CABINET
29TH January 2019

AGENDA ITEM 6.4

Subject:	**TREASURY MANAGEMENT STRATEGY 2019/20**
Report by:	Cabinet Member for Finance

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Purpose
This report sets out the recommended approach together with the associated risks in managing the Council's cash investments in 2019/20.

Options
To agree or vary the proposals in the report.

Recommendation
That the Cabinet accepts the report as endorsed by the Audit Committee and recommends to Council that:

i. the Council recognises that the investment strategy does result in some risk to capital invested but this is at an appropriate level
ii. the Treasury Strategy for 2019/20 is approved (**Appendix 1**), including the potential to invest up to a further £10m in external funds dependant on Treasury Sub-committee investigation of the risks and benefits.
iii. the Treasury Management indicators for 2019/20 are approved (**Appendix 2**)
iv. The Council formally adopts the 2017 revision of the Treasury Management Code of Practice (**Appendix 3**)

Corporate Implications	
Legal:	If no proposal is made to Council the authority will be in breach of its statutory duties
Financial:	As detailed in the report
Personnel:	None
Risk Management:	The strategy recommends further investment in pooled asset funds, which will require additional risk management measures to be put in place to manage these investments

Equalities and Diversity:	None
Health and Safety:	None
IT:	None
Other:	None

Consulters:
Audit Committee

Policies and Strategies:
N/A

Corporate Plan Priorities

The report relates to the following priorities in the Corporate Plan

Attracting investment and delivering infrastructure	X
Facilitating suitable housing for local needs	X
Providing high quality public spaces	X
Promoting a more sustainable environment	X
Promoting healthier and more active lives	X
Enhancing participation in cultural activities	X

1.0 Background

1.1 The Council can expect to have cash to invest arising from its revenue and capital balances, and collection of Council Tax. This cash can be usefully invested to produce a return to help support services and Council Tax. The activities around the management of this cash are known as 'Treasury Management'.

1.2 The amount of cash the Council has to invest will decline as the Council funds its capital programme.

1.3 Treasury Management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:
"The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks"

1.4 CIPFA produce a framework for managing treasury activities, called a 'Code'. Councils are legally required to have regard to this Code and members of CIPFA are expected to comply with its requirements. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the MHCLG Guidance.

1.5 CIPFA published a revised version of the Code in December 2017, too late for inclusion in the 2018/19 Treasury Strategy. CIPFA recommends that all public service organisations formally adopt the code and include four essential clauses with formal policy documents. Officers therefore recommend that the code is officially adopted, and the relevant clauses are provided in **Appendix 3** to this report.

1.6 Treasury Management regulation for local authorities requires the Council to produce the following documentation:

i) An overarching **Treasury Management Policy Statement.** This sets out the objectives of the Council's treasury management activities (To be contained in the Capital Strategy).
ii) **Treasury Strategy (Appendix 1)**. This sets out the Council's approach to managing its investments for the year ahead.
iii) **Treasury Management Practice Statements (TMPS).** These are procedure notes, detailing how the Council will manage its treasury management risks. The Director of Finance is delegated to produce the TMPS; they do not require member approval and are therefore not reported formally.
iv) **Yearly and Half Yearly Activity Reports.** Made to Council in June and December each year.
v) **Quarterly Reports to Treasury Management Audit Sub-committee.** Detailing performance and reviewing the strategy.

1.7 The Council's investment priorities as required by Government regulations are in order of priority:
(a) the security of capital
(b) the liquidity of its investments; and
when these are satisfied
(c) Yield.

1.8 In 2018 changes have been made to both the Prudential Code and the MHCLG investment guidance for local authorities. As such the Council is now required to prepare a Capital Strategy as an overarching document to support the prudent management of its capital expenditure, borrowing and investment activity. The Treasury Management Strategy now serves as a detailed supporting document to the Capital Strategy and focuses on the management of investments arising from the organisation's cashflows. New treasury management indicators are now included, and these will be reviewed regularly.

