Audit and Governance Committee

22 January 2019

Appendix 1

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CHESHIRE WEST AND CHESTER COUNCIL

TREASURY MANAGEMENT STRATEGY STATEMENT

MANAGEMENT OF CASH BALANCES STRATEGY

2019-20

CONTENTS

EXECUTIVE SUMMARY

1. INTRODUCTION

This executive summary identifies the core components of the Council's treasury management strategy and brings out for Members the key areas covered within that strategy together with key statistical information and issues for consideration.

2. BACKGROUND

CIPFA (the professional accountancy body of the public sector) requires that all Councils produce a treasury management strategy setting out the treasury management activities that the Council plans to undertake in the forthcoming financial year. CIPFA also requires that the strategy be approved prior to the start of the financial year concerned.

3. RISK APPETITE

The Council's primary aim when investing public funds remains the security (ie preservation) of capital. The liquidity, or accessibility, of the Council's investments is a secondary consideration. The yield (ie rate of return) will only be considered once the security and liquidity objectives have been satisfied. The return of the capital is more important that the return on the capital.

The Council's underlying aim when raising new long term loans is one of seeking to strike a balance between securing low interest payable costs along with certainty of cost for the period that the monies are borrowed for.

During the year 2019-20 the Council does not intend to use derivatives in order to help manage these risks.

4. GENERAL FUND AND HRA

The strategy explains how the borrowings by the General Fund and the HRA are separately managed such that the decisions taken by one do not impact on the other.

5. PRUDENTIAL INDICATORS

Each year the Council sets for itself a set of Prudential Indicators. These indicators are designed to ensure that the Council's treasury management and capital financing activities are undertaken in an affordable, prudent and sustainable manner.

6. INTEREST RATES

Short term interest rates are forecast to increase slightly over the course of 2019-20 before remaining stable thereafter. Long term interest rates are forecast to rise very slightly in the year 2019-20 before falling back ever so slightly in the period between March 2020 and March 2022 to leave them around 0.10% higher than they were at March 2019.

	March 2019	Sept 2019	March 2020
UK base rate	0.75%	1.00%	1.25%
5 year loan rate	2.05%	2.30%	2.20%
10 year loan rate	2.45%	2.60%	2.55%
20 year loan rate	2.75%	2.80%	2.80%

7. CURRENT PORTFOLIOS

The portfolio of loans and deposits that it is estimated the Council will hold during the year 2019-20 are as follows

	March 2019 £ million	March 2020 £ million	Rate of Interest
Long term loans – general fund	189	176	4.10%
Long term loans – HRA	88	82	2.71%
Cash balances	40	40	0.40%

8. NEW LOANS REQUIREMENT

By the end of the year 2019-20 the Council's General Fund expects that it will need to raise up to £26 million of new long term loans. Such loans are only likely to be needed until March 2027 at the latest (see the General Fund loans gap chart in Appendix A).

Consequently the General Fund will look to raise new loans for periods of up to 8 years. The expectation is that such amounts will be borrowed from other local councils as fixed rate loans and / or the Public Works Loans Board (PWLB) as either fixed rate or variable rate loans at the Certainty rate of interest and / or the UK Municipal Bond Agency (UKMBA) as fixed rate loans where appropriate. Loans from other councils and the UKMBA are likely to be raised at rates lower than the PWLB Certainty rate.

The plan for the HRA is to raise up to £2 million of new loans for periods of up to 1 year. Such loans will be raised in a manner similar to that planned for the General Fund and will be consistent with the assumptions made in the HRA's 30 year business plan.

9. MANAGEMENT OF CASH BALACES STRATEGY

It is proposed that the Council will choose to deposit monies in the following instruments during the year 2019-20. This strategy is unchanged from that of the years 2018-19.

No limit on the amount invested

- Gilts (UK Government bonds)
- Treasury Bills (short term UK Government bonds)
- Deposits with the Debt Management Account Deposit Facility

£20 million limit on the amount invested with each bank

- Deposits and Certificates of Deposit (CDs) with high quality banks and building societies subject to a Reverse Repurchase Agreement (Repo).
- Covered Bonds with a high quality credit rating

This limit will be increased to £22.5 million for Lloyds Bank only (Lloyds being the Council's main banker).

£10 million limit on the amount invested with each bank, body, council, fund or scheme

- Unsecured deposits and CDs with high quality banks and building societies
- Bonds issued by Multilateral Development Banks (MDB) eg World Bank
- Deposits with other UK local councils, pension funds and public sector bodies
- Bonds issued by UK local councils and UK public sector bodies
- Commercial Paper (bonds) issued by high quality corporate bodies
- Constant net asset value (CNAV) money market funds
- Low volatility net asset value (LVNAV) money market funds
- Corporate bonds issued by high quality corporate bodies
- Variable net asset value (VNAV) money market funds
- Strategic pooled funds (ie equity, property and bond funds)
- Real estate investment trusts (REITs)
- Other Money Market and Collective Investment Schemes

This limit will be increased to £12.5 million for Lloyds Bank only.

The higher limits set with Lloyds Bank allow for the Council's 'daily money market dealing' process to be more operationally efficient and avoid the Council incurring bank charges on the placing of deposits which are of relatively small value.

CHESHIRE WEST AND CHESTER COUNCIL

Treasury Management Strategy Statement (TMSS) 2019-20 and Management of Cash Balances Strategy (MCBS) 2019-20

1. Background

1.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") and the Prudential Code require local councils to determine their Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis.

