Somerset County Council

Cabinet
- 12th February 2018

Treasury Management Strategy Statement 2018-19

Cabinet Member: Mr David Hall – Cabinet Member, Resources
Division and Local Member: All
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	Seen by:	Name	Date
Report Sign off	County Solicitor	Honor Clarke	16/01
	Monitoring Officer	Julian Gale	16/01
	Corporate Finance	Kevin Nacey	16/01
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	Senior Manager	Stephen Morton	09/01
	Cabinet Member	Councillor David Hall	16/01
Forward Plan Reference:	FP/17/11/01		
Summary:	This report brings together the requirements of the Local Government Act 2003, including the revised guidance applicable since 1 April 2010, the CIPFA Treasury Management in the Public Services Code of Practice Revised 2011 Edition (CIPFA TM Code), and the CIPFA Prudential Code for Capital Finance in Local Authorities: Revised 2011 Edition (CIPFA Prudential Code). 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 best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.		
Recommendations:	The Leader and Cabinet are asked to endorse the following and recommend approval by Council on 28th February 2018: • To adopt the Treasury Management Strategy (as shown in Section 2 of the report). • To approve the Annual Investment Strategy (as shown in Section 3 of the report) and proposed Lending Counterparty Criteria (attached at Appendix B to the report). The Leader and Cabinet are recommended: • To note the Prudential Treasury Indicators at point 4.8. • To note the current Treasury Management Practices (TMPs) attached at Appendix D to the report.		

Reasons for recommendations	Full Council must approve a Treasury Management Strategy Statement (TMSS) including an Annual Investment Strategy (AIS) prior to the start of each financial year, and it usually does this at its February meeting.
Links to Priorities and Impact on Service Plans:	Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver the Somerset County Plan.
Consultations undertaken:	None
Financial Implications:	As per links to priorities box
Legal Implications:	Treasury Management must operate within specified legal and regulatory parameters as set out in the summary, and in more detail in the TMPs.
HR Implications:	None
Risk Implications:	The TMSS including the AIS is the Council's document that sets out strategy and proposed activities to conduct Treasury activity while mitigating risks. Appendix D, the Treasury Management Practices document gives detailed explanation of the policies and procedures specifically used in treasury risk management.
Other Implications (including due regard implications):	None
Scrutiny comments / recommendation (if any):	The Audit Committee is the body responsible for ensuring effective scrutiny of the treasury management strategy and policies.

1. Background and Current Position

1.1. The CIPFA TM Code requires that each Local Authority prepare a report outlining the proposed Treasury Management policies, strategy, and activities for the coming financial year. CIPFA consulted on changes to the Treasury Management and Prudential Codes in 2017. The revised Codes were published in late December but the specific guidance notes which include the treasury management indicators for local authorities, have yet to be published. The Council's treasury advisor has recommended authorities draft and obtain Full Council approval for the 2018-19 treasury management strategy under the 2011 CIPFA Codes.

1.2. The Local Government Act 2003 (LGA 2003) requires that an Annual Investment Strategy Statement be submitted, outlining the proposed investment strategy. This can be combined with the Treasury Management Statement, but must state explicitly where it is dealing with the guidance by the Secretary of State. CLG Guidance is also expected to be revised and updated in the near future, but again, as per our Advisors' advice, this strategy will act in accordance with the current Guidance and wait for the revised Guidance before taking any action. If the CIPFA Code and Guidance, and CLG Guidance necessitate immediate changes to the Strategies, new ones will be presented to Full Council at the earliest opportunity.

1.3. Under Section 3 of the LGA 2003 (duty to determine affordable borrowing limit), a Local Authority must have regard to the CIPFA Prudential Code. This code requires the setting of a number of Prudential Indicators, benchmarks within which, Treasury and Investment Management, and Capital Financing are managed.