2.0 Audit Committee Review of Treasury Management Strategy

2.1 The Treasury Management Sub-committee of the Audit Committee has reviewed the contents of this report and any comments or changes recommended have been incorporated.

3.0 Executive summary of Proposed Investment Strategy

3.1 The key requirements operationally for the Council are summarised in paragraph 3.2, with a more detailed version in **Appendix 1.**

3.2 **Summary of Treasury Strategy for 2019/20 (full details Appendix 1)**

1) All Council investments will be made in UK sterling.

2) The Council's cash flow and investment balances will be lower but more certain in 2019/20 following the completion of the Riverside Capital Project. Officers therefore recommend that Council approve up to £10m (maximum of £5m per fund) of investments in multi-asset or bond funds; subject to the Treasury Management sub-committee being satisfied that appropriate risk management processes are put in place for these investments. Such investments will help to offset the impact of inflation on the Council's purchasing power and help support the revenue budget.

3) To continue holding up to £8m (£5m initial investment plus a generous allowance for unrealised capital growth) investment in the CCLA Local Authority Property

Fund. The Council's share of the fund was some £6.5m in November 2018. However, officers will undertake withdrawals of cash from the fund if it is deemed in the Council's best interest and following consultation with the members of the treasury management sub-committee.

4) Below are the criteria by which officers will choose counter parties with whom to invest the Council's funds. The information is split into two categories as required by government guidance; specified and unspecified investments. The criteria cannot however remove all risk of loss of funds. The criterion balances security of funds and return on investments. The following are the maximum investment limits that may be used, and officers may in practice operate lower ones. The decision to operate lower limits will be based on market information and advice from Arlingclose the Council's Treasury Management advisor.

Specified Investments
-investments of duration less than 365 days and denominated in sterling.
-investments made to UK Government, UK local authorities or institutions of high credit quality.
-high credit quality defined as a minimum A- by Fitch or the equivalent score of the other main rating bodies.

Counterparties	Minimum Credit Criteria	Max. Limit £m	Max. maturity period	Change from Prev. approach
Enhanced Money Market Funds (Variable Unit Price) Up to 5 funds	AAA	£6m each fund	2-5 day notice	None
Money Market Funds (per fund)	AAA	£6m each fund	Instant Access	None
Debt Management Agency Deposit Facility, Government Treasury Bills or Gilts	UK Government	No Limit	364 days	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	No Limit	364 days	None
UK Banks	A-	£3m each group	364 days	None
Building Societies	A-	£3m each group	364 days	None
Non-UK Banks	AA-	£3m each group	364 days	None
Non-UK Banks	A-	£3m each group	100 days	None
Registered Social Landlord Loans	A-	£3m each group	364 days	None
Covered Bonds	AA-	£6m	364 days	None
Reverse Repurchase Agreements (each agreement)	AA-	£6m	364 days	None
Supranational Bonds (per institution)	AAA	£6m	364 days	None

Non-specified Investments These do not meet the criteria of specified investments. They are identified separately to ensure the Council understands that these are higher risk, either due to counter party risk, liquidity risk, market risk or interest rate risk				
Counterparties	**Min. Credit Criteria**	**Max. Limit £m**	**Max. maturity period**	**Change from existing approach**
CCLA Local Authority Property Fund	Unrated	£8m	n/a	Removed option for additional property fund investment
Multi-Asset or Bond funds	Unrated	£5m per fund	n/a	New approach and higher overall allocation allowed
Covered Bonds (per bond)	AA-	£6m	3 years	None
Supranational Bonds (per each institution)	AAA	£6m	3 years	None
Debt Management Agency Deposit Facility, Government Bills or Gilts	UK Government	No Limit	5 years	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	No Limit	5 years	None
Challenger Banks e.g. Aldermore, Metro etc	Unrated	Delegate to Treasury Mgt committee authority to determine criteria to invest up to £3m		

5) As an overall principal the maximum amount invested in non-specified investments will not exceed £18m, including an allowance for capital growth. These investments are effectively strategic, and the Council is projected to have sufficient long cash holdings to support this longer-term investment.

