COUNCIL

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TREASURY MANAGEMENT STRATEGY 2017/2018

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Summary

This report presents the Council's Treasury Management Strategy for the 2017/2018 financial year. The Treasury Management Strategy incorporates within it the Treasury Management Policy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy.

1. Budget and Policy Framework

1.1 Audit Committee is responsible for the scrutiny of the Council's Treasury Management, Investment Strategy and Minimum Revenue Provision Policy Statement. The Constitution also specifies the role of Cabinet in implementing and monitoring treasury management policies and practices.

1.2 Following scrutiny by Audit Committee, Cabinet will consider the strategy taking into account this Committee's comments.

1.3 Final approval of the policy and the setting of prudential indicators is a matter for Council on 23 February 2017.

2. Background

2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

2.2 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.

2.3 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. "

2.4 <u>Reporting requirements</u>

2.5 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.

2.5.1 Prudential and treasury indicators and treasury strategy (this report): The first, and most important report covers:

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

2.5.2 A mid-year treasury management report: This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

2.5.3 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.

2.6 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee.

3. Treasury Management Strategy for 2017/18

3.1 The strategy for 2017/18 covers two main areas:

3.1.1 Capital issues

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

3.1.2 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.

3.1.3 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.

3.2 Training

3.2.1 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. The training needs of Members and of treasury management officers are periodically reviewed.

3.3 Treasury management consultants

3.3.1 The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

3.3.2 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.

3.3.3 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. The Prudential and Treasury Indicators 2017/18 – 2019/20

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

4.2 The Capital prudential indicator is contained within Appendix 3. 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. Due to uncertainties over future funding the Capital expenditure it is likely that these indicators will evolve as the budget setting process progresses.

4.3 It is a statutory duty for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the authorised Limit represents the legislative borrowing limit.

4.4 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

4.5 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years; details of the Authorised Limit can be found in Appendix 3 of this report.

4.6 The Authorised Limit and Operational Boundary for external borrowing within Appendix 3 differentiate between external borrowing and “other long term liabilities”. Other long term liabilities are other methods the authority has used to finance capital expenditure including embedded leases. Embedded leases are where we pay for the lease of equipment by our contractors, for example refuse collection. Currently our embedded leases account for £497,000. We have therefore set the Operational Boundary for other long term liabilities at £500,000 and £550,000 for Authorised Limit in 2017/18 as well as 2018/19 and 2019/20.

4.7 The Prudential and Treasury indicators are set out in Appendix 3 to this report and are relevant for the purposes of setting an integrated strategy.

5. Borrowing requirement

5.1 In recent years the Council has used available cash balances to fund capital expenditure in preference to taking new external borrowing. Principally, because of the profile of the capital programme, the cash flow position is now such that in order to maintain liquidity we will need to take out external borrowing to manage our cash flow over the medium term.

5.2 It is envisaged that borrowing will have increased by £25.0m over the course of 2016/17, with further borrowing of £12.5m in 2017/18 and £2.0m in 2018/19 before making net repayments of £12.8m in 2019/20. These figures may be considerably lower dependant on slippage and changes to the capital programme and funding.

6. Borrowing Strategy

6.1 The Council is currently maintaining an under-borrowed position. This means that the Capital Financing Requirement has not been fully funded with loan debt. Due to this and the availability of inexpensive short term loans, the council wishes to avail itself of the opportunities offered by low interest rates to maximise its investment returns while remaining within its under-borrowed position. This represents a change from the previous policy of not borrowing in advance of need.

6.2 The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

6.3 Short term borrowing rates and investment returns are very low and are expected to remain so for the medium term. Subject to factors outlined above, borrowing requirements will be met by use of short term loans. This approach minimises net cost of financing as it avoids the cost of carrying large cash balances which would need to be invested for a lower return than the borrowing cost.

7. Prospects for Interest Rates

7.1 The Council has appointed Capita 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 gives Capita Asset Services' central view:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

7.1.1 The Monetary Policy Committee (MPC), cut Bank Rate from 0.50% to 0.25% on 4 August 2016 in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017–2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

7.1.2 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.