1.4. The setting of Prudential Indicators for Treasury Management requires Authorities to recognise key implications of their borrowing and investment strategies. These relate to the affordability of overall borrowing limits and the risk of exposure to interest rate changes; the maturity structure of borrowing; and longer-term investments.

1.5. In formulating the Treasury Management and Annual Investment Strategies, and the setting of Prudential Indicators, Somerset County Council (SCC) adopts the Treasury Management Framework and Policy recommended by CIPFA. These can be found in Appendix A.

1.6. The current TMPs are attached for information as Appendix D to this report, and set out the main categories of risk that may impact on the achievement of Treasury Management objectives. No treasury management activity is without risk. The successful identification, monitoring and control of risks are the prime criteria by which the effectiveness of its treasury management activities will be measured. The main risks to the Council's treasury activities are:-

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in price / interest rate levels)
- Refinancing Risk (impact of debt maturing in future years)
- Legal & Regulatory Risk

The schedules to the TMPs provide details of how those risks are actively managed. They form a living document (last updated May 2016), and are subject to ongoing review and amendment.

1.7. SCC has a projected cash income of approximately £770m for 2018-19. As at 27th December 2017 the external long-term debt portfolio of SCC stood at just over £329m. The investment portfolio at the same time stood at just over £243m.

1.8. Investment interest is an important source of income for SCC. Nearly £2.1m was earned in 2016-17. Interest will be reduced for the year 2017-18 due to smaller balances and reduced rates, and 2018-19 is expected to be another year of low yields. With the uncertainty of Brexit negotiations, base rate is expected to remain low, and a cut in the future cannot be entirely ruled out. With inflation expected to remain above 2%, investment returns in real-terms are likely to be negative.

1.9. These factors represent significant cash flow, and debt and investment portfolio management for the Council's Officers. The major external influence on the Council's treasury management strategy for 2018-19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy remains relatively robust since the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. In the current financial and economic environment, and taking into account potential influencing factors (an economic forecast is given at Appendix C), it is imperative that the Council has strategies and policies in place to manage flows and balances effectively. The strategies and policies herein state the objectives of Treasury Management for the year, and set out the framework to mitigate the risks to successfully achieve those objectives.

2. Treasury Management Strategy

2.1. Long-Term Borrowing
SCC currently has £329.55m of borrowing. This consists of £113m of LOBOs, £57.5m of Barclays Ex-LOBOs (see 2.5 below) and £159.05m of PWLB loans, at a combined rate of 4.66%.

2.2. The Council's need to borrow for capital purposes is determined by the Capital Investment Programme. Specific projects have been identified for 2018-19 totalling £120m. Much of this will be funded using a combination of grant, capital receipts, and contributions. Although timings of capital expenditure may not be totally predictable, it is envisaged that borrowing of up to £40m may be necessary.

2.3. The differential between investment earnings and debt costs remains negative and this is expected to continue during 2018-19 and beyond. The cost of carry associated with long term borrowing compared to temporary investment returns, as well as the added counterparty risk by having more funds to invest, means that a passive borrowing strategy, borrowing funds as they are required would be most appropriate. The benefits of this strategy will be monitored and weighed against the risk of shorter-term rates rising more quickly than expected.

2.4. Shorter-dated gilt yields, and therefore shorter-dated PWLB rates, are forecast to be lower than medium and long-dated gilt yields during the financial year (An economic and interest rate forecast can be found at Appendix C). It is envisaged that any new borrowing, should it be taken, will be in these shorter periods, as this is also compatible with the current maturity profile. Yields for these maturities are expected to remain lowest as the continued recovery necessitates lower interest rates for longer. Variable rate loans currently mitigate the cost of carry. Shorter-dated Equal Instalment of Principal (EIP) loans are cheaper than loans paid on maturity and are repaid systematically in equal instalments over their life. Both will be actively considered, as will shorter dated loans from other Local Authorities.