6) Due to the risk of market volatility surrounding the UK's exit from the European Union, the 2019/20 budget assumes that interest rates will not change materially in 2019/20.

7) In addition, Officers can invest funds in domestically domiciled banks and UK government institutions should market volatility make access to EU-domiciled investment products, such as the majority of Money Market Funds, difficult.

8) The current capital and revenue projections show there is currently no need to undertake any external borrowing to fund the capital programme in 2019/20, although short term borrowing for cashflow purposes may be necessary.

4.0 Conclusion

4.1 The Council's Treasury Management Strategy prioritises the security and liquidity of the Council's financial assets over yield.

4.2 The proposed Strategy reflects a continued transition of the Council's investments away from unsecured bank and building society deposits to a more diverse range of highly rated products. Pooled funds are an important part of this strategy; they provide access to diversified pools of assets which generate inflation beating returns, helping to preserve the capital value of the Council's financial assets.

4.3 The Council's methods for investment and selecting counter parties do not remove all risk of losses but balance the need to make an appropriate return with reasonable risk parameters.

4.4 With the Riverside capital project approaching completion, the Council now has the opportunity to invest a larger proportion of its portfolio in pooled investment funds. This investment would need to be carefully managed but will help protect the Council's financial assets from the impact of inflation.

Background Papers
Treasury Management Practice Statements
Treasury Management Sub-committee papers

Appendices
1) Treasury Management Strategy
2) Treasury management Indicators
3) Treasury Management Code of Practice – clauses to be formally adopted

Appendix 1 - Treasury Management Strategy 2019/20

Introduction

1.1 Chelmsford City Council has adopted and complies with both the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes and the Department of Communities and Local Government's Guidance on Local Government Investments.

1.2 Both the Code and MHCLG regulations require the Authority to prepare and authorise a Treasury Management Strategy prior to the start of each financial year. This report fulfils the Council's legal requirement under the Local Government Act 2003.

1.3 Chelmsford City Council has invested substantial sums of money and is therefore exposed to a series of financial risks including the loss of invested funds and the risk of changes in interest rates affecting the revenue contribution these investments make to the Council's budgets. It is possible but not projected that in future years the Council may be required to borrow in order to fund capital expenditure.

1.4 This strategy will set out how the Council monitors and manages the financial risks arising from its treasury management operations. It should be noted that the Council prioritises the security of its capital first and foremost, its liquidity needs secondly and finally the maximisation of yield on investments only once security and liquidity have been addressed. Performance indicators designed to demonstrate these priorities are shown in appendix B.

1.5 It is important to note that the borrowing of monies purely to invest or lend on and make a return is unlawful and this Council will not engage in such activity.

1.6 In the event of major changes to the external or internal context in which this strategy has been set, it may be necessary for the Council to revise its strategy during the year.

1.7 There have been significant revisions to the Prudential Code and MHCLG Statutory Guidance on Local Government Investments in 2018. The Council is required to have regard to both these and the CIPFA Code of Practice on Treasury Management, and these revisions will have an impact on the reporting structures for treasury management:

- The Treasury Management Strategy fulfils one part of a new, wider, capital strategy which sets out the long-term context in which capital expenditure and investment decisions are made
- The Treasury Management Strategy now considers purely the actions related to managing the authority's financial assets and liabilities
- Non-financial assets held for commercial purposes, such as investment property, must be considered separately to treasury management within the capital strategy
- The prudential indicators now sit within the Capital Strategy rather than in the Treasury Strategy
- Separate local treasury management indicators may be used within the Treasury Strategy

1.8 The prudential code now requires authorities to publish an overarching capital strategy which considers capital expenditure, treasury management, investment strategy and various other factors.

1.9 In addition, the revised MHCLG guidance requires authorities to consider both financial and non-financial assets held for the generation of profit in a new investment strategy.

1.10 Therefore, this Treasury Management Strategy will focus solely on investments arising from the organisation's cashflows and debt management activity. Non-treasury investments will be covered separately under the Capital Strategy. Prudential indicators will now be presented within the capital strategy and this report will instead put forward separate treasury management indicators.