7.1.3 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. 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 strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

7.1.4 PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

7.1.5 The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

7.1.6 Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
    - Italian constitutional referendum 4.12.16 resulted in a ‘No” vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.

    - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
    - Dutch general election 15.3.17;
    - French presidential election April/May 2017;
    - French National Assembly election June 2017;
    - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

7.1.7 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include:

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

8. Investment and borrowing rates

8.1 Investment returns are likely to remain low during 2017/18 and beyond;

8.2 Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. 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 later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;

8.3 There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

9. Current Portfolio Position

9.1 The Council's treasury portfolio position at 31 March 2016, 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.

	2016/2017	2017/2018	2018/19	2019/20
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£'000	£'000	£'000	£'000
External debt				
Debt at 1 April	162,987	188,142	200,534	202,587
Other long-term liabilities (OLTL) at 1 April	497	243	0	0
Expected change in Debt	24,912	12,393	2,052	(12,818)
Expected change in OLTL	(254)	(243)	(0)	(0)
Actual gross debt at 31 March	188,142	200,535	202,587	189,769
The Capital Financing Requirement	261,725	262,733	261,148	259,425
Under borrowing	73,583	62,198	58,561	69,565

9.2 The Council has examined the potential for undertaking early repayment of some external debt to the PWLB in order to reduce size of the external debt position. However large premiums would be incurred by such action and make this course of action unattractive in the short term. This situation will be monitored in case the position changes.

9.3 The Council awaits the outcome of the objection to the 2015-16 Statement of Accounts relating to the LOBO loans. In the meantime exploratory discussions with lenders have indicated that early repayment would be prohibitively expensive. Unless the situation changes the current intention is to hold these debts until maturity.

9.4 The general aim of this treasury management strategy is to optimise treasury management performance, recognising that there is little opportunity to restructure long term debt, and therefore a need to maximise investment returns whilst adhering to the core principles of security, liquidity, and only then, yield.

9.5 The updated 2017-18 Strategy recognises the opportunities presented by the current economic conditions as characterised by low interest rates.

9.6 Bank rate is not expected to rise until 2019 and this supports the strategy to resist long- term borrowing, as over the next three years, investment rates are expected to remain below long-term borrowing rates.

9.7 Against this background caution will be adopted with the 2017-18 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances with decisions reported within the reviews of this strategy.

9.8 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 2017-18 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.

9.9 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.

10. Debt Rescheduling

10.1 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).

10.2 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).

10.3 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.

10.4 Decisions related to rescheduling will similarly be reported in reviews of this strategy.

11. Annual Investment Strategy

11.1 <u>Investment Policy</u>

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

11.3 In accordance with guidance from 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 Short Term and Long Term ratings.

11.4 Ratings should not be the sole determinant of the quality of an institution and that 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. This is fully integrated into, the credit methodology provided by the advisors, Capita Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.

11.5 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.

11.6 The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk.

11.7 Investment instruments identified for use in the financial year are listed in Appendix 5 under the ‘Specified’ and ‘Non-Specified’ Investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices – Schedules, as agreed by Cabinet on 7 February 2017.

11.8 <u>Creditworthiness policy</u>

11.9 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, Moodys 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.

11.10 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
- 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

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

11.12 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1, a Long Term rating 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.

11.13 All credit ratings will be monitored primarily via Capita Asset Services updates by Officers on a continuous basis. The Council is alerted to changes to ratings of all three agencies through its use of the Capita 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 against the iTraxx benchmark and other market data on a weekly 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.

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

11.15 Counterparty Limits

11.16 The current counterparty limits are set as;

- in-house team £20 million limit per counterparty and £25 million for counterparties with a Capita Asset Services duration rating of 12 months or above.

11.17 No amendments are requested to these counterparty limits.

11.18 Country limits

11.19 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from by officers should ratings change in accordance with this policy.

