

## Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

### **Capital Issues**

- the capital plans and the prudential indicators; the MRP strategy (Appendix 4).

### **Treasury Management Issues**

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on the use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Department of Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

## Capital issues

### The Capital Prudential Indicators 2017/18 – 2019/20 (See Table 1 in Appendix 2)

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

**Capital Expenditure.** This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

<b>Table 1 Capital Expenditure</b>	<b>2015/16 Actual £000</b>	<b>2016/17 Revised Estimate £000</b>	<b>2017/18 Estimate £000</b>	<b>2018/19 Estimate £000</b>	<b>2019/20 Estimate £000</b>
Programmed Spend	5,542	7,501	12,027	5,852	5,291
<b>Financed by:</b>					
Capital receipts	943	1,584	2,008	1,593	1,353
3rd Party Contributions	175	735	249	150	1,098
Capital grants	2,332	2,558	4,371	3,636	2,511
Revenue	332	666	1,378	243	254
<b>Net borrowing need for the year</b>	<b>1,760</b>	<b>1,958</b>	<b>4,021</b>	<b>230</b>	<b>75</b>

## Ratio of Financing Costs to Net Revenue Streams

This indicator shows the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) expressed as a percentage against the net revenue stream. Table 1 in Appendix 2 shows there is a general trend that financing costs are taking up a higher percentage of the revenue budget. This is due to forecast reductions in future aggregate external funding based on 'revenue spending power' for the Council through reduced Government grant.

## The Council's Borrowing Need (the Capital Financing Requirement)

This prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR and is represented by the net financing need for the year line. The Council's CFR is shown in Table 1 of Appendix 2 and below.

The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

<b>Table 2</b>	<b>2015/16 Actual £000</b>	<b>2016/17 Revised Estimate £000</b>	<b>2017/18 Estimate £000</b>	<b>2018/19 Estimate £000</b>	<b>2019/20 Estimate £000</b>
<b>Capital Financing Requirement</b>					
Total CFR at 31 <sup>st</sup> March	27,438	28,607	31,807	31,053	30,106
<b>Net financing need for the year</b>	<b>1,065</b>	<b>1,169</b>	<b>3,200</b>	<b>( 754)</b>	<b>(947)</b>

<b>£m</b>	<b>2015/16 Actual £000</b>	<b>2016/17 Revised Estimate £000</b>	<b>2017/18 Estimate £000</b>	<b>2018/19 Estimate £000</b>	<b>2019/20 Estimate £000</b>
<b>Movement in CFR represented by</b>					
Net borrowing need for the year (Table 1 above)	1,760	1,958	4,021	230	75
Less MRP and other financing movements	(695)	(789)	(821)	(984)	(1,022)
<b>Movement in CFR in Year</b>	<b>1,065</b>	<b>1,169</b>	<b>3,200</b>	<b>(754)</b>	<b>(947)</b>

## Incremental Impact of Capital Investment Decisions on Council Tax

This indicator identifies the revenue costs associated with the proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The costs include the investment interest to be foregone by using capital receipts and the proposed revenue contributions to capital (RCCO). The costs are expressed as an amount per Band D property using the 2017/18 council tax base of 22,579 for comparative purposes.

### Treasury Management Issues

The capital expenditure plans set out above, provide details of the activity of the Council. The treasury management function ensures that the Council's cash is organised within the relevant professional codes, so that sufficient cash is available to meet these activities. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

### The Council's Current Portfolio Position

Within the prudential indicators in Appendix 2 there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its total debt, net of any investments, does not exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. In the Council's case, the estimated external debt at 31<sup>st</sup> March 2017 of £20.6m is less than the CFR which ranges from £30.1m to £31.8m which means that the Council 'borrows internally' (using reserves and balances) to finance past capital spending as this tends to be cheaper than external debt.

### Treasury Limits for 2017/18 to 2019/20

It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Borrowing Limit".

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

Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the Authorised Limit can be found in Table 2 in Appendix 2 of this report outlining the prudential and treasury indicators for 2017/18 – 2019/20.

