TREASURY MANAGEMENT STRATEGY 2019/20

Report to	**Audit and Accounts Committee**
Ward(s):	All
Key Decision:	No
Attachments:	Cabinet Report – Draft Treasury Management Strategy 2019/20
Papers relied on:	None

Recommendations to Audit and Accounts Committee:

It is recommended that this committee notes and provides comments on the Draft Treasury Management Strategy for 2019/20.

Main considerations

The purpose of this report is to present the Draft Treasury Management Strategy 2019/20 that will be considered by Cabinet on 5 February 2019 (see attached report) and to consult with the Committee on the proposed Strategy. The final strategy will be considered by the Council on 28 February 2019.

It should be noted that the strategy sets the overall limits and parameters within which the operational delivery strategy operates and as such needs to be flexible enough to cope with operational changes in the delivery of the strategy. The strategy sets the absolute limits but does not set the actual asset allocation up to those limits (i.e. when or how much is actually invested in each of the allowable investment types) and fund manager selection. These areas are delegated to the Head of Financial Services (Section 151 Officer) may be the subject of separate Portfolio Holder Reports if there are significant changes.

It should also be noted that this Committee is not responsible for determining the strategy. It has responsibility for the scrutiny and monitoring of the Treasury Management function.

Date: 28 January 2019
Decision taken by: Audit and Accounts Committee

Lead officer	Head of Financial Services (Section 151 Officer) – Phillip Hood
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Version	Final
Dated	15 January 2019
Status	Open
Confidentiality	It is considered that information contained within this report (and appendices) do not contain exempt information under the meaning of Schedule 12A of the Local Government Act 1972, as amended, and therefore can be made public.

TREASURY MANAGEMENT STRATEGY 2019/20

Cllr Tate, Cabinet Member for Finance, Service Delivery and Improvement

Report to	**Cabinet**
Ward(s):	**All**
Key Decision:	**No**
Appendix 1:	**Treasury Management Policy Statement 2019/20**
Appendix 2:	**Treasury Management Strategy Statement 2019/20**
Papers relied on:	**None**

Foreword – Cllr Tate, Cabinet Member for Finance, Service Delivery and Improvement

Treasury management continues be a core pillar of the Council's budget strategy. In 2019 the Treasury Management Policy remains unchanged.

As there is a transition to new investment vehicles to deliver higher returns, the focus for treasury management will be on security and liquidity rather than fully enhanced returns in support of the transition.

Recommendation to Cabinet

It is recommended that:

Cabinet notes:

1. The Treasury Management Strategy for 2019/20 (Set out in Appendix 2).

2. The new Treasury Management Risk Indicators set out in section 5 of Appendix 2).

3. That the Treasury Management Policy Statement (set out in Appendix 1) remains unchanged.

4. The Chief Finance Officer (Head of Finance) comments on the level of risk set out in Section 13 of this report

Cabinet recommends that the Council notes:

5. That the Treasury Management Policy Statement (set out in Appendix 1) remains unchanged.

6. The new Treasury Management Risk Indicators set out in section 5 of Appendix 2).

7. The Chief Finance Officer (Head of Finance) comments on the level of risk set out in Section 13 of this report.

Cabinet recommends that the Council approves:

8. The Treasury Management Strategy for 2019/20 (set out in Appendix 2).

Background, corporate objectives and priorities

This report accords with the Council's Policy and Budget Framework and supports the development of an effective and efficient council.

This report relates to the council's treasury management investments only. Investments held for service purposes or for commercial gain such as investment property are considered in a separate Investment Strategy report.

This report sets out the Treasury Management Policy Statement and proposed Treasury Management Strategy for 2019/20 which set the framework and limits for the delivery of the council's Treasury Management Strategy.

This report accords with the council's Policy and Budget Framework in that it sets out a strategy for achieving the 2019/20 budgeted treasury management investment income that is critical in providing the council with the resources necessary to deliver its objectives.

This report has been produced in accordance with the new Treasury Management Code of Practice issued in 2017.

The Treasury Management Strategy is one of a number of strategies that together set out how the council will manage its resources and investments. The other strategies include the Capital Strategy, the Investment Strategy, the Invest to Grow Fund Strategy and the Property Investment Strategy.

It should be noted that the Treasury Management Strategy sets the overall limits and parameters within which the operational delivery of the strategy operates and as such needs to be flexible enough to cope with operational changes in the delivery of the strategy during the coming year.

The strategy sets the absolute limits but does not set the actual asset allocation up to those limits (i.e. when or how much is actually invested in each of the allowable investment types) and fund manager selection. These responsibilities are delegated to the Chief Finance Officer and may be the subject of separate portfolio holder reports if there are significant changes.