11.20 In addition:

- no more than £40m will be placed with any non-UK country at any time;
- limits in place will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

11.21 Investment Strategy

11.22 In-house funds. 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).

11.23 Investment returns expectations. Bank Rate forecasts for financial year ends (March) are:

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

11.24 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

11.25 The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

11.26 Investment in Property Funds

11.27 Property Funds are a form of investment, comprising a portfolio of commercial properties to achieve investment returns through rental income and capital growth. However, the value of such investments may fall as well as rise. There may also be restrictions on redemption of the investment. This type of investment is regarded as a 5 to 7 year minimum timeframe.

11.28 Due diligence was undertaken before the Council invested in the CCLA Property Fund and the CFO would carefully consider the Council's cash balances and cashflow projections before investing further amounts.

11.29 Investment in Money Market Funds

11.30 Money Market Funds (MMFs) offer enhanced returns compared with bank call accounts while reducing bail- in risk through diversification. Members are asked to approve the use of MMFs as part of the Council's investment portfolio.

11.31 <u>End of year investment report</u>

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

12. Kent County Council (KCC) Local Government Reorganisation (LGR) Debt

12.1 The charge for the share of KCC debt for which Medway Council was responsible on local government reorganisation is based on the current average cost of debt for the County Council as a whole. Whilst the County rate at a projected 5.162% remains marginally higher than our own average long- term debt rate of 4.218% for 2016/17, the penalty involved in early repayment makes early redemption an unattractive option. The outstanding principal at 1 April 2017 will be £36.9 million.

13. Minimum Revenue Provision (MRP)

13.1 The Minimum Revenue Provision is explained and the Policy Statement for 2016/17 is set out at Appendix 1.

13.2 An annuity method of allocating amounts of MRP to each year of asset life was adopted with effect from 2015/16. This works in a similar way to a repayment mortgage where the principal repaid in the early years is small but grows proportionally towards the end of the repayment period. Similarly the amount of MRP under this method starts with a small level of provision and rises over the life of the assets.

14. Risk management

14.1 Risk and the management thereof is a feature throughout the strategy and in detail within the Treasury Management Practices 1.

15. Diversity Impact Assessment

15.1 The Treasury Management Strategy does not directly impact on members of the public as it deals with 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. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group (Appendix 6 refers).

16. Audit Committee – 10 January 2017

16.1 **Discussion:**

Members considered a report regarding the Council's Treasury Management Strategy for the 2017/2018 financial year. The Treasury Management Strategy incorporated within it the Treasury Management Policy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy.

The following issues were discussed:

- The Council's contract with Capita Asset Services for external treasury management advice was due to expire at the end of February 2017. In response to a question about the possibility of a joint procurement exercise with other councils, officers advised that this had been discussed with other Kent councils but everyone had concluded that it would be better to procure individually as a joint approach would increase the value of the contract and EU procurement rules would then apply. A Member asked officers to bear in mind that when the contract came up for renewal again the procurement rules may have changed and joint procurement may be easier.
- A Member asked what training had been provided to the Members of the Committee, given the CIPFA code required that Members with responsibility for treasury management received adequate training. The Chief Finance Officer commented that the specification for the contract for external treasury management advice would include a minimum of two Member training sessions per year for the Committee. The possibility of this being opened up to all Members would be looked into.
- Due to the Council's under-borrowed position and the availability of inexpensive short term loans, the Council wished to avail itself of the opportunities offered by low interest rates to maximise its investment returns while remaining within its under-borrowed position. This represented a change from the previous policy of not borrowing in advance of need.
- Money Market Funds (MMFs) offered enhanced returns and it was proposed to use MMFs as part of the Council's investment portfolio. Many other councils followed the same approach. In response, a Member commented that there may be similar concerns from some Members with this proposal as with the proposal that the Council should invest in the CCLA property fund. Another Member asked how volatile these products were. Officers assured Members that they were very safe investments, although the returns were not high.
- In response to a question about the likely risks and impact on the Council following Article 50 being triggered by the end of March as part of the UK's exit from the EU, officers advised that any impact on the Council was likely to be a result of the wider effect on the UK economy and interest rates, as well as the possible consequences for levels of revenue support grant.
- Noting that borrowing increased by £25m over the course of 2016/17, a Member asked if this represented an additional £25m of unplanned borrowing. Officers replied that this was not the case and this was a reference to the fact that there had been £25m more borrowing than the previous year. This was due to capital expenditure and was not seen as a matter of concern by officers.

