: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum high rating criteria where applicable.

	Minimum 'High' Credit Criteria	**Use**
Debt Management Account Deposit Facility	---	In-house
Term Deposits – Other Local Authorities	---	In-house
UK Nationalised and Semi Nationalised Banks	Semi Nationalised	In-house
Term Deposits – Bank and Building Societies	Sovereignty AA Short Term F1 Long-term A,	In-house and Fund Managers
Certificates of deposits issued by banks building societies covered by UK government	Sovereignty AA Short-term F1 Long-term A	In-house buy and hold and fund managers
UK Government Gilts	Sovereignty Rating AA	In-house and fund managers
Treasury Bills	Sovereignty Rating AA	In-house and fund managers
Money Market Funds	AA	In-house and fund managers

Non-Specified Investments: A maximum of 60% or £15m, whichever is the lower of the total portfolio, will be held in aggregate in non-specified investment (i.e. over 1 year)

	Minimum Credit Criteria	**Use**	**Max. maturity period**
Term deposits – local authorities	--	In-house	5 Years
UK Nationalised and Semi Nationalised Banks	Semi Nationalised	In – House	5 Years
Term deposits – banks and building societies	Sovereignty AA Short-term F1+ Long-term AA-	In-house	5 Years
Certificates of deposits issued by banks and building societies	Sovereignty AA Short-term F1+ Long-term AA-	In house and Fund managers	2 Years
UK Government Gilts	Sovereignty Rating AA	In house and Fund Managers	5 Years
Bonds issued by multilateral development banks	Sovereignty Rating AA	In-house and fund managers	5 Years
Sovereign bond issues (i.e. other than the UK gov't)	Sovereignty Rating AA	In house and Fund Managers	5 Years

For both specified and non-specified investments the UK is an exception to the stated criteria in that we will continue to deal with UK institutions in the event of a downgrading in the UK sovereign rate.

8.2 Creditworthiness Policy

This Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The Council criteria are set on the Fitch credit rating and in the absence of this Moody's ratings will be taken. However, it does not rely solely on the current credit ratings of counterparties but also uses the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of Credit Default Swaps (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 Enhanced money market funds with a credit score of 1.25
•	Light Pink	5 years for Enhanced money market 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

This Council will use the approach suggested by CIPFA in the 2011 Code of using all ratings from all three rating agencies to determine creditworthy counterparties. The Capita Asset Services creditworthiness service uses ratings from all three agencies, and by using a scoring system does not give undue weight to just one agency's 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 Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

- 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.
- If a body is placed on negative rating watch with Fitch or Moody's in the absence of a Fitch rating (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near the floor of the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body. Alternatively if the result of a negative rating watch keeps the counterparty within the credit ratings set out by the Council, the counterparty can be considered for investment.
- The Council uses Fitch ratings to derive its counterparty criteria. Where counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings will be monitored daily.

- The Council is alerted to changes in Fitch ratings through its use of the Capita Asset Services credit worthiness service.

- Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

8.3 Country Limits

With the exception of the UK, the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them).

8.4 Current Investment situation

At the present time as advised by the Section 151 Officer, all current investments are being made with the Government's Debt Management Office in their Debt Management Account Deposit Facility (DMADF), other Local Authorities, Banks and Building Societies that meet the criteria set by the Council and all Nationalised and Semi Nationalised Banks. Investments can also be made in Treasury Bills, Money Market Funds and Certificates of Deposits. Processes in Treasury Management are now well embedded and improved and give confidence that by utilising the full list of counterparties the authority will still be operating within very tight and strict limits.

8.6 Treasury Management Practices

The Council's Treasury Management Practices (TMP's) set out the manner in which the Council will seek to achieve its treasury management policies and objectives, and how it will manage and control those activities.

The Council's TMP's schedules cover the detail of how the Council will apply the TMP Main Principles in carrying out its operational treasury activities. They reviewed annually and approved by the Council's Chief Financial Officer.

8.6 Investment returns expectations

Capita Asset Services forecast for Bank Rate is to remain unchanged at 0.25% before starting to rise from mid 2019. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

8.7 End of year investment report

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

9. Implications

9.1 Financial – This report is wholly concerned with financial issues.

9.2 Personnel - None, other than those mentioned in the report above.

9.3 Legal/Constitutional – No implications.

9.4 **Environmental** – No implications.

9.5 **Policy** – No implications.

9.6 **ICT** – No implications.

9.7 **Crime and Disorder** – No implications.

9.8 **Human Rights** – No implications.

9.9 **Equalities** – No implications.

10. Conclusions

10.1 Despite the shock to the economy immediately following the Brexit vote, there was a sharp recovery in confidence and business surveys and the fall in the value of sterling has had a positive effect in boosting manufacturing in the UK due to improved competitiveness in world markets. If appropriate the Section 151 Officer will not hesitate to restrict investments, in line with the approved strategy, should there be a need to. Returns on investments will continue at a very low level for the foreseeable future with security being the overriding factor.

Audra Statham
Chief Financial Officer

Background papers:

CIPFA Treasury Management Code of Practice 2011 (the Code)

Previous minutes:

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