Treasury Management Strategy Statement 2019/20

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Purpose of the Report

1. This report has been prepared for Audit Committee which is responsible for the scrutiny of the Council's treasury management strategy, risk management and performance. The Committee is requested to review the draft annual Treasury Management Strategy Statement, the Prudential Indicators and MRP statement which are due to be submitted to full Council for approval in February 2019.

Recommendation(s)

(a) To approve the details of the proposed Treasury Management Strategy Statement for 2019/20 to be submitted to full Council for approval (Appendix 1).

(b) To note the Capital prudential indicators and the annual MRP statement (This is to go to full council for approval. The figures within the report are provisional dependant on the report going to District Executive in Feb 2019 so it is anticipated that these will change) (Appendix 2)

Introduction

2. Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Treasury Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

3. The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

4. In addition, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised Guidance on Local Authority Investments in February 2018. The revised guidance requires the Council to prepare an investment strategy annually (or include the required details in their treasury management strategy) and explain how investments made (including commercial property portfolios) relate to the Council's core purposes.

5. The investment strategy was previously included as part of the treasury management strategy required by CIPFA. The Council's treasury management advisor's advice is to create two separate strategy reports to cover the two different areas and not include the investment strategy as part of the treasury management report.

6. It should be noted that the Treasury Management Strategy Statement includes the strategy for investing surplus cash funds, i.e. the strategy is in respect of treasury

investments and not non-treasury investments such as council-owned investment properties.

7. The investment strategy mentioned in point 3 and 4, focuses on two types of investments which are:

    - Investments made to support local public services by lending to or buying shares in other organisations, known as **service investments.**
    - Investments made to earn investment income known as **commercial investments**.

8. The Investment Strategy will be presented to District Executive to review, and recommend to Full Council for approval in conjunction with the 2019/20 Revenue and Capital Budgets. As such the draft strategy will be scrutinised by the Scrutiny Committee.

Background

9. The CIPFA Treasury Code and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis.

10. CIPFA has defined Treasury Management as:

    "the management of the organisation's borrowing, investments and cash flows, its banking, its 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.

11. 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. Specific treasury management risks are identified and managed through the Council's Treasury Management Practices. The risks include:

    - Liquidity Risk (Adequate cash resources)
    - Market or Interest Rate Risk (Fluctuations in the value of investments).
    - Inflation Risks (Exposure to inflation)
    - Credit and Counterparty Risk (Security of Investments)
    - Refinancing Risks (Impact of debt maturing in future years).
    - Legal & Regulatory Risk (Compliance with statutory and regulatory requirements).
    - Fraud, Error and Corruption Risk (Exposure to risk of loss in its treasury management dealings).

12. The Local Government Act 2003 requires the Council to have regard to the Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow.

13. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out indicators that must be set and monitored each year.

14. The Treasury Management Strategy Statement is attached at Appendix 1 and is split into the following main areas:

    - Local Context
    - Borrowing Strategy
    - Treasury Investment Strategy
    - Treasury Management Indicators
    - Other Items (related matters)

15. The capital prudential indicators and MRP Statement for 2019/20 are set out in Appendix 2.

16. These are included in draft at this stage, and will potentially be amended for the report to Executive to reflect final budget proposals for 2019/20.

Proposed Changes to Strategy

17. The main change to the Treasury Strategy Statement for 2019/20 is in respect of the approved counterparty types. The Council's advisors have added Real Estate Investment Trusts (REIT's) as a counterparty available for investment.

18. REIT's purchase shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

19. The investment limit advised by the advisors, and requested for approval, for a REIT is £10m per fund.

20. There are no other changes requested to the approved investment counterparties or the respective investment limits.

Financial Implications

21. The budget for investment income in 2019/20 is £927,820, based on an average investment portfolio of £50 million at an interest rate of 1.86%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