2.5. SCC has £113m of loans that are active LOBO loans, of which £88m will have an option during 2018-19. A LOBO is called when the Lender exercises its right to amend the interest rate on the loan at which point the Borrower can accept the revised terms or reject them and repay the loan without penalty. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion. In June 2016, Barclays Bank announced that they had waived all their rights to the options on the LOBO loans that they made. This included the £57.5m held by SCC. These loans are now effectively long-term fixed loans.

SCC will continue with the current policy not to accept any option to pay a higher rate of interest on its' LOBO loans, and will exercise its own option to repay the loan should a lender exercise an option. SCC may utilise cash resources for repayment or may consider replacing any loan(s) by borrowing from the PWLB or other Local Authorities. Depending on prevailing rates and the amount to be repaid, new loans might be taken over a number of maturities. If rates were comparatively high at the time, variable rate loans may be taken until rates became lower. The 'Maturity Structure of Borrowing' indicators have been set to allow for this contingency strategy.

2.6. The introduction of a repayment rate by the PWLB significantly reduced the opportunities for borrowers to prematurely repay or reschedule PWLB loans without paying a premium. The premium payable (or discount gained) is derived from the yield of the Gilt (Government Bond) corresponding to the maturity of the PWLB loan. Gilt yields, ergo premia, are constantly moving, sometimes aggressively, in response to many economic and political factors. They may at times offer windows of opportunity to repay or reschedule debt at comparatively advantageous levels of premium. To highlight volatility, in December 2009 the entire portfolio had a £13.8m premium and 1 loan in discount. In November 2012 it was a premium of £49.7m and no loans in discount. As at 15th August 2016, due to the effects of the Brexit vote, overall premia stood at £129.6m. By 12th December 2017 this had reduced to £97m.

Officers continually monitor repayment rates and calculate premiums to identify opportunities to repay or reschedule PWLB loans. These are reported and discussed by SCC Officers at monthly Treasury Meetings.

2.7. When making any premature repayment or rescheduling decisions, the overriding objective is that it would be carried out in line with the CIPFA TM Code, i.e. that performance measurement should consider risk as well as return (borrowing rate). Priority would be given to risk management, and then the pursuit of minimising rate. Premature repayment / rescheduling will consider: -

- Cost (premium) v benefit (revenue savings) analysis to assess which loan(s) to repay
- Repayment / rescheduling of loans of a stated maturity to improve overall maturity profile and thereby reduce refinancing risk.
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.

2.8. Any rescheduling activity will be undertaken within the Council's treasury management policy and strategy. The Council's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by Arlingclose or SCC Officers and discussed with Senior Management. Any decision to prematurely repay or reschedule will first be approved by the Section 151 Officer (Director of Finance & Performance).

2.9. All rescheduling activity will comply with the requirements of the Capital Finance and Accounting Regulations (SI 2007 No 573 as amended by SI 2008/414).

2.10. Short-Term Borrowing
SCC has not needed to obtain short-term funds from the money market to date during 2017-18. This has been due mainly to the use of Call Accounts and Money Market Funds (MMFs), which offer better security and liquidity (instant access in most cases), with the added benefit of better rates than for many short-term deposits of up to 3-months. It is intended to continuously and incrementally improve cash flow performance, to minimise bank and temporary loan interest.

2.11. The use of Call Accounts and MMFs will continue where advantageous to rates and/or cash flow; However, many counterparties have reduced their call facility rates further during 2017-18 and with possible changes towards more short-term deposits, it may be appropriate and necessary to borrow short-term to cover cash flow fluctuations. Where this is deemed advantageous, short-term funds will be obtained from the money market using the services of a panel of money market brokers.

3. Annual Investment Strategy

3.1. Introduction
The Office of the Deputy Prime Minister, (now Communities and Local Government) issued guidance on Local Government Investments under section 15(1) of the LGA 2003 (Revised 2011). The overriding aim of the guidance is to encourage authorities to invest prudently, without burdening them with detailed prescriptive regulation. The guidance defines a prudent investment policy as having two objectives: achieving first of all security (protecting the capital sum from loss) and then liquidity (keeping the money readily available for expenditure when needed). It goes on… "Provided that proper levels of security and liquidity are achieved, it may then (but only then) be reasonable to seek the highest yield consistent with those priorities".