16.2 The Committee agreed to note the report and forward its comments on to Cabinet.

17. Cabinet – 7 February 2017

17.1 The Cabinet considered this report on 7 February 2017 and made the following decisions.

17.1.1 The Cabinet noted the comments of the Audit Committee, as set out in paragraph 16 of the report.

17.1.2 The Cabinet recommended to Full Council the Treasury Management Strategy as set out in the report and Appendices 1-5 to the report including the proposed revisions (decision no. 9/2017):

a) The change in borrowing strategy to enable the Council to borrow in advance of need.
b) The use of Money Market Funds as part of the Council's investment portfolio.
c) The removal of the £5m counter party limit and the imposition of a maximum of 40% of total investments in Property Funds.

17.3 The Cabinet approved the amendments to the Treasury Management Practices as set out in Appendices 7-8 to the (Cabinet) report (decision no. 10/2017).

18. Financial and legal implications

18.1 The finance and legal positions are set out throughout the main body of the report.

19. Recommendations

19.1 The Council is asked to approve the Treasury Management Strategy as set out in the report and Appendices 1-5 to the report including the proposed revisions:

19.1.1 The change in borrowing strategy to enable the Council to borrow in advance of need.

19.1.2 The use of Money Market Funds as part of the Council's investment portfolio.

19.1.3 The removal of the £5m counter party limit and the imposition of a maximum of 40% of total investments in Property Funds.

Appendices

1. Minimum Revenue Provision Policy Statement
2. Interest rate forecasts
3. Prudential and Treasury indicators
4. Specified and non specified investments
5. Approved countries for investments
6. Diversity Impact Assessment Screening Form

Background Papers
None

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Minimum Revenue Provision Policy Statement 2016/17

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2007/2008*,* and assessed MRP for 2007/2008 onwards in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

In setting the Minimum Revenue Provision Policy, Medway Council has regard to the guidance and will set a policy to ensure a prudent provision for the repayment of debt.

MRP is based on the estimated lives of assets funded from debt.

The Council will treat all expenditures as not ranking for MRP until the year after the scheme or asset to which they relate is completed and/or brought into use

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

In the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements (such as long term investments), or where borrowing has occurred but will be repaid by future Capital Receipts or agreed income from other source, there will be no Minimum Revenue Provision made.

There is no requirement on the HRA to make a minimum revenue provision, though in the interests of prudence the council has opted to do so.

APPENDIX 2

INTEREST RATE FORECASTS 2017-2020

PWLB rates below have taken into account the 20 basis points certainty rate reduction effective from 1.11.2012.

Capita Asset Services Interest Rate View	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%
50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%

Prudential and Treasury Indicators

PRUDENTIAL INDICATORS	2017/2018	2018/2019	2019/2020
Extract from budget and rent setting report	**Estimate**	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**
Capital Expenditure			
Non - HRA	32,418	5,146	317
HRA	7,054	7,256	6,579
TOTAL	39,472	12,402	6,894
Ratio of financing costs to net revenue stream			
Non - HRA	4.46%	4.47%	5.00%
HRA	14.44%	14.90%	15.60%
Gross borrowing requirement			
brought forward 1 April	187,899	200,292	202,344
carried forward 31 March	200,292	202,344	189,526
in year borrowing requirement	12,393	2,052	(12,818)
Capital Financing Requirement as at 31 March			
Non – HRA	219,373	217,315	214,052
HRA	43,360	43,833	45,373
TOTAL	262,733	261,148	259,425
Annual change in Cap. Financing Requirement			
Non – HRA	1,307	2,057	(3264)
HRA	(300)	473	1,540
TOTAL	1,007	(1584)	(1724)
Incremental impact of capital investment decisions	**£ p**	**£ p**	**£ p**
Increase in council tax (band D) per annum	12.69	5.30	5.10
Increase in average housing rent per week	(2.90)	0.30	0.52