GLOSSARY OF TERMS

Term	**Definition**
Gilts	These are issued by the UK Government in order to finance public expenditure. Gilts are generally issued for a set period and pay a fixed rate of interest. At the end of the set period the investment is repaid (at face value) by the Government. However, during the life of a gilt it will often be traded (bought and sold) at a price decided by the market.
Counterparties	These are the organisations responsible for repaying the Council's investment upon maturity and making interim interest payments. The Counterparties used by the Council are highly credit worthy banks, building societies or local authorities.
Debt Management Agency Deposit Facility (DMADF)	An investment facility run by part of the HM Treasury taking deposits at fixed rates for up to 6 months.
Diversified Credit Funds	Externally managed pooled investment schemes investing in wide ranging mix of credit instruments including Gilts, Corporate Bonds, Investment Grade Credit, Asset Backed Securities, Senior Mortgages, Leverage Loans and High Yield Bonds.
Absolute Return Bond Funds	These are pooled investment schemes which invest in a wide range of credit asset classes. Although similar to Diversified Credit Funds they typically have lower levels of volatility and risk with a correspondingly lower level of return. They also provide better protection than traditional bond funds against rising interest rates or widening credit spreads.
Fixed Deposits	These are loans to banks, building societies or other local authorities which are for a fixed period and at a fixed rate of interest.
Local Authority Bonds	Similar to gilts, these are issued by UK local authorities rather than the Government in order to raise capital.
Money Market Funds / Short Term Cash Funds	Externally managed pooled investment schemes investing in short term cash instruments. These are extremely low volatility, low return funds mostly used for cash liquidity management.
Supranational Bonds	These are very similar in nature to gilts except that rather than being issued by the UK Government they are issued by supranational bodies supported by more than one national government such as the European Investment Bank which is supported by all of the EU member states.
Treasury Bills	Tradable debt securities issued by the UK Government with a short term maturity (3 months to 1 year) issued at a discount. The income from these is in the form of a capital gain rather than interest income.
Call Accounts	Deposit accounts with banks and building societies that provide same day access to invested balances. Interest paid is usually linked to the level of the official base rate.
Reverse Repurchase Agreements (Repo)	An agreement to purchase a security from a counterparty, typically a bank, and then sell the security back to the bank on a predetermined date for the principal amount plus interest. The security is collateral to be used in the event of a default by the counterparty.

Main considerations

1 Executive Summary

1.1 The council is forecast to have £145 million of treasury investments at the beginning of 2019/20. The average cash resource available for treasury investment during 2019/20 is forecast to be £142 million and this is estimated to generate £2.8 million of interest income at an average rate of 2.0%.

1.2 The council's Treasury Management Policy Statement remains unchanged for 2019/20 and is shown in Appendix 1.

1.3 The main treasury management investment policy objective for this council continues to be to invest prudently having regard to the security and liquidity of investments and to aim to achieve the optimum return on treasury investments commensurate with the proper levels of security and liquidity.

1.4 The Treasury Management Strategy for 2019/20 is set out in Appendix 2 and includes the treasury management investment limits and risk indicators.

1.5 The only change to the strategy is the introduction of a new set of risk indicators set out in section 5 of Appendix 2. These indicators replace the previous prudential indicators for treasury management following changes to both the Prudential Code of Practice and the Treasury Management Code of Practice.

1.6 The annual review of the council's treasury management investment strategy, investment portfolio and investment criteria was carried out by the council's appointed treasury advisors (Arlingclose Ltd.) during October and November 2018. The review concluded that the council continues to score very well in the main areas of security, liquidity and return (scoring excellent, very good and very good respectively).

1.7 The council has been implementing alternative investment strategies that look to invest most of the council's former treasury cash balances in non-treasury investments which have the potential to provide returns that are higher than the returns that can be obtained from the council's treasury management investments currently and for the foreseeable future.

1.8 Whilst these strategies are outside of the scope of the Treasury Management Strategy, they have a significant impact on the Treasury Management Strategy for 2019/20 in terms of the types and duration of investments that can be made.

1.9 The council is still in a period of transition to the new strategies and therefore the Treasury Management Strategy for 2019/20 remains largely unchanged from 2018/19. The focus of the treasury strategy is therefore on maintaining security and liquidity rather than enhancing returns.

1.10 The performance of the council's treasury investments will continue to be monitored monthly against the limits and indicators in the strategy and will be reported quarterly to the Audit and Accounts Committee and half-yearly to Cabinet and to Council.

2 Background Information

2.1 The council is required by the treasury management code of practice to have:

i) A Treasury Management Policy Statement.

ii) An annual Treasury Management Strategy Statement.

iii) Risk indicators relating to treasury management.

3 Responsibilities

3.1 The **council** is responsible for:

i) Creating and maintaining a Treasury Management Policy Statement which sets out the main policy objectives.

ii) Approving the annual Treasury Management Strategy Statement that sets out the amount that can be prudently invested in long term investments, the type of investment instruments that can be used, limits for each type of investment instrument and limits for exposure to fixed and variable interest rates.

iii) Approving the treasury management prudential indicators.

3.2 The **Chief Finance Officer** is responsible for:

i) Determining the delivery methodology for, and implementation of, the Treasury Management Strategy.

ii) Deciding on the amounts to invest and instruments to invest in within the limits set in the Treasury Management Strategy.

iii) Selecting suitable investment criteria and funds that fulfil the requirements of the Treasury Management Strategy.

3.3 The council has delegated responsibility for the monitoring and scrutiny of its treasury management practices and activity to the Audit and Accounts Committee and for the execution and administration of treasury management policies, strategy, practices and activity to the council's Chief Finance Officer. This officer acts in accordance with the council's policy statement and Treasury Management Practices (TMPs) and as a member of The Chartered Institute of Public Finance and Accountancy (CIPFA) with CIPFA's Standard of Professional Practice on Treasury Management.

4 Treasury Management Policy Objectives

4.1 The council's treasury management policy objectives remain unchanged and are set out in the council's Treasury Management Policy Statement (see Appendix 1).

4.2 The primary objective is security and the secondary objectives are liquidity (or accessibility of funds) and achieving the optimum return on investments commensurate with the proper levels of security, liquidity and predictability of returns.