1.11 The revised prudential code requires Council to approve the capital strategy but gives Council the option to delegate approval of the underlying strategies to other bodies. For 2019/20, both reports will be taken to Council for authorisation.

1.12 As the 2019/20 Strategy recommends a different approach to the current strategy, it may be necessary to review the treasury management indicators set here as they may not be appropriate to a different portfolio context. The treasury reporting process via the mid-year review and outturn reports give scope to review the indicators if needed.

2. External Context

2.1 The Council's treasury management strategy operates in a macroeconomic environment which can have a significant impact on the Council's treasury operations in terms of inflation, interest rate and counterparty risks.

The economic environment and interest rate forecast

2.2 Market volatility is to be expected around a large political event like the UK's exit from the European Union. So, whilst the domestic economy remains relatively robust, there is a risk that the Council's investment activity could be negatively affected by any market instability.

2.3 Inflation fell back to 2.4% year on year in September 2018. The Monetary Policy Committee of the Bank of England judged that, with the ILO unemployment rate at its lowest level since 1975 (4%), this level of inflation could be reflective of a lack of spare capacity in the economy.

2.4 Arlingclose, the Council's treasury advisors, project that interest rates are likely to continue to rise steadily to 1.25% by the end of 2019 as the MPC looks to tighten monetary policy. Because of current economic uncertainty, officers decided that it was prudent not to build in any interest rate rise in to the 2019/20 original budget.

Credit Outlook and counterparty risk

2.5 Over recent years the Council has continued to reduce the amount of unsecured bank deposits it holds in reaction to the "bail in" risk arising from reform to the banking sector. Under "bail in" provisions, investors would face losses to their deposits and share-holdings in order to recapitalise a bank before any Government bailout would occur.

2.6 2018 saw the introduction of ringfenced banks to increase the protections for retail clients (individuals and small businesses). The Council saw the credit ratings of its banking counterparties either improve or remain static as a result of ringfencing and so no further strategy changes are proposed as a result of ringfencing. Exposure to bail-in risk is monitored by officers and reported in the treasury management performance indicators (appendix B).

2.7 The ability to invest in UK and overseas banks remains an important tool for the Council's Treasury Management operations but Officers will continue to monitor creditworthiness and will recommend changes to the strategy if necessary. Officers will invest cautiously with non-UK institutions in the lead up to the UK's exit from the EU. In the event of significant market instability, the Council may decide to place funds with the UK Government via the Debt Management Account Deposit Facility (DMADF) or UK Treasury Bills. The counterparties set out in this strategy will support such an approach, but it should be recognised that a loss of yield may result.

3. <u>Local Context</u>

3.1 On 30th November 2018, the Council held £81.3m of investments. These investments arise from balances and reserves, as well as income received in advance of expenditure and allow the Council to generate a useful income stream to support revenue expenditure.

3.2 The Council is currently undertaking an ambitious capital programme designed to improve the quality of the services available to Chelmsford's residents. The Authority has no external debt and its approved capital expenditure plans do not currently imply a need to externally borrow within the forecast period. However, this strategy retains the option to borrow should the Council approve additional capital expenditure or for short term liquidity purposes.

3.3 Whilst the Council does hold significant cash balances, it should be noted that a large proportion of this cash is collected on behalf of other authorities and so is only held temporarily by the Council. However, with major capital projects such as the Riverside redevelopment approaching completion, the Council will be able to invest some of its cash resources for longer periods than it has in the past 18 months. This will allow for opportunities to increase yield on the Council's portfolio above what has been achieved in recent years.

4 <u>Investment Strategy</u>

4.1 The Council's investment strategy prioritises its investment objectives in the following order:

- Security of assets – investing in counterparties only where the risks of incurring a capital loss through default and the risks of late payment of principal and interest are low

- Liquidity – Ensuring that the authority is able to access sufficient cash to meet its obligations with appropriate notice

- Yield – subject to the management of risks associated with security and liquidity of assets, the Council will seek to maximise the yield from its investment portfolio

This is a prudent approach in line with CIPFA and MHCLG guidance.