TREASURY MANAGEMENT INDICATORS	**2017/2018**	**2018/2019**	**2019/2020**
	Estimate	**Estimate**	**Estimate**
	£'000	**£'000**	**£'000**
Authorised Limit for external debt -			
Borrowing	439,620	436,253	432,798
other long term liabilities	550	550	550
TOTAL	440,170	436,803	433,348
Operational Boundary for external debt -			
Borrowing	399,655	396,549	393,452
other long term liabilities	500	500	500
TOTAL	400,155	397,094	393,952
Actual external debt	200,292	202,344	189,526
HRA Maximum CFR Debt Limit	45,846	45,846	45,846
Upper limit for fixed interest rate exposure			
Net principal re fixed rate borrowing / investments	100%	100%	100%
Upper limit for variable rate exposure			
Net principal re variable rate borrowing / investments (excluding LOBOs)	40%	40%	40%
LOBO Limit	65%	65%	65%
Upper limit for total principal sums invested for over 364 days (per maturity date)	£150,000	£150,000	£150,000

TABLE 5: Maturity structure of fixed rate borrowing during 2017/2018	**upper limit**	**lower limit**
under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

Specified and Non-Specified Investments

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 Agency Deposit Facility	--	In-house and Fund Manager
Term deposits – local authorities	--	In-house and Fund Manager
Term deposits – banks and building societies	See note 1	In-house and Fund Manager
Collateralised deposit (see note 3)	UK sovereign rating	In-house and Fund Manager
Certificates of deposit issued by banks and building societies	See note 1	In-house and Fund Manager
UK Government Gilts	UK sovereign rating	In-house buy and hold and Fund Manager
Bonds issued by multilateral development banks	AAA	In-house buy and hold and Fund Manager
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government (refers solely to GEFCO - Guaranteed Export Finance Corporation)	UK sovereign rating	In-house buy and hold and Fund Manager
Sovereign bond issues (other than the UK govt)	AAA	In-house buy and hold and Fund Manager
Treasury Bills	UK sovereign rating	In house and Fund Manager
Government Liquidity Funds	* Long-term AAA volatility rating V1+	In-house and Fund Managers
Money Market Funds	* Long-term AAA volatility rating V1+	In-house and Fund Managers

Note 1. Award of "Creditworthiness" Colour by Capita Asset Services as detailed in paragraph 11.2

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the Specified Investment criteria. A maximum of 70% ** will be held in aggregate in non-specified investment

1. Maturities of ANY period

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Fixed term deposits with variable rate and variable maturities: - Structured deposits	See note 1	In-house	£10m	Lower of 5 years or Sector duration rating
Property Funds	See note 2	In-house	40%	N/A

2. Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	** Max % of total investments	Max. maturity period
Term deposits – local authorities	--	In-house	40%	5 Years
Term deposits – banks and building societies	See note 1	In-house	40%	As per Capita duration rating
Certificates of deposit issued by banks and building societies covered by UK Government (explicit) guarantee	See note 1 and 2	In-house	40%	As per Capita duration rating and see note 3
Certificates of deposit issued by banks and building societies	See note 1 and 2	In-house	40%	As per Capita duration rating and see note 3
UK Government Gilts	UK sovereign rating	In-house	40%	see note 1
Bonds issued by multilateral development banks	AAA	In-house	20%	see note 1
Sovereign bond issues (other than the UK govt)	AAA	In-house	20%	see note 1

Note 1. Award of "Creditworthiness" Colour by Sector Treasury services as detailed in paragraph 11.2

Note 2 Property Funds are not credit rated.

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

N.B. buy and hold may also include sale at a financial year end and repurchase the following day in order to accommodate the requirements of SORP.