**The Operational Boundary** is the limit beyond which external debt is not normally expected to exceed and is normally similar to the CFR. It is proposed to set this at 5% above the CFR.

**The Authorised Limit** is a further key indicator representing a control on the maximum level of borrowing, beyond which external debt is prohibited, and this limit needs to be set or revised by the Full Council. It reflects the level of external debt which, whilst not desired, could be afforded in the short term, but is not sustainable in the longer term. It is proposed to set this at 5% above the operational boundary and includes provision for 'unusual cash movements'.

### **The Borrowing Strategy**

The Council is currently maintaining an under-borrowed position which means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

The Head of Finance will monitor interest rates and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp fall in long and short term rates, then long term borrowings will be postponed,
- if it was felt that there was a significant risk of a much sharper rise than that currently forecast, then the portfolio will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still relatively low.
- will take a view on prevailing and perceived future interest rates and take decisions on whether to borrow longer-term or short-term accordingly whenever a borrowing requirement arises. As well as taking a view on the appropriate mix of fixed and variable interest rate exposure in the light of prevailing and perceived future market conditions.
- undertake a constant review of the Council's total external debt portfolio to determine the scope for any restructuring possibilities and make recommendations to Full Council accordingly.

### **Treasury Management - Limits on Activity**

There are three debt related treasury activity limits, the purpose of which is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

- Upper limits on variable rate exposure;
- Upper limits on fixed rate exposure;
- Maturity structure on borrowing limits which are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

### **The Borrowing Policy and Borrowing Requirement**

The Council will not borrow more than or in advance of its need purely in order to profit from the investment of the extra sums borrowed.

The Council's maximum borrowing requirement (Authorised Limit for external debt) is £35.067m next year. This is limited to 5% above the operational boundary of £33.397m, which has been set at 5% above the CFR.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### **Debt Rescheduling**

As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include: -

- the generation of cash savings and / or discounted cash flow savings
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council at the earliest meeting following its action.

### **Municipal Bond Agency**

It is likely that the Municipal Bond Agency will be offering loans to local authorities in the near future. It is hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). Officers intend to keep a watching brief of this new source of borrowing.

### **Investment Strategy**

#### *Background:*

There are strict limits in terms of the type of institution with which funds may be deposited and the length of time funds can be invested for. These limits are reviewed annually [as a minimum] and the current listing was incorporated into the treasury management report approved by Full Council on 24<sup>th</sup> February 2016.

The Council's deposit priorities focus on;

- Security of Capital
- Liquidity, and
- Yield

The Council will aim to achieve optimum return [yield] on deposits commensurate with proper levels of security and liquidity.

#### *Monitoring Performance:*

Within the counter parties listing we have retained a £15m limit with HSBC Bank plc, coinciding with retaining HSBC as the provider for administering the Council's banking facilities [contract renewed in December 2015 for a three year term]. The Council continues to have a 'sweep' facility for our current account. This means that if we do not deposit monies with other counterparties but leave the balance with HSBC, they will automatically transfer the money into an interest earning deposit account. This account is

## Appendix 1

effectively a call account whereby we can get the money back instantly if required. The current rate the Council is achieving on these deposits is higher than that achieved with some other counterparties.

### Approved list of Counterparties for Deposits

As part of the Treasury Policy Statement as a minimum the approved list of counterparties are reviewed annually and reported to Council. The current list was approved on 24<sup>th</sup> February 2016. It is proposed that the maximum amount that can be deposited with counterparties for a period exceeding 364 days and up to 2 years remains limited to £4m which is shown in Appendix 3.

### Creditworthiness Policy

This Council uses the creditworthiness service provided by Capita Asset Services. This service uses a sophisticated modelling approach with credit ratings from all three rating agencies – Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

The Council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

In addition to the use of Credit Ratings the Council will be advised of information on

- movements in CDS against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

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

**Policy on the use of treasury management consultants**

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Head of Finance through recommendations to Full Council, will ensure that the terms of their appointment and the methods by which their value will be assessed, are properly agreed and documented, and will be subject to regular review.