4.3 The policy statement also includes the council's approach to ethical investment.

5 Main Factors Influencing the Treasury Management Strategy

5.1 The main factors influencing the council's Treasury Management Strategy are:

i) The level of the council's overall cash resources.

ii) The outlook for interest rates.

iii) The credit risk environment.

iv) The future spending plans and need to generate income to support the cost of services and balance the budget.

6 Overall Resources (Available for Treasury Management Investments)

6.1 Officers maintain daily cash flow forecasts, monthly interest income forecasts and quarterly projections of overall resources available and spending plans, covering the medium term (up to five years), as part of the normal financial management process.

6.2 These projections are used in the Medium Term Financial Forecast and provide estimates of the likely size of the treasury management investment portfolio in future years and the amounts that can be invested in the longer term and those that are needed in the medium and short term.

6.3 The Medium Term Financial Forecast assumes that overall cash resources available for treasury investments will reduce from £149 million to £50 million over the next five years in line with the council's spending plans (capital programme) and plans to allocate funds to non-treasury investments, £75 million of this reduction relates to the continuation of the move from treasury investments to property related investments (£15 million already completed) as part of alternative investment strategies.

7 Interest Rate Outlook

7.1 The outlook for interest rates is set out in section 2 of the Treasury Management Strategy Statement (Appendix 2). The overall assessment is that an increase in the official base rate during 2019/20 is possible but very much dependant on an agreement for the UK's exit from the European Union. Rates are expected to remain at comparatively low levels throughout the medium term period.

7.2 Long term rates incorporate expectations for official base rate movements and inflation. Although inflation is forecast to rise long term rates are expected to remain at subdued levels due to the economic uncertainties surrounding the UK's negotiations to leave the European Union.

8 Credit Risk Environment

8.1 Generally credit risk has been stabilising and improving since the credit crisis in 2008, however banking reform legislation has had a significant effect on risks for the council.

8.2 Several directives have been passed into law over recent years which give regulators legal powers to intervene and allow fast resolution of a failing financial institution by enforcing a "bail-in" as a tool to allow fast recapitalisation of a bank at the expense of creditors (i.e. depositors and bondholders).

8.3 The creditors and shareholders of a failing bank will be required to make good a bank's losses in place of a government "bail-out" funded by taxpayers.

8.4 The advice from Arlingclose Ltd. is that in order to address this increased risk the council should:

i) Diversify (i.e. have a wider range of counterparties) and make use of externally managed money market funds and pooled funds (which will already be diversified).

ii) Use "low" risk investments like treasury bills, gilts, supranational bonds and local authority loans.

iii) Refrain from using unsecured deposits with banks or building societies.

iv) Use "asset backed" investments like covered bonds, reverse repurchase agreements, guaranteed loans and property based investments.

9 Impact of other Non-Treasury Management Investment Strategies

9.1 The Budget Strategy Report for 2019/20 to 2022/23 identified a remaining income target of £2.070 million by 2022/13 from property investments as part of the approach to balance the budgets in future years.

9.2 The council has been developing other strategies that look to invest the council's cash resources in alternative investments. Details of these plans are contained in the Capital and Investment Strategy.

9.3 It will take a number of years for all of these strategies to be fully developed and generate returns and the investments would effectively replace £90 million of the council's longer term cash investments. The alternative investments have the potential to generate returns in excess of the budget strategy income target by 2021/22 and therefore reduce the need to generate increased returns from treasury investments.

9.4 Whilst these investments are currently outside of the scope of the Treasury Management Strategy they do impact on the amount of liquidity required in the Treasury Management Portfolio and would restrict the council's ability to invest in long term treasury investments that might otherwise generate increased returns.

9.5 There is an increase in risk associated with these property related investments and this should influence the amount of risk the council should be willing to take with the treasury management cash investments to maintain a suitable balance in the total risk being taken.

10 Operational Review of the 2018/19 Investment Portfolio

10.1 The council's appointed treasury advisors (Arlingclose Ltd.) have recently carried out their annual review of the council's treasury investment strategy, treasury investment portfolio and investment criteria.

10.2 The review was structured around the council's main investment policy objectives of security, liquidity and return and the council was scored in each of these areas.

10.3 Reviewing the security within the portfolio involves looking at the levels of credit risk, mix of investment types, whether the asset classes are appropriate, what the risks are associated with each type of investment and how prudent the investment criteria are.

10.4 Liquidity is reviewed in terms of the council's cash requirements and how the council ensures it maintains liquidity to meet its spending requirements.

10.5 The investment return is reviewed by comparisons with returns available in the financial markets, other local authorities, fund managers, and the council's returns in previous years.

10.6 The main findings relating to **security** were as follows:

i) "Over the past year the council has continued its strategy to limit credit risk and take steps to decrease the credit risk of the in-house portfolio"

ii) "Arlingclose is very much for the council's credit strategy which focuses foremost on security and risk management"

iii) The council was scored 5 (EXCELLENT) out of 5 for this area which is the same score as last year.

10.7 The findings relating to **liquidity** were as follows:

i) "Although the liquidity of the council's portfolio has reduced in the past twelve months there is still a significant liquidity buffer"

ii) The council was scored 4 (VERY GOOD) out of 5 for this area having scored a 5 (EXCELLENT) last year.

10.8 The findings relating to **returns/yield** were as follows:

i) "A portfolio primarily consisting of liquidity products, gilts and high quality bonds would struggle to meet the council's aspirations".

ii) "The use of pooled funds will help the council in generating the income stream it aims to achieve over a 3-5 year investment time horizon".

iii) The client benchmarking shows the council has "very strong risk adjusted returns on its in-house managed investments compared to the Arlingclose Ltd. local authority client peer group".

iv) The council was scored 4 (VERY GOOD) out of 5 for this area which is the same score as last year.