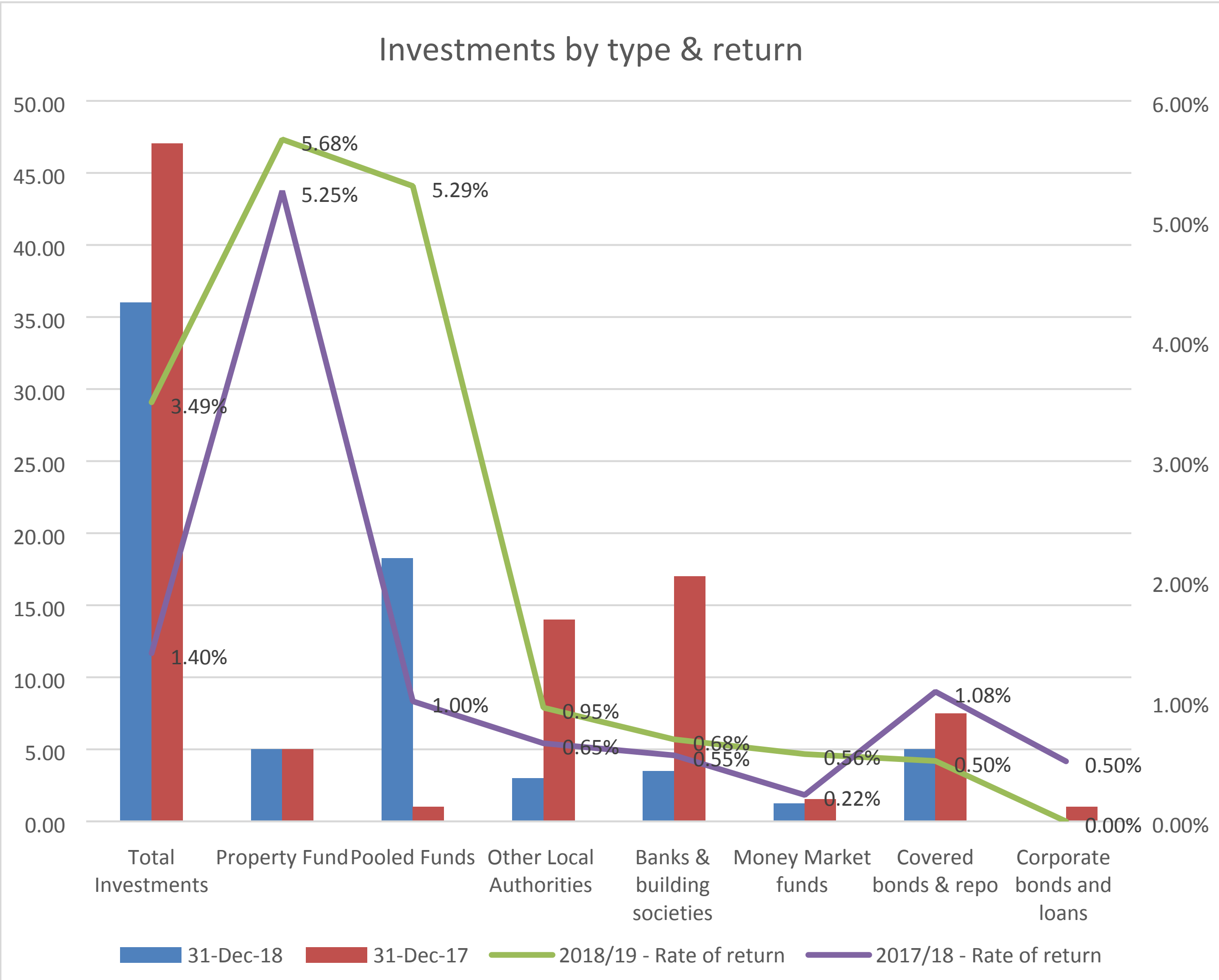
22. The budget for minimum revenue provision (MRP) i.e. the charge to the revenue budget for capital debt repayment in 2019/20 is £372,950.

Summary of Key Points from the TMSS

23. The TMSS is quite a lengthy, and arguably complex, document. This section of the cover report aims to summarise the key points from the proposed full TMSS to provide a simpler presentation of the main elements.

LOCAL CONTEXT – INVESTMENT BALANCES

Investment Type	Investment Balance £m			Rate of Return	
	31-Dec-18	31-Dec-17	Change	2018/19	2017/18
Property Fund	5.00	5.00	0.00	5.68%	5.25%
Pooled Funds	**18.25**	**1.00**	**17.25**	**5.29%**	**1.00%**
Other Local Authorities	3.00	14.00	-11.00	0.95%	0.65%
Banks & building societies	3.50	17.00	-13.50	0.68%	0.55%
Money Market funds	1.25	1.53	-0.28	0.56%	0.22%
Covered bonds & repo	5.00	7.50	-2.50	0.50%	1.08%
Corporate bonds and loans	0.00	1.00	-1.00	0.00%	0.50%
Total Investments	**36.00**	**47.03**	**-11.03**	**3.49%**	**1.40%**