4.2 The Council recognises that, whilst interest rates have increased in the last 2 years, they remain relatively low. Therefore, the yield that investment in cash-based investment products generates on investments is lower than the prevailing rate of inflation – the spending power of the sums invested is therefore being eroded. As demand for such high levels of liquidity will fall once the Riverside project is complete, there is now an opportunity to invest in longer term or alternative investment products which can generate a higher yield and so offset the impact of inflation on the portfolio.

4.3 Given the continued risk of bail-in losses from investing in banks, the Council will continue its policy of diversifying its investments away from unsecured bank deposits.

4.4 Both news media and the Council's treasury advisors, Arlingclose, have highlighted concerns about the financial stability of some UK Local Authorities. Whilst it is seen as highly unlikely that any UK Local Authority would be permitted to default on debts, particularly following the government's decision to support struggling Northamptonshire County Council, the Council carefully reviews publicly available information prior to making investments in other UK Local Authorities and will continue to invest with other local authorities, subject to appropriate due-diligence checks.

4.5 The Council currently holds an investment with the CCLA Local Authorities' Property Fund, an original investment of £5m together with an unrealised capital gain of c.£1.6m as at the end of November 2018. This investment is held primarily for the income yield it generates and the Council expects to continue to hold this investment throughout 2019/20 but has the option to sell this asset if necessary; recognising that the prevailing market rate may result in a loss of capital.

4.6 Given that the Council already holds a £5m investment in the CCLA Property Fund and also holds significant direct property investments in assets in Chelmsford, officers do not recommend any further investment in property funds at this time. This option has therefore been removed from the Treasury Strategy.

4.7 Capital receipts, Community Infrastructure Levy contributions (CIL) and Business ratepayer appeals will continue to support the Council's average cash balance in 2019/20 but with major construction works on the Riverside redevelopment scheduled to complete in early 2019/20, it is anticipated that cash balances will be significantly lower than in recent years; with capital resources having been applied to the scheme.

4.8 The Council's current and projected year end levels of investments are shown in the table below. It should be noted that year end tends to be the lowest point in the year for the Council's cash balances because most residents pay their Council Tax over 10 instalments, but the Council pays these out to central government and other precepting authorities on a monthly basis; therefore, significant net cash outflows occur in February and March each year. Average cash balances in 2017/18 were £85.9m and are projected to be £73.3m in 2018/19 and £47m in 2019/20.

	November 2018 Actual £m	**31 March 2019 Projected £m**	**31 March 2020 Projected £m**
Cash	81	32	38

4.9 Officers have made a prudent estimate that an additional £10m of the Council's current portfolio will be available to invest in either longer dated fixed term deposits or higher yield pooled funds which will protect the authority from the impact of inflation on its purchasing power. This could be achieved without exposing the Council to undue liquidity risk. The Council's strategic investment portfolio would be deemed to be £16m (initial investment value) long term core holdings and the remaining projected balance of £31m could be kept relatively liquid in traditional investments such as bank, building society and local authority deposits as well as instant access money market accounts.

4.10 For a long-dated fixed term deposit, the Council would only be able to invest with another local authority or the UK Government. Alternatively, further investment in covered bonds could be considered. These options would satisfy the Council's appetite for counter-party risk. However, long-term fixed rates would expose the Council to interest rate risk – the possibility of rate rises making the fixed term deposit less appealing.

4.11 Arlingclose has modelled the Council a pooled fund investment portfolio of £10m across a range of mixed asset and bond funds designed to provide low volatility and increased yield. Whilst some of the underlying assets would be below the Council's appetite for direct investment, the pooled fund approach means that the Council would own a small share of a diversified portfolio of many different assets. These funds are professionally managed and poor performance in individual assets is generally offset by the performance of the remainder of the fund; generating income and capital growth from the investment.