10.9 The overall **conclusion** was as follows:

i) "We commend the council's strategy and continued effort over the past year to maintain a high credit profile and liquidity and to generate investment returns against an abnormally low interest rate environment".

ii) "We are pleased to note that the council has further diversified its investment portfolio into pooled funds with £65 million invested across different asset classes".

iii) "Further diversification in externally managed pooled funds or those with alternative asset classes can further increase the risk adjusted returns to the council".

11 Recommended Changes to the Treasury Management Strategy Statement

11.1 The Treasury Management Strategy for 2019/20 is set out in Appendix 2.

11.2 The only change to the strategy is the removal of prudential indicators (required by previous versions of the Prudential Code of Practice). These have been replaced by treasury management risk indicators as required by the revised Treasury Management Code of Practice. The new indicators are set out in section 5 of Appendix 2.

11.3 There are no changes to the limits and allowable investments from last year's approved strategy. This is required to allow for the transition period as the council's strategic investments move from treasury investments to property related investments.

11.4 The strategy continues to manage credit risk by externalising this wherever possible through the use of externally managed investment funds.

12 The Treasury Management Strategy for 2019/20

12.1 The recommended Treasury Management Strategy Statement for 2019/20 are set out in Appendix 2. The strategy statement contains the following:

- i) Background and context to the strategy
- ii) Interest rate forecasts
- iii) Details of the investment portfolio
- iv) Risk management assessment
- v) Treasury management risk indicators
- vi) The treasury management strategy
- vii) Borrowing requirements and strategy
- viii) Investment performance monitoring and reporting
- ix) Training for officers and members
- x) Use of external consultants/treasury advisors

13 Chief Finance Officer's Comments on the Level of Risk

13.1 The primary objective of the council's treasury management strategy remains to invest prudently having regard to the security of investments.

13.2 It is important to note that there is a statutory requirement for security, liquidity and yield (in that order) to be the main investment priorities and these are reflected in the Treasury Management Policy Statement.

13.3 The strategy has been arrived at following due and proper consideration of the options based on specialist external advice, and looks to strike an appropriate balance between risk and return and the underlying security of the investments proposed.

13.4 The strategy for 2019/20 looks to maintain the current level of overall credit risk in the portfolio, in particular the continued absence of direct fixed deposits with banks and building societies as an allowable investment type. It does however reflect an increased use of collective bond funds as a short/medium term investment instrument as well as the longer term diversified credit funds to enhance returns with a potential increase in the volatility of these returns.

13.5 The in-house managed funds will be in very low credit risk investments and this will provide a balance to the externally managed and higher credit risk diversified credit fund investments and other collective bond fund investments.

13.6 There will be volatility in returns particularly from diversified credit funds and the possibility that the value of the collective investments could reduce in the short term.

13.7 Diversified credit funds must therefore be regarded as a medium to long term investment with a 3 to 5 year time horizon.

13.8 The volatility and revenue impact will be managed by using the Interest Rate Risk Reserve.

14 Legal implications

14.1 There are no legal implications other than the requirement to approve a strategy prior to the start of each financial year.

15 Financial implications

15.1 Included in the report.

16 Risk management

16.1 A risk assessment has been completed in accordance with the council's risk management process and has identified the following significant (Red or Amber) residual risks that cannot be fully minimised by existing or planned controls or additional procedures. The main risks at this stage are as follows:

16.2 A funding gap could materialise due to another funding crisis, being too risk averse, counterparty default, decline in fund valuations and a lower interest rate environment.

16.3 Treasury management involves the management of risk and achieving a balance between risk and reward.

16.4 The Treasury Management Strategy Statement in Appendix 2 contains details in section 2 on how the risks to the council are managed. This covers credit risk, counterparty risk, market risk, interest rate risk and other risks (mainly fraud).

16.5 All investment risks are constantly monitored and are also reviewed annually along with all the other risks as part of formulating the council's annual Treasury Management Strategy. The significant risks relating to Treasury Management are recorded on the council's Corporate Risk Register with details of how these risks are mitigated.

17 Equalities implications

17.1 There are no equalities issues.

18 Consultation and communication

18.1 An investment strategy workshop will be held on 28 January 2019 for the members of the Audit and Accounts Committee as they have specific responsibility for the monitoring and scrutiny of Treasury Management activity.

18.2 The Audit and Accounts Committee will meet on 28 January 2019 to discuss and comment on the proposed Treasury Management Strategy. Any comments from the committee will be circulated prior to the Cabinet meeting on 5th February 2019.

19 HR implications

19.1 There are no HR implications.

20 Investments considered and rejected

20.1 In formulating the strategy all available instruments are considered and a number of them have been deemed to be unsuitable because of the council's risk appetite, treasury management policy requirements, conflicts with the council's other investment strategies, liquidity requirements (having access to funds when needed) and counterparty selection issues.

20.2 The treasury management instruments deemed to be unsuitable included;

- i) Direct investment in corporate bonds, covered bonds and equities
- ii) Investment in equity and private debt funds
- iii) Loans to housing associations and other public bodies (excluding local authorities)
- iv) Unsecured long term investment with banks and building societies.