3.2. The guidance makes it clear that this need not be a once-a-year event, but that the initial strategy may be replaced by a revised strategy, at any time during the year, on one or more occasions, subject to Full Council approval. Officers will from time to time appraise the Investment Strategy, including counterparty criteria, to ensure that it continues to be fit for purpose, and if necessary, to realign it with evolving market conditions and expectations for future interest rates.

3.3. Under the guidance there are two types of investment, 'Specified' and 'Non-Specified'. Specified investments are those that offer high security and high liquidity, are made in Sterling, and with a maturity of no more than one year. Investments with the UK Government, other Local Authorities, or bodies with 'high credit quality' will count as specified investments (unless greater than 1-year). Non-Specified investments are all other investments that fall outside of this description, and must be dealt with in more detail than those classified as Specified.

3.4. A requirement of the revised guidance was that the strategy should report on procedures for ensuring that treasury management staff has the right kind of training in investment management. Current SCC treasury management practitioners hold investment, as well as accounting qualifications. In addition to the normal SCC Performance Review and Development process, training needs are both identified and addressed whilst undertaking Continuous Professional Development by these on-going means:-

- Attendance at CIPFA Treasury Management Network meetings, and at the Annual CIPFA Treasury Management Conference.
- Regular seminars and updates via our treasury advisors, Arlingclose Ltd.
- Semi-Annual seminars organised by treasury management software provider specifically for Local Authority users.
- Ad hoc seminars arranged by market participants, including banks and credit rating agencies.
- Daily contact with brokers and investment houses, and a plethora of market information from the press, and many other sources.

3.5. <u>Investment Strategy</u>
The County Council's investments can be divided into two areas. Money that is lent to help smooth anticipated monthly cash flow movements, and funds which have been identified as not being immediately required (core balances), which are generally invested as part of the 'Comfund'. Total balances for 2017-18 to the end of November have ranged between £219m to £287m, averaging £258m to the 30th November 2017.

3.6. The Council uses cash flow software to help identify surplus cash, and to determine periods for which funds may prudently be committed. The Council's cash flow investments are then made with reference to the outlook for the UK Bank Rate and money market rates. Short-term deposits will continue to be made with suitable counterparties, where this is deemed beneficial. However, it is likely under current market conditions that Call Accounts and MMFs will predominantly be used.

3.7. The strategy for investment of funds identified as not immediately needed has historically been to utilise the Comfund. Comfund is a diversified portfolio of rolling cash deposits, and other approved investment instruments, with maturities on a monthly basis to provide adequate liquidity. The majority of this fund, which at 31st December 2017 stood at £200m, constitutes SCC reserves and core balances.

Given the increasing risk and falling returns from short-term unsecured bank investments, it was deemed appropriate to diversify into the higher yielding CCLA Property Fund during 2017-18. A £10m investment was made, and this will continue to be held for at least the medium-term.

3.8 The Section 151 Officer (Director of Finance & Performance) under delegated powers will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. He in turn delegates responsibility for implementing policy to Treasury Management Officers. Details of deposits and investments taken by Officers are reported to the monthly treasury management review meeting.

3.9 Under current market conditions SCC will continue to use the following investments: -

- Business Reserve Accounts and term deposits.
- Deposits with other Local Authorities.
- AAA-rated Money Market Funds *
- The Debt Management Office (DMO)
- Variable Net Asset Value (VNAV) Money Market Funds.
- Gilts and Treasury Bills.
- Certificates of Deposit with Banks and Building Societies
- Commercial Paper

* Following EU reform to the operation and management of Money Market Funds which will be implemented during 2018-19, all non-government MMFs will have to convert from Constant Net Asset Value (CNAV) to LVNAV (Low Volatility Net Asset Value) or VNAV. Many are expected to choose to convert to LVNAV. LVNAV funds will have to operate within tighter requirements (e.g. tolerance of the fund's NAV deviating from £1 narrows from 99.5p to 99.8p; higher liquidity requirements). For the Council, the important aspect is that the net asset value of LVNAV funds is likely to remain at £1, as is currently the case for CNAV funds, and only change in exceptional market conditions.