1.2. The Ministry of Housing, Communities and Local Government's (MHCLG's) Investment Guidance also requires local councils to approve a Management of Cash Balances Strategy (MCBS) on an annual basis.

1.3. This Council adopted the CIPFA Treasury Management Code at a meeting of Full Council on 26th February 2009. The 2011 revision to the CIPFA TM Code was also approved in January 2012.

1.4. The purpose of this TMSS is, therefore, to approve:

- Treasury Management Strategy for 2019-20;
- Management of Cash Balances Strategy for 2019-20;
- Treasury Management Prudential Indicators for the years 2019-20 to 2022-23;

1.5 Where a capital strategy is approved by full Council approval of the treasury management strategy may be delegated to the Committee responsible for the implementation and regular monitoring of treasury management activity being Audit and Governance Committee.

1.6 Under most circumstances Council will be asked to approve a single treasury management strategy, management of cash balances strategy and prudential indicators for the forthcoming year. However in exceptional circumstances there may be a need to ask full Council to approve revised strategies and prudential indicators. Such situations are expected to be rare and are only likely to arise if there is a significant change in either the economic environment of the UK, the Council's capital expenditure programme or the Council's portfolio of long term loans or investment balances.

1.7 The Council currently has long term loans totalling £278 million and cash holdings of circa £65 million (December 2018). An analysis of these loans and investments is provided in Appendix B. The holding of such loans and cash balances potentially exposes the Council to significant risks including the loss of invested funds and the effect of changing interest rates. Conversely, taking no action has risks associated with it too. The successful identification, monitoring and control of risk is therefore central to the Council's treasury management strategy.

1.8 All of the Council's treasury activities will comply with relevant statutes, guidance, accounting standards and the requirements of the Bribery Act 2011.

2. Economic and Legislative Outlook

2.1 The latest interest rate forecast from the Council's treasury management advisors is detailed in Appendix C. This forecast is updated monthly. The Council will keep its Treasury Management Strategy under constant review and adjust it to take account of changes in the economic, financial and / or regulatory outlook.

2.2 The forecast indicates that long term interest rates in the UK will rise very slightly (by 0.15%) during 2019-20 before falling very slightly during 2020-2021 and 2021-22 to end the three year period around 0.10% higher than at the start. The forecast also indicates that it is more likely that actual long term interest rates will be below those forecast rather than above.

2.3 The forecast for the Bank of England base rate is that the base rate will rise very gently from the current level of 0.75% to 1.25% by the end of March 2020.Thereafter the base rate is forecast to remain stable at 1.25%. The risks around this forecast are such that it is more likely that the base rate will rise more slowly than forecast (or not at all) than it will rise more quickly than forecast. The Bank of England has, on several occasions, re-iterated that it expects any increase in the base rate will be at a gradual pace and to a limited extent.

2.4 The main influence on interest rates during the year 2019-20 is likely to be the consequences of the UK's departure from the EU (ie Brexit). Whilst this influence is likely to keep interest rates at low levels it does potentially allow for some significant volatility to occur around this general trend.

2.5 The rate of inflation is forecast to start the year 2019-20 at just below 3% and is expected to fall back slightly to end the year at just below 2.5%. Much of this fall in inflation will be due to the impact of the fall in the value of Sterling that followed the announcement of the result of the EU Referendum 'dropping' out of the calculation of the annual rate.

2.6 The largest UK banks have now split their retail and investment banking activities into separate banks under so called 'ring-fencing legislation'. The credit rating agencies have adjusted the ratings of some of the banks to reflect the split of activities. In general the banks undertaking retail banking activity have a higher credit rating that those bank undertaking investment banking activity.

2.7 European banks are considering their approach to Brexit. Some are looking to create new UK subsidiaries in order that they are able to continue trading in the UK. The credit rating to be assigned to any new UK subsidiary is not yet known.

Capital Financing Requirement

3.1 The Council's underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The Council's usable reserves and net working capital (debtors less creditors) represent the amounts potentially available for investment. Together these two measures are the core drivers of the Council's Treasury Management activities.

3.2 The forecast movement in the CFR in coming years is one of the Council's Prudential Indicators (PIs). By comparing the forecast level of the CFR with the existing loans outstanding and the forecast level of reserves and balances to be held at each year end the Council is able to identify either

i) the amount of long term loans that it potentially needs to raise over the next 4 years

or

ii) the level of cash balances available for investment over that period.

Table 1: Summary of Council Balance Sheet (Estimate)	March 2019 £m	March 2020 £m	March 2021 £m	March 2022 £m	March 2023 £m
Capital Financing Requirement (CFR)					
General Fund Mainstream Programme	269	284	292	293	277
Self Financing Schemes	6	12	11	10	9
Winsford Cross	21	22	22	22	22
Northgate	29	37	37	37	37
Barons Quay	71	71	71	71	71
Housing Revenue Account	101	99	92	87	79
Total CFR	**497**	**525**	**525**	**520**	**495**
Less					
Existing outstanding long term loans					
General Fund Mainstream Programme	(129)	(129)	(129)	(129)	(129)
Northgate	(10)	0)	0	0	0
Barons Quay	(50)	(47)	(45)	(42)	(40)
Housing Revenue Account	(88)	(82)	(80)	(60)	(58)
Total external borrowing requirement before the use of existing cash balances	**220**	**267**	**271**	**289**	**268**
Usable reserves – General Fund	(137)	(129)	(122)	(119)	(119)
Usable reserves – HRA	(12)	(15)	(15)	(17)	(16)
Working capital	(95)	(95)	(95)	(95)	(95)
Total external borrowing requirement after the use of existing cash balances	**(24)**	**28**	**39**	**58**	**38**
Split					
General Fund (including Winsford Cross, Northgate and Barons Quay)	(25)	26	42	48	33
HRA	1	2	(3)	10	5

3.3 Table 1 above indicates that the Council's overall planned capital expenditure over the next 4 years cannot be funded from existing cash balances (ie the cash represented by its reserves and the excess of its short term creditors over its short term debtors).