4.12 However, members should be aware of the risk of capital losses arising from market behaviour during the period of ownership and if this does occur, processes will need to be in place to decide whether to crystallise a loss by disposing of the asset or to hold the asset until market conditions improve. This approach will be familiar to member as it operates in the same way as the CCLA Property Fund but for a mix of assets including cash, bonds, equities and property.

4.13 The table below shows the potential increase in yield which could be achieved via an additional investment of £10m in either a 5-year fixed deposit with a local authority or a pooled fund portfolio. It should be noted that this is based on past performance and is not an indicator of future performance.

	Indicative Yield	Indicative income	Additional income earned
Current Strategy	0.80%	£80,000	-
5-year local authority Investment	1.50%	£150,000	£70,000
Pooled fund portfolio	4.35%	£435,000	£355,000

4.14 This strategy therefore gives the Council the option to invest an additional £10m in pooled investment funds. It is recommended that the Treasury Management sub-committee, in conjunction with the Director of Finance and the Cabinet Member for Finance will undertake a full risk management exercise to consider controls around pooled fund investments before any initial investment activity is undertaken. The Director of Finance and Cabinet Member for Finance will then have responsibility for the management of individual investments within the framework set out.

Counterparties

4.15 The Council is required by law to identify the proposed investment rules under the categories Specified and Non-Specified:

Specified Investments
-investments of duration less than 365 days and denominated in sterling.
-investments made to UK Government, UK local authorities or institutions of high credit quality.
- high credit quality defined as a minimum A- by Fitch or the equivalent score of the other main rating bodies.

Specified Counterparties	Minimum Credit Criteria	Max. Limit £m	Max. maturity period	Change from Prev. approach
Enhanced Money Market Funds (Variable Unit Price) Up to 5 funds	AAA	£6m each fund	2-5 day notice	None
Money Market Funds (per fund)	AAA	£6m each fund	Instant Access	None
Debt Management Agency Deposit Facility, Government Treasury Bills or Gilts	UK Government	No Limit	364 days	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	No Limit	364 days	None
UK Banks	A-	£3m for each group	364 days	None
Building Societies	A-	£3m for each group	364 days	None
Non-UK Banks	AA-	£3m each group	364 days	None
Non-UK Banks	A-	£3m each group	100 days	None
Registered Social Landlord Loans	A-	£3m each group	364 days	None
Covered Bonds	AA-	£6m	364 days	None
Reverse Repurchase Agreements (each agreement)	AA-	£6m	364 days	None
Supranational Bonds (per institution)	AAA	£6m	364 days	None

Non-specified Investments These do not meet the criteria of specified investments. They are identified separately to ensure the Council understands that these are higher risk, either due to counter party risk, liquidity risk, market risk or interest rate risk				
Counterparties	**Min. Credit Criteria**	**Max. Limit £m**	**Max. maturity period**	**Change from existing approach**
CCLA Local Authority Property Fund	Unrated	£8m	n/a	Removed option for additional property fund investment
Multi-Asset or Bond funds	Unrated	£5m per fund	n/a	New approach and higher overall allocation allowed
Covered Bonds (per bond)	AA-	£6m	3 years	None
Supranational Bonds (per each institution)	AAA	£6m	3 years	None
Debt Management Agency Deposit Facility, Government Bills or Gilts	UK Government	No Limit	5 years	None
Local Authorities / Bank Deposits Collateralised (guaranteed against local authority loans)	UK Government	No Limit	5 years	None
Challenger Banks e.g. Aldermore, Metro etc	Unrated	Delegate to Treasury Management sub-committee authority to determine criteria to invest up to £3m		

Commentary on credit ratings and proposed counterparties

4.16 Arlingclose, as part of their service, provide advice on what they believe to be suitable investment counter parties for the Council. Arlingclose's approach is not based on a rigid model but on an assessment of a range of measures that require a final human judgement of the overall risk. The assessments include the following; credit ratings, the likelihood of UK or another Government support, market information (e.g. share price or CDS), collateral offered by the Counter Party, types of activity undertaken by the institution and other external advice. The Counter Parties recommended in this report reflect discussions with Arlingclose by officers, the Cabinet Member for Finance and the Treasury Management Sub-committee.