3.10 Due to the implementation of the UK Banking Reform Act 2014 and the broadly similar European Union Bank Recovery and Resolution Directive, and the perceived lack of government support for, and potential bail-in risk at banks and building societies, it would seem prudent to continue to allow for greater diversification of investment instruments and counterparties. The list of further potential investment activities below was included last year, and they will continue to be monitored and assessed as alternatives to mitigate bail-in risk and falling, potentially negative returns.

- Use of any public or private sector organisation that meets the creditworthiness criteria rather than just banks and building societies.
- Building Societies – Including unrated Societies with better creditworthiness than their credit rated peers.
- Corporate Bonds – Can offer access to high credit rated counterparties, such as utility, supermarket, and infrastructure companies.
- Covered Bonds and Reverse Repurchase Agreements (Repos) present an opportunity to invest short-term with banks on a secured basis and hence be exempt from bail-in
- Pooled Funds. These funds allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. Their values change with market prices, so will be considered for longer investment periods. It would be the Council's intention to be invested in Longer-dated Bond Funds or Equity Funds for at least 3 years, and for Property Funds for 5 years plus.

3.11 As is current procedure, the use of a new instrument or counterparty would be proposed in conjunction with the Council's Treasury Advisors, Arlingclose and specifically authorised by the Section 151 Officer (Director of Finance & Performance).

3.12 'Non-Specified' investments proposed for 2018-19, will be: -

- Deposits, Certificates of Deposit, Gilts, and other marketable instruments over 364 days and up to 5 years. Total investments over 364 days will not exceed £100m as per Prudential Indicators.
- Use of the Council's current bankers, Nat West for short-term liquidity requirements and business continuity arrangements, even though their rating may be below the minimum credit rating.
- VNAV/Pooled Funds held for longer than 364 days. The merits of individual VNAV and other pooled funds will be discussed with Fund Managers and Treasury Advisors to ensure their philosophy and risk parameters are aligned with those of SCC. These funds have no defined maturity date, but are available for withdrawal after a notice period. The fact that their market value changes (and may at times go below the original investment) means that they need to be viewed as a longer-term investment. VNAV Funds will be considered on an individual basis, taking into account the risk/reward characteristics including volatility, expected income return and potential for capital growth. Any VNAV Fund is to be approved by the Director of Finance & Performance prior to use, and the Section 151 Officer will determine the level of prudent investment, with reference to the level of core balances and reserves, and the potential volatility of any proposed investment. No more than £30m of total deposits outstanding are to be held in VNAV Funds (excluding LVNAV MMFs).
- Unrated Building Societies. Many unrated Building Societies are of equal or better creditworthiness than their credit rated peers. Consideration will be given to Societies recommended by our Advisors after analysis of suitable creditworthiness indicators (Funding and Capital ratios, % of non-performing loans).

3.13 The possible benefits of investing in long-dated Gilts, short-dated Treasury Bills, Supranational Bonds, Commercial Paper, and Corporate Bonds will continue to be assessed and used if appropriate, subject to the limits above and in the counterparty criteria at Appendix B.

As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities will be treated as retail clients by investment counterparties, but can "opt up" to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the authority have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. The Council has met the conditions to opt up to professional status with a range of counterparties. By so doing, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice.