APPENDIX 5

Approved countries for investments – based on lowest available rating

AAA

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

AA+

- Finland
- Hong Kong
- U.S.A

AA

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

AA-

- Belgium

Diversity Impact Assessment: Screening Form APPENDIX 6

Directorate **BSD**	**Name of Function or Policy or Major Service Change** **Treasury Management Strategy**			
Officer responsible for assessment Jonathan Lloyd		Date of assessment 12/12/2016	New or existing? Existing	
Defining what is being assessed				
1. Briefly describe the purpose and objectives	The Treasury Management Strategy is the strategy that the Council applies to effectively manage its Treasury Function. This is defined by CIPFA 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.*			
2. Who is intended to benefit, and in what way?	All stakeholders with a safe and effective Treasury Management Strategy			
3. What outcomes are wanted?	The successful and secure 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.			
4. What factors/forces could contribute/detract from the outcomes?	<u>Contribute</u> Effective Strategy, Good planning Effective use of information and intelligence	<u>Detract</u> Resources, Further cuts		
5. Who are the main stakeholders?	The Chief Finance Officer, Full Council and residents			
6. Who implements this and who is responsible?	Chief Finance Officer, and the Finance Operations and Strategy Teams			
Assessing impact				
7. Are there concerns that there <u>could</u> be a differential impact due to *racial/ethnic groups*?	~~YES~~ NO			
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due racial or			

	ethnic group membership.	
8. Are there concerns that there <u>could</u> be a differential impact due to *disability*?	~~YES~~ NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due disability.	
9. Are there concerns that there <u>could</u> be a differential impact due to *gender*?	~~YES~~ NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due gender.	
10. Are there concerns there <u>could</u> be a differential impact due to *sexual orientation*?	~~YES~~ NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due sexual orientation.	
11. Are there concerns there <u>could</u> be a have a differential impact due to *religion or belief*?	~~YES~~ NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due religion or belief.	
12. Are there concerns there <u>could</u> be a differential impact due to people's *age*?	~~YES~~ NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the	

	Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due to people's age.	
13. Are there concerns that there <u>could</u> be a differential impact due to *being trans-gendered or transsexual*?	~~YES~~	
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact due an individual's gender identity.	
14. Are there any *other* groups that would find it difficult to access/make use of the function (e.g. speakers of other languages; people with caring responsibilities or dependants; those with an offending past; or people living in rural areas)?	~~YES~~	
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact.	
15. Are there concerns there <u>could</u> be a have a differential impact due to *multiple discriminations* (e.g. disability <u>and</u> age)?	~~YES~~	
	NO	
What evidence exists for this?	The Treasury Management Strategy does not directly impact on members of the public as it deals with the Treasury management functions of the authority. Decisions are based upon the principles highlighted within the Strategy and have no impact on any one particular group. Hence there will not be a differential impact.	

Conclusions & recommendation		
16. Could the differential impacts identified in questions 7-15 amount to there being the potential for adverse impact?	~~YES~~	
	NO	

<table>
<tr><td rowspan="2">17. Can the adverse impact be justified on the grounds of promoting equality of opportunity for one group? Or another reason?</td><td>YES</td><td rowspan="2" colspan="4"></td></tr>
<tr><td>NO</td></tr>
<tr><td colspan="6">Recommendation to proceed to a full impact assessment?</td></tr>
<tr><td>NO</td><td colspan="5">This function/ policy/ service change complies with the requirements of the legislation and there is evidence to show this is the case.</td></tr>
<tr><td><s>NO, BUT …</s></td><td colspan="2"><s>What is required to ensure this complies with the requirements of the legislation? (see DIA Guidance Notes)?</s></td><td colspan="3"></td></tr>
<tr><td><s>YES</s></td><td colspan="2"><s>Give details of key person responsible and target date for carrying out full impact assessment (see DIA Guidance Notes)</s></td><td colspan="3"></td></tr>
</table>

Action plan to make Minor modifications		
Outcome	**Actions (with date of completion)**	**Officer responsible**

Planning ahead: Reminders for the next review	
Date of next review	January 2018
Areas to check at next review (e.g. new census information, new legislation due)	
Is there *another* group (e.g. new communities) that is relevant and ought to be considered next time?	

Signed (completing officer/service manager) **Jonathan Lloyd**	**Date**	12/12/2016
Signed (service manager/Assistant Director) Phil Watts	**Date**	16/12/2016