20.3 Officers will engage with the council's treasury advisors throughout the year to identify any new investment instruments/opportunities that might arise. If any new instruments are found which meet the council's investment policy objectives, but are not included in the approved strategy, then an amendment to the strategy will require approval by full Council.

Date: 5 February 2019
Decision taken by: Cabinet

Lead officer	Head of Finance – Phillip Hood
Report author	Accountancy Manager – Dean Pletts 01256 845506 Email dean.pletts@basingstoke.gov.uk
Version	Draft for Cabinet Briefing
Dated	8 January 2019
Status	Open
Confidentiality	It is considered that information contained within this report (and appendices) do not contain exempt information under the meaning of Schedule 12A of the Local Government Act 1972, as amended, and therefore can be made public.

Appendix 1

Basingstoke and Deane Borough Council

TREASURY MANAGEMENT POLICY STATEMENT 2019/20

1 Introduction

1.1 The council has adopted the key recommendations from the CIPFA Treasury Management Code of Practice. Accordingly the council will create and maintain, as the cornerstone for effective treasury management, a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities.

1.2 The council will receive reports on its treasury management practices and activity including as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close.

1.3 The council delegates responsibility for the monitoring and scrutiny of treasury management practices and activity to the Audit and Accounts Committee.

1.4 The council has delegated responsibility for the execution and administration of the treasury management policy, strategy, practices and activity to the council's Section 151 Officer. This officer should act in accordance with the council's treasury management policy statement, strategy and Treasury Management Practices (TMP's) and as a member of CIPFA with standards of professional practice on treasury management.

2 Treasury Management Policy Objectives

2.1 The council defines its treasury management activities as:

2.2 "The management of the council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.3 The council acknowledges that it is responsible for its treasury management decisions and activities.

2.4 The council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the council.

2.5 The council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

2.6 The primary policy objective of the Treasury Management Strategy is:

i) To invest prudently having regard to the security of investments.

2.7 The supplementary policy objectives of the Treasury Management Strategy (in order of importance) are:

i) To maintain liquidity (accessibility) in the investment portfolio to meet the council's spending plans

ii) To aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity and predictability of returns

iii) To minimise the cost of any temporary borrowing (which may be required for day to day cash flow reasons)

3 The Council's Approach to Ethical Investments

3.1 As an organisation the council does not have an overall ethical policy and has not defined what is, or what is not, ethical. The council does not invest in equities and therefore does not have influence over the activities of companies that part-ownership might provide. However as an investor the council is able to take the following approach:

i) For direct investments the council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have 'Responsible Investment Policies or Environmental, Social and Governance (ESG) policies' in place prior to investing.

ii) For indirect investments the council will seek to ensure that any fund managers used have their own responsible investment policies or have signed up to widely recognised policies such as the United Nations Principles for Responsible Investment.

iii) The council recognises that it has no control or influence over where its counterparties themselves lend money or invest once an investment has been made by the council.

Appendix 2

Basingstoke and Deane Borough Council

TREASURY MANAGEMENT STRATEGY FOR 2019/20

Contents:

1 Background Information

1.1 This strategy statement has been produced in accordance with:

i) The council’s Treasury Management Policy Statement.

ii) The latest Code of Practice on Treasury Management published by the Chartered Institute of Public Finance and Accountancy (CIPFA).

iii) The council’s constitution which requires the annual production of a Treasury Management Strategy for the forthcoming year.

iv) The Government Department guidance on local government investments which requires treasury management investments to consider security, liquidity and yield (in that order).

1.2 The Council’s Treasury Management Strategy is undertaken within the following context:

i) The level of the council’s investment balances is one of the highest of all district authorities and has been for some time. The council has therefore been able to take a longer term view on investment decisions.

ii) The income generated from investments is significant to the council and supports the cost of services. The Medium Term Financial Forecast assumes that income from cash investments will be £2.8 million in 2019/20 reducing to £2.0 million by 2022/23.

2 Interest Rate Forecast

2.1 In order to put a treasury management strategy into context it is necessary to appreciate the current forecasts for interest rates.

2.2 The UK Central Bank Official Rate (base rate) is currently at 0.75%. The average of forecasts from independent city forecasters is that the official rate will average 0.97% in 2019, 1.37% in 2020 and 1.69% in 2021.

2.3 The council’s treasury advisors (Arlingclose Ltd) are forecasting that the Bank of England will increase rates to 1.25% before the end of March 2020.

2.4 The council's advisors' forecasts for interest rates for future years are shown in Table 1:

Table 1 – Arlingclose's Forecast for Interest Rates (Oct 2018)

	Official Bank Rate			**Longer Term Rates (5yr Gilts)**		
	Upside Risk	Central Case	Downside Risk	Upside Risk	Central Case	Downside Risk
	%	%	%	%	%	%
Mar-19	0.00	**1.00**	-0.50	+0.15	**1.20**	-0.30
Jun-19	0.00	**1.00**	-0.50	+0.20	**1.25**	-0.35
Sep-19	0.00	**1.25**	-0.75	+0.25	**1.35**	-0.45
Dec-19	+0.25	**1.25**	-0.75	+0.35	**1.40**	-0.50
Mar-20	+0.25	**1.25**	-0.75	+0.35	**1.40**	-0.60
Jun-20	+0.25	**1.25**	-0.75	+0.35	**1.35**	-0.60
Sep-20	+0.25	**1.25**	-0.75	+0.35	**1.35**	-0.60
Dec-20	+0.25	**1.25**	-0.75	+0.35	**1.30**	-0.60
Mar-21	+0.25	**1.25**	-0.75	+0.35	**1.30**	-0.60
Jun-21	+0.25	**1.25**	-0.75	+0.35	**1.30**	-0.60
Sep-21	+0.25	**1.25**	-0.75	+0.35	**1.30**	-0.60
Dec-21	+0.25	**1.25**	-0.75	+0.35	**1.30**	-0.60

2.5 Arlingclose's commentary on their forecasts is as follows:

i) The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case is for the Bank Rate to rise twice in 2019. The risks are weighted to the downside.

ii) Gilt yields have remained at low levels. We expect some upward movement from current levels based on our interest rate projections, the strength of the US economy and the ECB's forward guidance on higher rates. However, volatility arising from both economic and political events will continue.