3.4 Table 1 also shows however that within this overall position the respective positions of the General Fund and the HRA are different. The General Fund is likely to have a relatively (to the existing amount of loans outstanding) small borrowing need that rises gradually over the next 3 years before falling back thereafter. The HRA however has a small borrowing requirement in the short term only. These conclusions are borne out by Appendix A (the loans gap charts for the General Fund and HRA).

3.5 In previous years there has been a limit on the maximum level that the HRA capital financing requirement could be increased to. This limit was set by Central Government and was known as the HRA borrowing cap. The Chancellor of the Exchequer announced during his budget on 29th October 2018 that the HRA borrowing cap was to be eliminated with immediate effect for all local councils.

3.6 Going forward the maximum level that the HRA capital financing requirement can be increased to will be determined in accordance with CIPFA's Prudential Code ie at a level that is affordable, prudent and sustainable.

4. Borrowing Strategy

4.1 At the end of March 2019 the Council's portfolio of long term loans is estimated to be £277 million. Of this amount £129 million has been raised on behalf of the General Fund, £60 million on behalf of major regeneration schemes and £88 million on behalf of the HRA.

4.2 The Council's underlying aim when raising new long term loans is one of seeking to minimise the net cost of interest payable to the Council's revenue account over the medium term. This is achieved by seeking to strike a balance between securing low interest payable costs along with certainty of cost for the period that the monies are borrowed.

4.3 In a low interest rate environment (ie one where short term interest rates are considerably lower than long term interest rates), and one which is likely to persist for the foreseeable future, then the 'cheapest' strategy is to defer raising new long term loans and to use existing cash balances to temporarily fund capital expenditure payments.

4.4 Whilst this strategy will lead to a loss of investment income this loss will be less that the interest payable on the long term loans that would otherwise need to be raised. In addition such a strategy would reduce the amount of credit risk and interest rate risk that the Council is exposed to.

4.5 The interest rate forecast shown in Appendix C shows an environment of relatively stable interest rates. Such a forecast would suggest that there is little risk of making a poor borrowing decision by deferring the raising of new long term loans given that long term interest rates are not expected to rise much over the next three years and will over that period remain above short term interest rates.

4.6 The General Funds loans gap chart (see Appendix A) indicates that the Council's need for new long term loans (the lower of the 2 lines shown on the graph) only remains above the actual loans outstanding (ie the vertical bars shown on the graph) for the years up to 31st March 2027.

4.7 The gap between the lower of the line graphs and the vertical bars indicates that the General Fund's need to raise new long term loans. The fact that the lower line graph crosses the vertical bars in March 2027 and remain below it thereafter after, would tend to suggest that the maximum period for which any new General Fund long term loans should be raised is around 8 years. The gap is largest at March 2024 and gradually reduces thereafter. This indicates that the £48 million of new loans is not needed for the whole of the period to 31st March 2027 and that some of the required loans should be raised for a shorter period.

4.8 The HRA loans gap chart (see Appendix A) indicates that its need for new long term loans (the line graph) initially remains above the actual loans outstanding (ie the vertical bars shown on the graph) for the period up to 31st March 2020. This would tend to suggest that the maximum period for which any new HRA long term loans should be raised is initially around 1 year.

4.9 Raising loans for periods of up to 1 year and 8 years would be advantageous to the Council since such loans are amongst the cheapest currently available.

4.10 The current advice from the Council's treasury management advisers, Arlingclose, is that with short-term interest rates currently much lower than long-term interest rates, and forecast to remain so, it is likely to be more cost effective in the short term to use existing cash balances or borrow on a short term basis rather than raising new long term loans.

4.11 The most likely source of long term loans to the Council during the year 2019-20 are likely to other local councils (including police and fire authorities), pension funds together with the PWLB and any other UK public sector body. Other potential sources include the UK Municipal Bond Agency, commercial banks, building societies and bond issues. The Council will also be able to borrow monies from any organisation that it is able to lend money to.

4.12 Most of the Council's existing external long term loans are fixed rate PWLB loans. There is just one variable rate loan which makes up around 20% of the HRA loans portfolio. With long term interest rates forecast to rise gently over the next 3 years and remain well above short term interest rates, an expectation that the UK base rate will peak at around 2% to 3% in this interest rate cycle and the General Fund only needing to raise loans for up to 8 years then the possibility of raising any new long terms loans in the form of variable rate loans would seem to be a reasonably attractive one.