4.17 The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, advice from

Arlingclose and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria. The Council regularly review the credit ratings and other indicators relating to its approved counterparties.

4.18 **Money Market Funds:** The Council invests short term cash in a number of AAA rated money market funds. The funds provide a modest rate of interest on sums invested averaging 0.72% at 30/11/18 but allow same day access to funds called back. Due to the risks surrounding unsecured bank deposits (discussed below), the Council has increased its use of money market funds in recent years. The Council also has access to enhanced money market funds which offer a better rate of return but require 2 – 5 day notice to withdraw funds.

4.19 **Unsecured bank deposits:** The changes to UK Bank regulation from the adoption of a "bail-in" approach to recapitalising banks and the move to ringfencing of UK bank retail operations has increased the risk of loss of capital from such investments. The Council feels that it is still prudent to invest with specific counterparty banks on an unsecured basis but has previously reduced the duration of such deposits, in line with Arlingclose advice; increasing its investment in UK Local Authorities. With the completion of ringfencing activities by major banks to protect retail investors from investment banking losses, different banks have placed local authority depositors in either the retail or investment banking divisions. Due to the way this process works it is not a given that depositing in a retail bank is safer for the Council. Therefore, the Council does not feel that there is any need to make further alterations to its banking counterparties at this time. It should be noted that the credit scores for the banks with which the Council operates have either remained the same or improved as a result of ringfencing. The Council holds accounts with RBS/Natwest for its everyday banking operations. Following ringfencing RBS/Natwest have moved local authorities into their A- rated retail bank; therefore there is no longer a need for a special dispensation in the strategy to allow the Council to use this counterparty for its operations.

4.20 **Challenger Banks:** As part of the Government's policy to reduce the size of banks and to encourage competition new 'challenger banks' are appearing in the UK banking market. Many of these challenger banks are unrated but do have very high levels of capital buffers. There has been insufficient evidence to demonstrate during 2017/18 that investments would be appropriately secure. However, it is recommended that the Treasury Management Sub-committee reviews evidence on these challenger banks and if satisfied that they provide sufficient Security, Liquidity and Return, and that up to £3m could be invested by the Council.

4.21 **Investment Funds:** Funds are non-specified investments which offer the Council a share of the income and capital growth of the fund. There are several types of fund including property funds, bond funds, equity funds and mixed asset funds. Funds seek to reduce risk by building a pool of diversified investments and as such are considerably safer than an investment of comparable size in a specific single asset. However, any fund exposes the Council to market price volatility and so Officers will carefully consider any investment opportunity, in conjunction with the Treasury Management sub-committee.

5. <u>Borrowing Strategy</u>

5.1 Based on current authorised capital expenditure plans, the Council has no underlying need to borrow from external sources to fund its capital expenditure in the forecast period. This section of the report sets out the Council's approach to external borrowing should it become necessary because of additions to the authorised capital programme or for short term liquidity purposes – where the Council may need to borrow funds for a short period to manage cash flow.

5.2 If and when the Authority needs to borrow externally it will seek to strike a balance between minimising interest costs and securing certainty of borrowing costs. The Council will seek to borrow funds from one of the following sources:

- Public Works Loan Board (PWLB)
- Other UK Local Authorities
- Any institution approved for investments
- UK public or private sector pension funds (Excluding the Essex Local Authority Pension Fund)

5.3 Officers may decide to undertake very short term borrowing for the purpose of confirming that appropriate authorisations are in place with counterparties. This will ensure that the ability to borrow at short notice is available if the need arises. The Council has no other plans to borrow in advance of need but may do so in the future if this represents best value for money for the funding of the capital programme or for short term liquidity purposes. This amount will not exceed the authorised borrowing limit, as set out in Capital Strategy.