3 Overall Resources and the Treasury Management Portfolio

3.1 The council's Balance Sheet as at 31 March 2018 shows that it had overall net assets of approximately £421 million. This included £296 million of investment property and £153 million of cash resources in the form of long and short term treasury investments.

3.2 The council's Medium Term Financial Forecast estimates that the council will have cash resources of £145 million at the beginning of 2019/20. The latest forecast is for this to increase by £15 million in the early part of the year before reducing to £125 million at the end of the year. This results in an average balance for the year of £142 million and this is expected to generate £2.8 million of interest income in 2019/20.

3.3 The council's existing investment portfolio reflects the effect of previous treasury management strategies. Investments have been made for a combination of short and long term periods using different investment instruments.

3.4 A breakdown of the forecast investment portfolio position as at 31 March 2019 shows total investments of £145 million (at cost) as shown in Table 2.

Table 2 – Expected Treasury Investment Portfolio 31 March 2019

Instruments	**£'m**	**%**	**Maximum Limit**
Government Gilts	28.0	19%	91%
Supranational Bonds	4.0	3%	£50m
Local Authority Deposits/Bonds	25.0	17%	£50m
Money Market Funds	13.0	9%	£25m
Short Term Cash Funds	10.0	7%	£25m
Collective Investment Funds	65.0	45%	£80m
Total Investments	**145.0**	**100%**	

4 Risk Management Assessment

4.1 Treasury management involves the management of risk as no treasury management activity is without some risk.

4.2 Due to the size, complexity and importance of the income generated from treasury management activities it is important that all associated risks are assessed and managed.

4.3 The main risks associated with treasury management are as follows:

i) **Credit and counterparty risk** (risk to capital) – the risk that a third party will fail to meet its contractual investment obligation resulting in a loss of the council's capital investment or the risk that there will be a permanent reduction in the capital value of the investment.

ii) **Liquidity risk** – the risk that the council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or losses upon disposal of tradable securities.

iii) **Market or interest rate risk** – the risk that fluctuating interest rates will have an adverse impact on the council's investment income or the value of its investments.

iv) **Other risks** – this includes inflation risks and risks associated with cash management, legal requirements and fraud.

4.4 These risks are managed as follows:

i) Credit and Counterparty Risk (risk to capital)

Wherever possible the council will attempt to externalise the management of credit risk through the use of pooled funds and fund managers who have the required knowledge, experience and resources needed to assess and monitor credit risk effectively.

For any remaining internally managed credit risk the council's exposure to this risk is controlled by limiting the maximum sum invested with any single counterparty and by restricting investments to only those counterparties considered to be of high credit quality, as agreed in the council's Treasury Management Practices.

The Council's treasury advisors (Arlingclose Ltd) provide advice on the security of the council's investments which includes credit ratings and other factors such as sovereign guarantees, country of origin, credit default swaps, share prices and market sentiment.

The assessment of security also includes credit ratings produced by the international credit rating agencies which are used throughout the banking and investment industry. Credit ratings are continuously monitored.

The market prices of the council's tradable investments are also monitored as these give an indication of market sentiment which can include credit concerns.

If the credit rating of a counterparty or a security held by the council is downgraded with the result that it no longer meets the council's minimum acceptable credit quality or other factors give cause for serious concern then potential opportunities to dispose of the security will be investigated.

The council requires the necessary flexibility in its treasury management investment strategy to enable it to move a proportion of the portfolio into safer investment instruments during times of general concern about credit risk.

ii) Liquidity Risk

This risk is managed by maintaining a minimum proportion of investments in the short term for cash flow purposes and by setting a maximum amount that can be invested long term (more than 364 days).

When investing in external funds the council will have regard to each fund's access requirements (daily, monthly, quarterly etc.) and will ensure that a suitable mix of fund liquidity is available to meet planned expenditure.

When the council is using fixed long term investments it sets limits on the maximum amount that can be invested in each future year to ensure that the maturity structure for its investments results in a significant amount of investments maturing each year. The maturities can be used (rather than being re-invested) if required for short term cash requirements.

The council also has the option to borrow short term funds in order to meet its commitments if necessary.

iii) Market or Interest Rate Risk

The Treasury Management Strategy attempts to control interest rate risk by spreading investments across different financial instruments and for different time periods.

When using external funds consideration is given to the interest rate risk characteristics of each fund as part of the selection process. The fund manager's ongoing effectiveness in managing the risk is monitored on a regular basis with the assistance of the council's treasury advisors.

The council uses a mix of instruments in order to spread the risk and reduce the overall volatility. Limits are set on the maximum amount in each type of investment.

A proportion of investments in long term fixed rate instruments would provide the council with stable and known amounts of income for a sustained period of time.

A proportion of investments at variable interest rates would enable the council to benefit from future increases in interest rates.