4.13 Variable rate loans, however, inject potential volatility (ie variability in the amount of interest paid) into the loans portfolio. This volatility is counterbalanced by more affordable borrowing costs and by part of the Council's borrowing costs moving in line with the rate of return on its investments. The latest interest rate forecast (see Appendix C) would suggest that such volatility is likely to fairly limited in the next 3 years.

4.14 The Council (General Fund) now has just £7 million of exposure to LOBO (Lender's Option Borrower's Option) loans. The next option date on this loan falls early in 2021-22 (on 25th May 2021). There will be no action to take on this loan during 2019-20.

4.15 LOBO loans present a potential refinancing risk to the Council as the decision to call them is entirely at the lender's discretion. Given the current low interest rate environment it is unlikely that the lender will exercise their option to change the rate of interest payable on the loans for fear of the loan being repaid. The Council's position will be one of looking to repay the loan without penalty should the lender seek to increase the rate of interest payable.

4.16 It is possible for the Council's external PWLB loans portfolio to be restructured by prematurely repaying loans and refinancing them on similar or different terms. This will be considered where it will lead to a saving in cost or a reduction in risk.

5. Management of Cash Balances Strategy (MCBS)

5.1 In accordance with Investment Guidance issued by MHCLG and best practice (ie the CIPFA Code of Practice) this Council's primary objective in relation to the investment of its cash balances funds remains the security (ie preservation) of capital. The liquidity, or accessibility, of the Council's investments is a secondary consideration. The yield (ie rate of return) will only be considered once the security and liquidity objectives have been satisfied. The return of the capital is much more important than the return on the capital.

5.2 The Council makes decisions on how long a period monies can be deposited for by reference to a cashflow forecast. The forecast is prepared on a monthly basis for a period covering the next three years. The aim is to ensure that the amount available to the Council does not fall below £20 million at the month end.

5.3 During the year 2018-19 the average level of cash balances held by the Council has been £75 million. This average however disguises the volatility in the level of cash balances held during the year. Such balances however ranged between £90 million and £50 million. The forecast is for £40 million of cash balances to be held at the end of March 2020. Of this amount £10 million will be invested for the longer term in the CCLA Property Fund and the Schroders Income Maximiser Fund.

5.4 For the year 2019-20 the Council expects to be in a position where it will have on average £40 million of cash balances. Short term interest rates are forecast to remain at very low levels for the foreseeable future. In addition the UK base rate is expected to peak at a relatively low level relative to its historical average. With the markets providing little additional return for longer dated deposits then the Council's strategy will ordinarily be one of keeping investments short term in duration (ie liquid).

5.5 In a low interest rate environment additional return (ie interest) can only be earned if additional risk is taken on. This additional risk may be greater credit risk (ie making use of building societies that do not have a credit rating or making use of challenger banks (eg Metro Bank, Virgin Money, TSB, Sainsburys Bank), greater liquidity risk (by investing in longer term deposits) or greater market risk (ie investing in certificates of deposit, corporate bonds and pooled funds such as the CCLA Property Fund and the Schroder Income Maximiser equity fund, etc).

5.6 In such cases one should ensure that the additional return earned compensates for the additional risk being taken (ie after allowing for any expected losses and entry and exit charges).

5.7 The types of investents to be used by the Council in the year 2019-20 are detailed in Appendix D.

5.8 During the year 2019-20 the Council has no intention of placing deposits / making investments that are denominated in any currency other than sterling. Nor does it intend to make investments that will qualify as capital expenditure.

5.9 For the year 2019-20 the Council's definition of high quality remains

one with a credit rating of AA+ for bonds issued by Multilateral Development Banks and Governments other than the UK Government

one with a credit rating of A- for all other investments

5.10 The maximum amount that can be invested with any institution at any one point in time is set by reference to the lowest published long-term credit rating from a selection of external ratings agencies. Investment decisions are never made solely based on credit ratings alone and all other relevant factors including external advice will be taken into account. The other factors taken into account are:

- Government or other parent company support mechanisms
- Credit default swap rates (when available);
- Share prices (when available);
- Economic factors such as a country's net debt as a percentage of its GDP and its forecast rate of economic growth
- Corporate news, press articles, markets sentiment

5.11 Should any of the factors identified above give rise for concern then no further monies will be deposited with these organisations.

5.12 Where a secured deposit is placed / a secured CD is purchased then the credit rating to be used to determine whether it meets the minimum credit rating is the lower of the credit rating assigned to the bank with whom the deposit is placed / CD has been issued by and the credit rating of the collateral security.

5.13 Credit ratings attempt to give a measure of the bank's ability to absorb losses and therefore how likely a depositor is to be 'bailed in'. Arlingclose promptly advises the Council on ratings changes and whether any action need be taken in response to the change.

5.14 Where an organisation has its credit rating downgraded so that it fails to meet the Council's minimum requirement then

- No new investments will be made,
- Any existing investments that can be recalled or sold at no cost will be,
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.15 When an organisation's credit rating is placed under review for possible downgrade such that the review may result in the credit rating falling below the minimum requirement of AA+, A+ or A– then the only further investments that will be made with that organisation will be ones that are available on the next working day (ie instant access deposits or overnight deposits).

5.16 No investments will be made with an organisation if there are doubts over its creditworthiness. This is the case even if the organisation meets all of the investments criteria.