3.14 Counterparties for Lending

As has always been the case, and in full compliance with Government guidance, a restricted list of counterparties is maintained. SCC only places deposits with banks that are authorised by the Prudential Regulation Authority (PRA) to accept deposits, or is a passported EEA institution, which is entitled to accept deposits in the UK, or is a UK Building Society. For other marketable instruments (other than VNAV pooled funds, many of which are not credit rated), only organisations or issues that meet the credit rating criteria will be considered. SCC has constructed and will maintain a counterparty list based on the criteria set out in Appendix B. The minimum credit quality is proposed to be set at A- or equivalent. The credit standing of institutions (and issues if used) will be monitored and updated on a regular basis. This assessment will include credit ratings and other alternative assessments of credit strength as outlined below.

3.15 SCC will continuously monitor counterparties. All three credit rating agencies' websites will be visited frequently, and all ratings of proposed counterparties will be subject to verification on the day of investment. All ratings of currently used counterparties will be reported to the monthly treasury management meeting, where proposals for any new counterparties will be discussed. New counterparties must be approved by the Section 151 Officer (Director of Finance & Performance) before they are used. Any changes to ratings that put the counterparty below the minimum acceptable credit quality whilst we hold a deposit or we hold a marketable instrument will be brought to the attention of the Section 151 Officer (Director of Finance & Performance) immediately, and an appropriate response decided on a case-by-case basis. Sovereign credit ratings will be monitored and acted on as for financial institution ratings.

3.16 Besides the UK, the sovereign states whose banks and other organisations are to be considered are Australia, Canada, Denmark, Finland, France, Germany, Netherlands, Singapore, Sweden, Switzerland and the USA.

Maximum investment levels with counterparties, by country, and by type of investment are included in the criteria to ensure prudent diversification is achieved.

3.17 SCC will continue to use a range of indicators to assess counterparties, not just credit ratings. Other indicators to be taken into account will be:

- Credit Default Swaps and Government Bond Spreads.
- GDP and Net Debt as a Percentage of GDP for sovereign countries.
- Likelihood and strength of Parental Support.
- Banking resolution mechanisms for the restructure of failing financial institutions, i.e. bail-in.
- Market information on corporate developments and market sentiment towards the counterparties and sovereigns.
- Underlying securities or collateral for 'covered instruments'.
- Other macroeconomic factors

Such indicators of creditworthiness are considered in relative rather than absolute terms, and this is how short-term ratings are also considered.

It remains the Council's policy to suspend or remove institutions that still meet criteria, but where any of the factors above give rise to concern.

Also, when it is deemed prudent, the duration of deposits placed is shortened or lengthened, depending on counterparty specific metrics, or general investment factors.

3.18 A requirement of revised guidance is that the strategy should report on the use of treasury advisors, and how the quality of that service is controlled. Arlingclose Ltd, are treasury advisors to SCC, and from an investments viewpoint provide ongoing independent analysis and advice on market and investment conditions, and the suitability of counterparties. They inform of any changes to counterparty creditworthiness, and update advice accordingly.

3.19 SCC recognises, as per CIPFA guidance, that, "the overall responsibility for treasury management must always remain with the Council". SCC has always performed its own analysis of market and investment conditions, and the suitability of counterparties. It continues to do so through embedded practices, thereby maintaining the skills of the in-house team to ensure that the services provided by the advisors can be challenged, and that undue reliance is not placed on them.

3.20 The revised CIPFA TM code requires that the Council must explicitly state whether it plans to use derivative instruments to manage risks.

Currently, Local Authorities' legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Bill is not sufficiently explicit. Consequently, the authority does not intend to use derivatives.

Should this position change, the Council may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require Full Council approval.

4. Prudential Indicators

4.1. The first Prudential Indicator in respect of treasury management is that the Council has adopted the CIPFA TM Code. It has done so, documented in the Financial Regulations, Part 2, C15, May 2015 Edition. The Council adopts the content and the spirit of the Revised Edition 2011.