INVESTMENT STRATEGY

1. Anticipated investment balance range = between **£39 million** and **£59 million**
2. Objectives:
    a. invest its funds **prudently**, and to have regard to the **security** and **liquidity** of its investments before seeking the **highest rate of return**.
    b. balance between **risk** and **return**, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.
3. Strategy:
    a. maintain investments in the **secure** and **higher yielding asset classes**.
    b. strategic (long-term) investments estimated at **£25m** by the end of 2018/19 and continue to be **maintained at this level**. Monitor for potential to increase this limit in future to maximum £35m.
    c. **Increase of £14m** in year in strategic investments, the diversification is a continuation of the strategy adopted in 2017/18.
    d. **Low proportion** of the Council's surplus cash to be invested in:
        i. short-term unsecured bank deposits
        ii. certificates of deposit
        iii. money market funds.
    e. Proportion of investments used for **liquidity purposes** which ensures ability to cover day to day cash flow requirements.
4. Counterparties:
    a. invest with the counterparty types in table below, subject to the **cash limits** (**per counterparty**) and the **time limits** shown.
    b. **Addition for 2019/20** – Real Estate Investment Trusts

Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Corporates**	**Registered Providers**
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£6 m 20 years	£6 m 50 years	£3 m 20 years	£3 m 20 years
AA+	£3 m 5 years	£6 m 10 years	£6 m 25 years	£3 m 10 years	£3 m 10 years
AA	£3 m 4 years	£6 m 5 years	£6 m 15 years	£3 m 5 years	£3 m 10 years
AA-	£3 m 3 years	£6 m 4 years	£6 m 10 years	£3 m 4 years	£3 m 10 years
A+	£3 m 2 years	£6 m 3 years	£3 m 5 years	£3 m 3 years	£3 m 5 years
A	£3 m 13 months	£6 m 2 years	£3 m 5 years	£3m 2 years	£3 m 5 years
A-	£3 m 6 months	£6 m 13 months	£3 m 5 years	£3 m 13 months	£3 m 5 years
None	n/a	n/a	£6 m 25 years*	n/a	£3 m 5 years
Pooled funds and real estate investment trusts		£10m (nominal value) per fund			

INVESTMENT STRATEGY - Continued

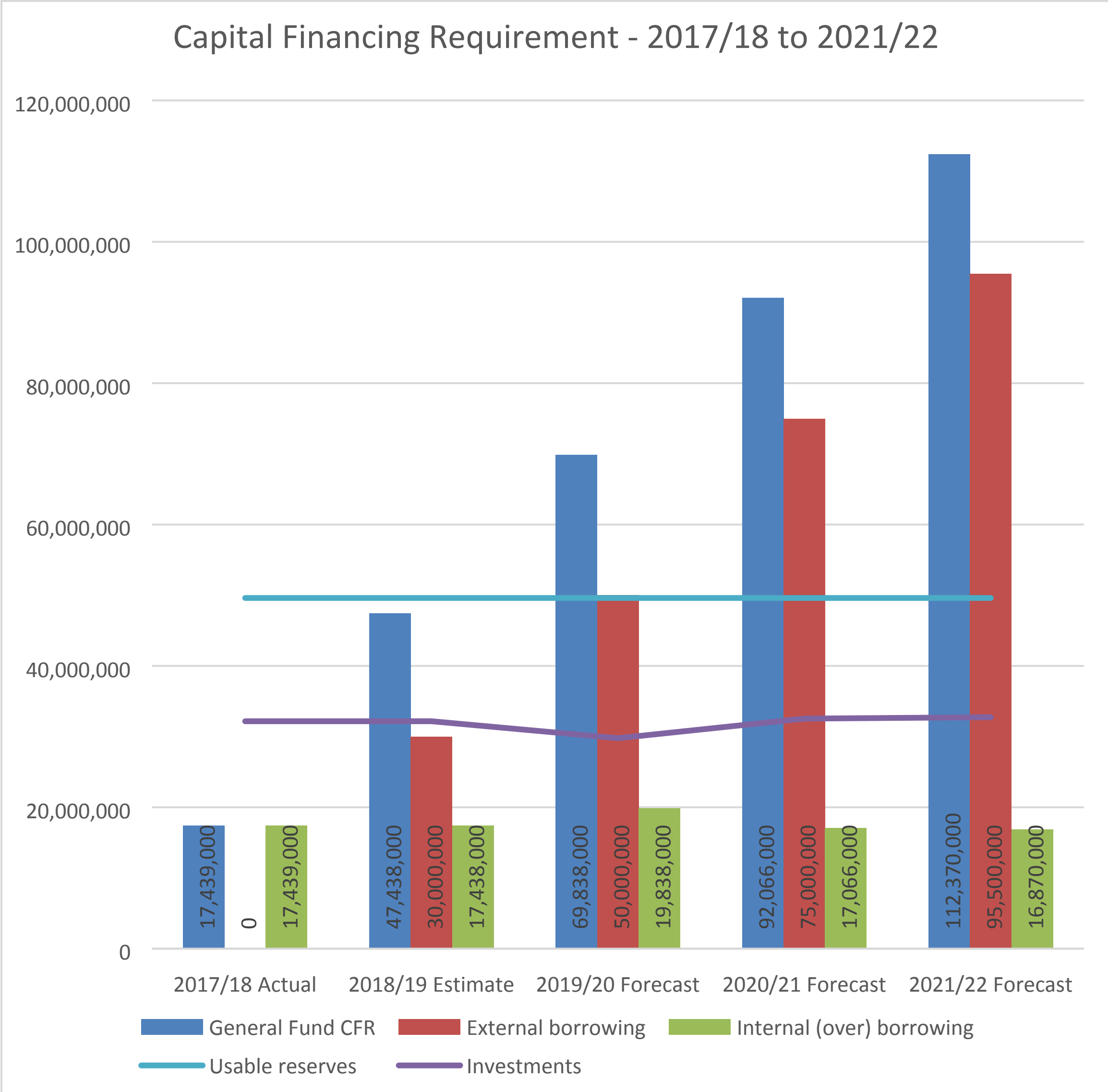
5. Investment Limits
    a. Cash limit by counterparty type are:

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£12m per country
Registered providers and registered social landlords	£8m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£4m in total
Money market funds	£20m in total
Real estate investment trusts	£10m in total

CAPITAL FINANCING REQUIREMENT

1. Forecast changes in the CFR:
    a. underlying need to borrow (capital purposes) is measured by the CFR
    b. usable reserves are the underlying resources available for investment

	31.3.18 Actual £'000	**31.3.19 Estimate £'000**	**31.3.20 Forecast £'000**	**31.3.21 Forecast £'000**	**31.3.22 Forecast £'000**
General Fund CFR	17,439	47,438	69,838	92,066	112,370
Less: External borrowing *	0	30,000	50,000	75,000	95,500
Internal (over) borrowing	**17,439**	**17,438**	**19,838**	**17,066**	**16,870**
Less: Usable reserves	-49,610	-49,610	-49,610	-49,610	-49,610
Investments	**32,171**	**32,172**	**29,772**	**32,544**	**32,740**



BORROWING STRATEGY

1. Current borrowing position:
    a. as at 31 December 2018 = **£1.5 million** (short term working capital, repaid 2 January 2019).

2. Borrowing forecast:
    a. **£30m** by 31 March 2019
    b. **£50m** by 31 March 2020
    c. **£75m** by 31 March 2021

3. Authorised borrowing limit:
    a. £124m
    b. Required to progress with significant **regeneration programmes** and investment properties acquisition needed for income generation to fund services

c. Financing approach for programmes meanings the CFR **could grow further**.

4. Objectives:
    a. strike an appropriately **low risk balance** between **securing low interest costs** and achieving **certainty costs**.
    b. Ensure have **flexibility to renegotiate loans** should the Council's long-term plans change.

5. Strategy:
    a. Key issues are **affordability**, **cost effectiveness** and **treasury risk**.
    b. Short-term, long-term or internal borrowing…
        i. Short-term rates currently lower – cost effective
        ii. Use internal resources if available
        iii. Long-term rates an option to use
    c. Monitoring
        i. Continually **monitor rates**, **options** and **other alternatives** (within strategy).
        ii. Deferring borrowing – an option when **long-term rates forecast to rise** modestly.
        iii. TM advisors will **assist with rate monitoring** and **options appraisal**.

6. Sources of borrowing:
    a. Public Works Loans Board (PWLB)
    b. Bank or building society in UK
    c. UK Public Sector Body
    d. Various others

7. Other Sources of Debt Finance:
    a. Leasing
    b. Hire Purchase
    c. Sale and Leaseback

Background Papers: *CIPFA Treasury Management Code of Practice*
CIPFA Prudential Code
Treasury Management Practices