5.17 Should conditions in the financial markets deteriorate such that the financial standing of all organisations is affected then the Council may decide to only deposit monies with organisation of the highest credit quality and for short periods. The exact nature of such restrictions on the investments made will be dependent upon the risk that the Council perceives it faces by making investments. At its most extreme this could result in the Council investing only with the UK Government and/or in UK government bonds and treasury bills or in money market funds which themselves only invest in UK Government bonds. This would ordinarily lead to a slight loss of interest earned. This loss of interest would necessarily reflect the reduction in credit risk that the Council would be exposing itself to.

5.18 Money market funds (MMFs) will continue to be utilised during 2019-20. MMFs provide good diversification of the Council's investments. The Council will also seek to diversify its exposure to MMFs by using a number of such funds. The Council will restrict its exposure to MMFs by limiting the amount held in any individual fund to £10 million.

5.19 The Council's General Fund balance, and other usable reserves, were slightly in excess of £48 million at 31st March 2018. Were the Council to suffer a default on one of its investments then the loss associated with that default would be charged to the GF and / or other usable reserves. To avoid too adverse an impact placed on these reserves as a result of a single default then the maximum amount that can be invested with any single organisation will be limited to £10 million.

5.20 The amount of £10 million has been calculated by reference to

i) 5% of the maximum investments held in 2018-19
plus the amount of internal borrowing at 31st March 2018
ie (£90 million + £146 million) * 5% = £12 million

ii) 20% of the Council's available reserves
(ie £48 million * 20%) = £10 million

Taking the lower of these two amounts rounded to the nearest £ million gives an amount of £10 million.

5.21 The Council's treasury management advisers recommend that such a limit can be doubled for secured investments and investments with national governments. Consequently it is proposed to set a limit of £10 million for unsecured deposits / secured deposits and a further £10 million limit for secured deposits only on top. Hence it will be possible for the Council to deposit £20 million in secured deposits with a high quality bank or £15 million (comprising £10 million of secured deposits and £5 million of unsecured deposits or vice versa) with a high quality bank. The Council will not, however, be able to deposit £15 million of unsecured deposits with any bank.

5.22 Where the Council makes purchases of T-bills, UK Government Gilts, Certificates of Deposit, Corporate Bonds or Covered Bonds the most efficient means of holding such investments is in a custodian's nominee account. The Council will limit its holding of such investments with any one custodian to £20 million. This will ensure that the Council's liquidity is not compromised should the custodian fail.

5.23 Under the new accounting standard IFRS9 how investments are accounted for is determined by the Council's 'business model' for managing them. In the case of this Council the aim of holding investments is to collect the contractual cashflows that flow from them. Consequently how investments are accounted for should not be affected by the introduction of this new standard wef 1st April 2018.

6. Financial Derivatives

6.1 Derivatives are financial instruments whose value is derived from other assets such as bonds, commodities or shares. They have evolved in order to try and reduce risk and can be thought of as a type of insurance. Derivatives include, amongst other things, the use of futures, options and interest rate swaps.

6.2 The Council does not presently see itself being in a situation whereby it will be appropriate, necessary or desirable to use derivatives and therefore has no intention of using derivatives in the foreseeable future.

6.3 Should this position change then a further report will be brought before Members at Full Council explaining why the use of derivatives is appropriate, what type of derivative it is proposed to use and how the derivative will be used. The report will seek Member approval to use such derivatives. It is expected that the use of derivatives would only be necessary in those situations where the Council faces a significant financial risk that could potentially have a material impact on the overall financial health of the Council.

6.4 Embedded derivatives (such as those contained within a LOBO loan) will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7. Housing Revenue Account

7.1 On 1st April 2012, the Council notionally split each of its existing long-term loans into one of 2 pools (the General Fund pool and the HRA pool). Post that day any new long-term loans taken out will be assigned to either one pool or the other. Interest payable on long-term loans will be charged to the respective revenue account.

7.2 Each year the value of the HRA loans pool will need to be compared to the HRA's underlying need to borrow (ie the HRA Capital Financing Requirement). Where the two are different the resulting amount will represent a notional cash balance. This notional balance may be positive or negative. This balance will be calculated on an annual basis and interest thereon will be transferred between the General Fund and HRA. The rate of interest used to determine this transfer will be the risk free rate of return as measured by the rate of return earned on deposits placed with the UK Government's Debt Management Office. The risk free rate is used because the HRA is not allowed, under statute, to bear any investment losses. The HRA generally has a negligible level of cash balances. Such balances are managed in the same way as those of the General Fund.

7.3 The HRA has a business plan that will see all of the amounts borrowed as part of the reform of housing subsidy that took place in March 2012, and all subsequent borrowing, charged in full to the HRA (ie repaid) within the 30 year period commencing on 1st April 2012.

7.4 Where loans raised on behalf of the HRA are raised as maturity loans (ie the whole of the loan falls to be repaid in one lump sum at the end of the loan period) then the HRA will make voluntary repayments in respect of the amount borrowed in the years between the loans being raised and the year in which it falls to be finally repaid. The amount to be repaid each year will be equal to the amount of the loan that would have been repaid in the year had the loan been raised as an annuity loan.

7.5 The HRA loans gap chart (see Appendix A) indicates that by March 2020 the HRA will have a net underlying need to borrow of £99 million with long term loans outstanding of £82 million and reserves of £15 million. This implies that the HRA will need to raise new long term loans of around £2 million between now and the end of 2019-20.