Internally managed investments that have a fluctuating market price are purchased with the intention that they will be held to maturity ('buy to hold'), thereby reducing the impact of market risk.

In addition the council currently has an interest rate risk reserve (estimated to be £2.4 million as at 31 March 2019) in order to reduce the impact of adverse in-year returns from interest income.

When the council uses investment instruments that could produce negative returns or where the accounting treatment for certain investment instruments does not allow the gains to be treated as income then it will adjust the level of the risk reserve to provide some degree of protection from losses and enable the smoothing out of any adverse or favourable variances against budgeted income.

iv) Other Risks

These risks are managed through the council's adoption of standard Treasury Management Practices (TMPs) which are reviewed annually. These cover all aspects of treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.

All treasury management procedures and transactions are subject to annual inspections by both internal and external auditors.

The council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

The council will ensure that all staff and elected members tasked with treasury management responsibilities will receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

5 Treasury Management Risks Indicators

5.1 The council measures and manages its exposure to treasury management risk using the indicators set out in Table 4.

Table 4 – Treasury Management Risk Indicators

		2019/20
Credit Risk Indicator		
Portfolio average credit rating		A-
Liquidity Risk Indicator		
Total cash available within 3 months		£113m
Interest Rate Risk Indicator		
Revenue impact of a 1% change in rates		£0.5m pa
		Limit
Price/Market Risk Indicator		
Principal Sums invested for more than 365 days	**2019/20**	£25m
	2020/21	£25m
	2021/22	£25m
	2022/23	£25m
	2023/24	£25m
	2024/25	£15m
	2025/26	£15m
	2026/27	£15m
	2027/28	£15m
	2028/29	£15m

5.2 The council will measure its exposure to credit risk by monitoring the overall credit rating/score of its treasury portfolio. This is calculated by applying a score to each investment (AAA = 1, AA+ = 2, etc.) and taking the average, weighted by the size of the investment. Unrated investments are assigned a score based on their perceived risk.

5.3 The council will measure its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without borrowing.

5.4 The interest rate risk indicator is set to control the council's exposure to interest rate risk by monitoring the impact that a 1% rise or fall in interest rates has on the council's income.

5.5 The limit on principal sums invested for periods longer than 365 days indicator sets the maximum total value of investments that can be made for periods of 1 year and beyond.

5.6 These indicators will be monitored throughout the year by the Head of Finance (Section 151 Officer) and will be reported quarterly to the Audit and Accounts Committee and half-yearly to Cabinet and Council.

6 The Treasury Management Strategy for 2019/20

Background

6.1 The Treasury Management Strategy is drawn up in order to comply with central government guidance on Local Government Investments and CIPFA's Treasury Management Code of Practice.

6.2 The Treasury Management Strategy sets out the ranges and limits within which the treasury management function can operate. It states which investment instruments the council may use for the prudent management of its treasury balances during the financial year and sets limits on the different types of investment instrument.

Investment Objectives

6.3 The treasury management policy objectives for this council are to invest prudently having regard to all of the associated risks including the security of investments and to maintain liquidity in the investment portfolio to meet the council's spending plans.

Fund Selection

6.4 The selection of collective investment schemes or pooled funds will be determined following a selection process that will include evaluation of certain criteria including the size, duration, credit worthiness of the underlying investments, income distribution levels, past performance, management fees and risk and reward profiles.

6.5 The council will seek to ensure that any fund managers used have their own responsible investment policies or have signed up to widely recognised policies such as the United Nations Principles for Responsible Investment.

6.6 Any selection of funds or fund managers by the council would be made with the assistance of its treasury management advisors Arlingclose Ltd and KPMG Investment Advisory.

Counterparty Selection

6.7 For in-house specified investments the council has determined that the minimum allowable credit rating for investments that are not with the UK Government or a UK local authority will be a long term rating of : A- (Fitch); A3 (Moody's); A- (Standard & Poor's).

6.8 The council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have 'Responsible Investment Policies or Environmental, Social and Governance (ESG) policies' in place prior to investing.

6.9 The lowest available counterparty credit rating will be used to determine credit quality, unless an investment specific rating is available.

6.10 In the event that the credit rating of the council's contracted provider of banking services falls below the council's minimum credit rating criteria the bank will continue to be used for business continuity and short term liquidity requirements (overnight and weekend) and the council will ensure that balances are kept at the minimum amount practicable.

6.11 Currently, the council's banking services are provided by HSBC Bank Plc.

6.12 For long term investments with other UK local authorities the council will consider their financial strength by assessment of their financial statements and other external indicators where available.

6.13 For externally managed investments minimum credit ratings shall be determined by the fund managers as part of their own investment policy and this policy will be considered fully by the council as part of the fund selection process prior to investment in any fund.

6.14 The council understands that credit ratings are not perfect predictors of investment default. Full regard will therefore be given to other available information on credit quality including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

6.15 All credit ratings and other factors detailed above are monitored in-house and by Arlingclose Ltd (the council's treasury advisors) and the council is alerted to any changes.

6.16 The council will consider the use of counterparties outside of the United Kingdom where the country of origin has a sovereign rating of not lower than AA+ or equivalent. The council may also have exposure to non-UK investments indirectly through the use of money market funds and collective investment funds.

Investment Balances / Liquidity of Investments

6.17 Based on cash flow forecasts, the council anticipates its fund balance at the end of 2019/20 will be £110 million. Of this, £10 million is required for cash flow requirements. This would leave £100 million available for short and long term investment.