5.4 In addition to borrowing, other debt financing models may be used to finance the capital programme where this represents best value for the authority. Such debt finance models include:

- Operating and finance leases (normally for vehicles)
- Sale and leaseback arrangements
- Hire purchase arrangements

5.5 With the introduction of a capital strategy and investment strategy in 2018, the prudential indicators are no longer reported in the Treasury Management Strategy. However, the Authorised Limit of Borrowing and the Operational Boundary of Borrowing are included with the treasury indicators as they have direct relevance to treasury management activity. These indicators both refer to external borrowing controls and can be found in appendix B.

5.6 The authorised borrowing limit for 2019/20 is £10m and the operational boundary is £nil. This confirms the fact that the authority does not expect to borrow, but if urgent need arises, the authority can borrow up to £10m without referral back to Council. Any borrowing would be in excess of the operational boundary and so would need to be reported via the normal mid-year or outturn treasury reports.

6. <u>Role of the Treasury management sub-committee</u>

6.1 The Sub-committee will be informed of investment activity and of significant changes in conditions that lessen or increase the risks of the Council's Treasury Management activity. The Sub-committee will recommend changes to officers and where necessary report back to Council.

APPENDIX 2

Treasury Management Performance Indicators

Period Ending: 30/11/2018

Security

	Month ending	Projection year ending	Target for year	Target for year	Target for year	Target for year
	30/11/2018	*31/03/2019*	*31/03/2019*	*31/03/2020*	*31/03/2021*	*31/03/2022*
Only to invest with approved counterparties	No breach	No breach	No breach	No breach	No breach	No breach
Only to invest up to approved limits	No breach	No breach	No breach	No breach	No breach	No breach
Bail in exposure to not exceed 33% of portfolio	27.00%	27.00%	33.00%	33.00%	33.00%	33.00%

Liquidity

	Month ending	Projection year ending	Target for year	Target for year	Target for year	Target for year
	30/11/2018	*31/03/2019*	*31/03/2019*	*31/03/2020*	*31/03/2021*	*31/03/2022*
At least £10m maturing in 100 days or less	£ 59,274,000	£ 19,000,000	£ 10,000,000	£ 10,000,000	£ 10,000,000	£ 10,000,000
Between 100 days and 1 year	£ 9,000,000	£ -		£ -	£ -	£ -
Investments maturing in more than 365 days and strategic funds	£ 13,000,000	£ 13,000,000	£ 13,000,000	£ 18,000,000	£ 18,000,000	£ 18,000,000
	£ 81,274,000	**£ 32,000,000**				

	Actual Borrowing Month ending	Borrowing projection year ending	Limit for year	Limit for year	Limit for year	Limit for year
	30/11/2018	*31/03/2019*	*31/03/2019*	*31/03/2020*	*31/03/2021*	*31/03/2022*
Authorised Limit of External Borrowing	£ Nil	£ Nil	£ 8,000,000	£ 10,000,000	£ 10,000,000	£ 10,000,000
Operational Boundary of External Borrowing (excluding finance leases)	£ Nil	£ Nil	£ Nil	£ Nil	£ Nil	£ Nil

Yield

	Month ending	Projection year ending	Projected benchmarks	Projected benchmarks	Projected benchmarks
	30/11/2018	*31/03/2019*	*31/03/2020*	*31/03/2021*	*31/03/2022*
Average yield on liquid portfolio	0.78%	0.78%			
3 month Libid benchmark	0.77%	0.77%	1.02%	1.27%	1.27%
Average yield on strategic portfolio	5.76%	5.76%			
Average yield on total portfolio	1.10%	1.10%			
1 year Libid benchmark	1.02%	1.02%	1.27%	1.52%	1.52%

Appendix 3

Treasury Management Code of Practice – clauses to be formally adopted

CIPFA recommends that all public service organisations adopt, as part of their standing orders, financial regulations, or other formal policy documents appropriate to their circumstances, the following four clauses.

1) This organisation will create and maintain, as the cornerstones for effective treasury management:

– a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

– suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Code's key principles.

2) This Council will receive reports on its treasury management policies, practices and activities, 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, in the form prescribed in its TMPs.

3)This Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Director of Finance, who will act in accordance with the organisation's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4) This organisation nominates the Treasury Management sub-committee of the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.