7.6 The HRA loans gap chart indicates that the HRA need for long term loans (the line graph) initially lies above the amount of actual long term loans outstanding (the bar charts) for the period up to 31st March 2020. This would suggest that any new HRA loans should only be raised for an initial period of around 1 year.

8. Balanced Budget Requirement

8.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget. This means that the Council has set its Council Tax at a level sufficient to meet its expenditure plans after taking account of all other sources of income.

9. Monitoring and Reporting Arrangements

9.1 The Director of Finance will report to the following Member bodies on treasury management activity / performance and Prudential Indicators (as detailed in Appendix E):

- The Audit and Governance Committee and Cabinet Member for Legal and Finance will receive quarterly reports updating them on the progress made by the Council in respect of treasury management activities in the year to date

- Full Council will receive the Treasury Management Strategy Report prior to the start of the financial year as part of the Capital Strategy

- Audit and Governance Committee will receive the Treasury Management Mid Year Review Report prior to the end of December each year

- Audit and Governance Committee will receive the Treasury Management Annual (Stewardship) Report prior to the end of September in the following financial year

- The Audit and Governance Committee will also be responsible for the scrutiny of treasury management activity and practices.

10. Markets in Financial Instruments Directive (MiFID)

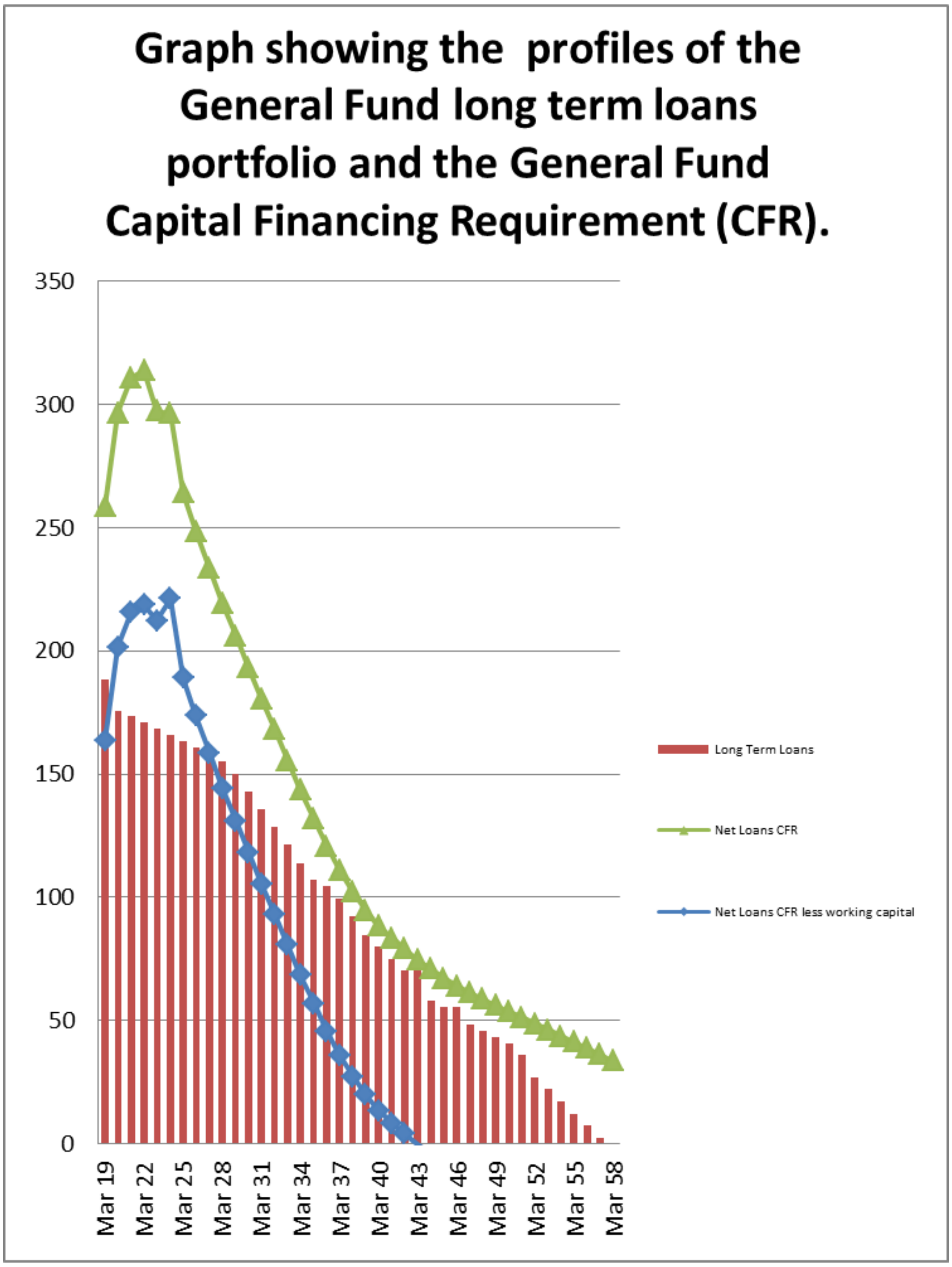
10.1 The Council has opted up to professional client status with its providers of financial services including its treasury management advisers, banks, money market brokers, money market funds and pooled funds.

10.2 Opting up to professional status allows the Council access to a greater range of services and products but without the greater regulatory protections afforded to private individuals and small businesses.