6.18 Giving due consideration to the council's level of balances over the next three years, the need for liquidity and its spending commitments, the council has determined that £100 million of its overall fund balances could be prudently committed to investments beyond 364 days.

6.19 Where investments are made in longer term instruments, the council will have regard to liquidity by using funds with appropriate withdrawal policies or by spreading fixed term investments over future years ensuring that significant amounts mature each year.

Allowable Investment Types for 2019/20

6.20 In deciding which types of investment to use the council has regard to its treasury management advisors. This year's strategy has been produced following consultation with the council's advisors, Arlingclose Ltd and KPMG Investment Advisory, and with assessment of the risks and returns of the different instruments used.

6.21 The investment types that this council will allow to be used for new investment in 2019/20 are as follows

Bank overnight call account deposits
Debt Management Agency Deposit Facility
Treasury Bills
Money Market Funds
Collective investment schemes (unitised pooled funds)*
Reverse repurchase agreements with banks and building societies up to 3 years (subject to minimum quality of collateral)
Loans to UK local authorities up to 5 years
Bonds issued by UK local authorities up to 10 years
UK treasury stock (Gilts) up to 10 years
Supranational bonds up to 10 years

*Includes Diversified Credit Funds, Absolute Return Bond Funds, Property Funds and Short Term Cash Funds

6.22 All investments will be denominated in pounds sterling.

6.23 The Authority defines “high credit quality” organisations and securities as:

- UK Government
- UK Local Authorities
- AAA rated Supra-national bonds
- Constant Net Asset Value (CNAV) or Low Volatility Net Asset Value (LVNAV) Money Market Funds
- Banks and building societies with a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

6.24 The code requires the council to state its position regarding the use of derivative investments. The council does not intend to use standalone financial derivatives directly. However, the use of derivatives by fund managers or collective investment schemes (pooled funds) is permitted.

6.25 The council will allow all previously purchased investments which are held as a result of investment decisions made under an earlier year's approved strategy to be held during 2019/20.

6.26 For each type of investment that might be used during 2019/20 the maximum amounts allowed (actual amount or percentage of the overall portfolio) are shown in Table 3.

Table 3 - Limits for Types of Investment

Type of Investment	**Counter-party Limit 2019/20**	**Maximum Limit £'s/ % age of Portfolio**
Government Gilts	None	91%
Treasury Bills	None	91%
H M Treasury (DMADF)	None	100%
Supranational Bonds	£20m	£50m
Local Authority Loans	£5m	£50m
Money Market Funds	£5m	£25m
Short Term Cash Funds	£5m	£25m
Collective Investment Funds [1]	£25m	£80m
Bank and Building Society Repurchase Agreements[2]	£10m	£25m
Bank Overnight Call Accounts[2]	£5m	£15m

[1]Counterparty limit is per fund. Collective Investment Funds include Diversified Credit Funds, Absolute Return Funds and Property Funds.
[2]Includes a £20 million limit on each allowable foreign country.

6.27 For bank and building society investments counterparties will be chosen in conjunction with the council's treasury advisors and will be approved by the Chief Finance Officer. A group of banks under the same ownership will be treated as a single organisation for counterparty limit purposes.

6.28 Under the new IFRS9 accounting standard the council is required to state its business model for accounting for certain investments. The council aims to achieve value from its internally managed investments by a business model of collecting the income under a buy to hold strategy and is not looking to make short term gains from selling investments when the valuation of those investments change.

7 Borrowing Requirement and Strategy for 2019/20

7.1 The council has no plans or intentions to carry out any long term external borrowing during 2019/20 however it has taken steps to secure preferential borrowing rates (called the preferred certainty rate) from the PWLB in case the borrowing position changes.

7.2 Although the council is a major investor it is occasionally necessary to borrow on a short term basis for cash flow reasons

7.3 Any borrowing (long term or short term) would need to be within the council's Authorised Borrowing Limit of £50 million as set out in the council's approved Capital Strategy.

8 Treasury Management Performance Monitoring and Reporting

8.1 Performance of the council's treasury function will continue to be monitored monthly and will be reported quarterly to the Audit and Accounts Committee. Half year and outturn reports on treasury management activities and performance will also be prepared for the Cabinet and Full Council.

8.2 The council participates in quarterly portfolio benchmarking provided by its treasury advisors Arlingclose. This benchmarking includes measures of the level of risk taken and the corresponding returns. Results of the benchmarking exercise are included in all of the monitoring reports detailed above.

9 Training

9.1 The Treasury Management Code of Practice requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the function, have access to appropriate training relevant to their needs and understand fully their roles and responsibilities.

9.2 Treasury workshops are provided for members of the Audit and Accounts Committee and are open to all members of the council. The workshops are delivered by a combination of external training providers, council officers and the council's treasury advisors.

9.3 Officers responsible for treasury management attend external workshops and seminars as part of their continued professional development.

10 Use of Investment Consultants/Treasury Advisors

10.1 The council has contracted Arlingclose Ltd. as treasury advisors. Under the contract Arlingclose provide the following services:

- Advice on counterparty selection and creditworthiness
- Assistance in compliance with codes of practice
- Economic and interest rate forecasts
- Strategy and review meetings
- An annual report on the council's investment strategy and portfolio
- Advice and guidance on treasury management issues
- Benchmarking and performance monitoring
- Seminars and training events

10.2 The council has also contracted KPMG Investment Advisory to provide asset allocation advice and monitoring services for the externally managed collective investment schemes (pooled funds) that are used by the council.