4.2. The Council is required to set an ***authorised limit*** for total external debt, gross of investments, separately identifying borrowing from other long-term liabilities. The Council is also required to set an operational limit separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the ***operational boundary***, and is based on the Council's estimate of the most likely, i.e. prudent, but not worst-case scenario. They are both set for the forthcoming, and the following two years.

4.3. Both the authorised limit and the operational boundary are consistent with the Council's plans for capital expenditure and financing; and with the treasury management strategy statement.

4.4. All current long-term borrowing is at fixed rates, but 'borrowing' cash from Exmoor National Park Authority and other smaller external Comfund investors is counted as variable, as the rate paid depends on other rates. In reality this is not a risk, as the cash is lent on at rates no worse than the rate paid to these bodies. However, the ***limits on fixed / variable rate exposure indicators*** have been set to take account of the movements in these balances. The possibility of rescheduling some borrowing into variable rates has also been factored in to give suitable flexibility should LOBO loan options be exercised. For the purpose of calculations, all investments with a maturity of less than 1 year are treated as variable rate whether they are fixed deposits or linked to a benchmark rate.

4.5. The Council has set for the forthcoming year, both the upper and lower limits with respect to the maturity structure of its borrowing. These indicators are referred to as the ***upper*** and ***lower limits*** respectively ***for the maturity structure of its fixed rate borrowing***. The calculation is the amount of projected borrowing that is fixed rate maturing in each period, expressed as a percentage of the total projected borrowing that is fixed rate. The periods to be used going forward therefore, are: -

Under 12 months
>12 months and within 24 months
>24 months and within 5 years
>5 years and within 10 years
>10 years and within 20 years
>20 years and within 30 years
>30 years and within 40 years
>40 years and within 50 years
>50 years

4.6. The 2011 Revised CIPFA Code guidance for the 'maturity structure' indicator has been revised to specifically state that the maturity of LOBO loans should be treated as if their next option date is the maturity date. The 'maturity structure of borrowing' indicators have been set with regard to this change, and having given due consideration to proposed new borrowing, current interest rate expectations, and the possibility of rescheduling or prematurely repaying loans outlined in the borrowing strategy.

4.7. The next treasury management prudential indicator is referred to as the ***total principal sum invested for a period longer than 364 days***. The purpose of this indicator is to help the Council to contain its exposure to the possibility of loss that might arise as a result of having to seek early repayment or redemption of principal sums invested. In the current climate it is also an indicator of investments at risk due to changes in counterparty's changing circumstances. Whilst the proposed investment strategy would point to a minimal prudential indicator for investments over 364 days, practice is that once an investment is over 364 days (and therefore 'Non-Specified'), it remains that until maturity. This means that if investment conditions were to improve during the year, SCC might well invest the majority of the Comfund on a rolling one-year basis. Furthermore, should the Council wish to diversify into pooled funds, it would be the Council's intention to be invested in these for periods of 3-5 years plus. Therefore, a prudential indicator of £100m is deemed necessary.

4.8. In order that preceding Treasury and Investment Management Strategies are carried out, the following Prudential Indicators have been proposed to Council in another paper:

	2018/19 £m	**2019/20 £m**	**2020/21 £m**
Authorised limit			
Borrowing	437	437	437
Other Long-Term Liabilities	54	53	52
Total	491	490	489
Operational boundary			
Borrowing	403	403	403
Other Long-Term Liabilities	54	53	52
Total	457	456	455
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	30%	30%	30%

Maturity structure of borrowing	Upper Limit	Lower Limit
Under 12 months	45%	15%
>12 months and within 24 months	20%	0%
>24 months and within 5 years	20%	0%
>5 years and within 10 years	20%	5%
>10 years and within 20 years	20%	5%
>20 years and within 30 years	20%	0%
>30 years and within 40 years	45%	15%
>40 years and within 50 years	15%	0%
>50 years	5%	0%

	2018/19 £m	**2019/20 £m**	**2020/21 £m**
Prudential Limit for principal sums invested for periods longer than 364 days	100	50	50

4.9. CIPFA introduced a new indicator in 2013-14, *'Gross debt and the Capital Financing Requirement'.* The objective of the indicator is to ensure that borrowing only takes place for capital purposes over the medium to long-term. Where the gross debt is greater than the CFR, the reasons should be clearly stated in the Treasury Management Strategy. SCC had an excess of £33.1m at the start of the 2017-18 financial year. This built up over the previous few years as capital expenditure had been funded via Government grants and capital receipts and the level of debt maturing has been less than the level of Minimum Revenue Provision (MRP).