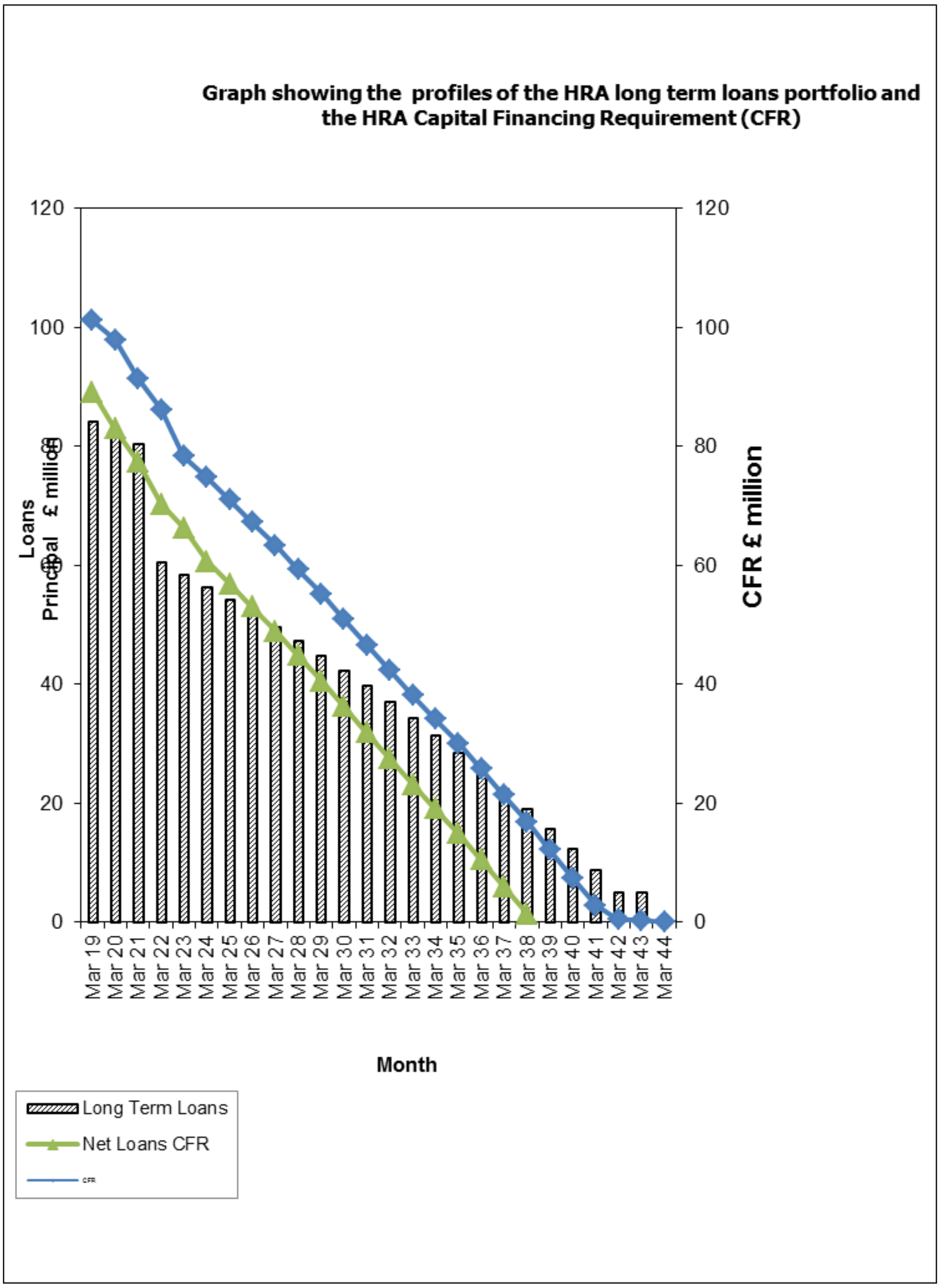
10.3 Given the magnitude and range of the Council's treasury management activities the Director of Finance is of the opinion that this is the most appropriate status.