This position is likely to be reversed during the current year due to two factors. There has been a change to the methodology of calculating the MRP resulting in the level of annual MRP being reduced, and an increase in the level of capital bids being supported requiring an additional £40m of debt to support the 2018-19 programme.

4.10. The 2011 Revision suggested that Authorities may wish to create an indicator that considers ***Credit Risk***. At this stage there has been no guidance on how this is to be measured or reported.

The Council considers security, liquidity and yield, in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk. The only indicators with prescriptive values are credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms. Counterparty Creditworthiness criteria and other indicators are stated in Appendix B.

5. Reporting Arrangements

5.1. Monthly meetings between officers will continue to take place to report performance, discuss current issues, and agree future activities and specific actions as necessary.

5.2. The Director of Finance & Performance will report to the Council on its treasury activities in the form of an Annual Treasury Management Report, and on an interim basis as required. As required by the revised CIPFA TM Code, a mid-year review of Treasury Management activity and performance will also be prepared for Full Council.

5.3. Appropriate analysis of the outstanding debt position as required by the Prudential Code will be included in the Annual Statement of Accounts.

5.4. Icelandic Investments Update

Landsbanki & Glitnir – As reported in the Treasury Management Outturn Report 2015-16, SCC has concluded any interest that it had with these two banks.

Kaupthing, Singer & Friedlander – The estimated range for total dividends was increased at the lower end, and is now at 86p-86.5p in the pound. Future dividends will be paid subject to consultation with the Creditors' Committee, and when the level of distributable funds makes it cost effective to do so.

In total, as at 31st December 2017 £23,215,519.30 had been recovered. The shortfall of £1.78m from the original £25m of investments was written off back in 2008-09.

6. Member Training

6.1. CIPFA's revised TM Code states that – "All public service organisations should be aware of the growing complexity of treasury management in general, and its application to the public services in particular. Modern treasury management demands appropriate skills…..".

It goes on, "Public service organisations have a responsibility to ensure that those charged with governance have access to the skills and knowledge they require to carry out this role effectively. The organisation should ensure that this also applies to treasury management".

It further states, "Those charged with governance also have a personal responsibility to ensure that they have the appropriate skills and training for their role".

6.2. All SCC Members receive introductory training, which includes an overview of the treasury management function.

SCC Officers would be able and willing to provide a more detailed level of training, if Councillors thought that there would be no conflict of interest.

Through contacts with the CIPFA Treasury Management Forum and it's independent Treasury Advisors, SCC could also facilitate training via an independent third party. SCC Officers also have contacts within a number of money market brokers and fund managers who could provide training.

As and when needed, information sheets could be prepared and made available to help keep members abreast of current developments.

7. Consultations undertaken

7.1. None.

8. Implications

8.1. The financial implications have been taken into account when producing the Council Budget for 2018-2019, the Medium Term Financial Plan, and the 5-year Capital Strategy.

8.2. The Treasury Management and Annual Investment Strategy Statements must be approved prior to the financial year to which they relate.

9. Background papers

9.1. Local Government Act 2003 – Guidance under section 15(1)(a). The CLG Guidance has been revised and updated, with changes effective from 1 April 2010.
The CIPFA 'Treasury Management in the Public Services' Code of Practice Revised Edition 2011.
CIPFA Prudential Code for Capital Finance in Local Authorities: Revised Edition 2011.

Note: For sight of individual background papers please contact the report author.