Cheshire West and Chester Council

Loans Gap Chart – General Fund

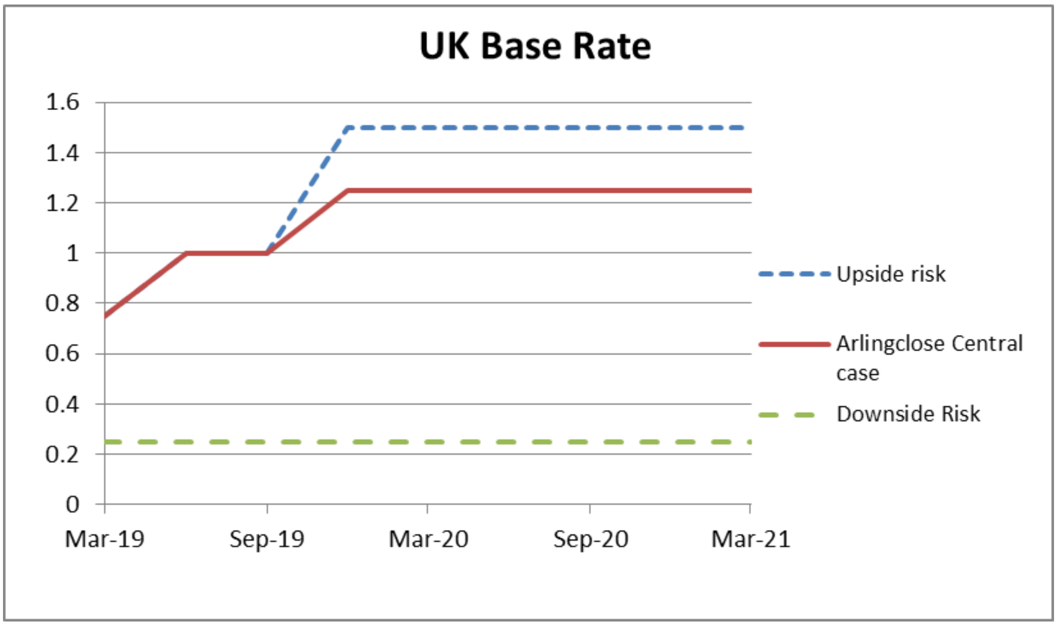


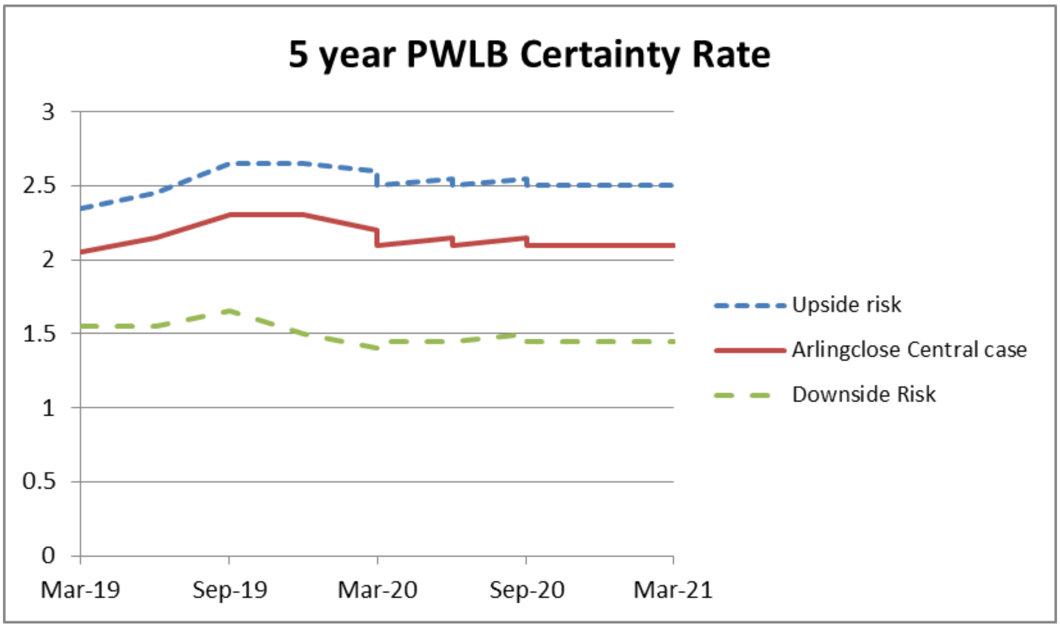
Loans Gap Chart – HRA

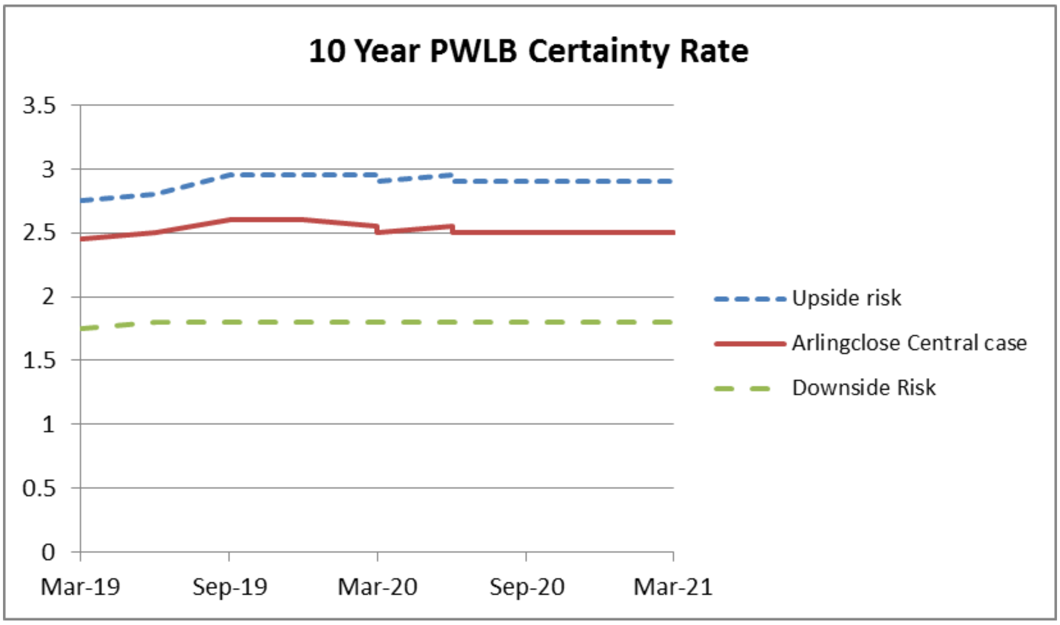


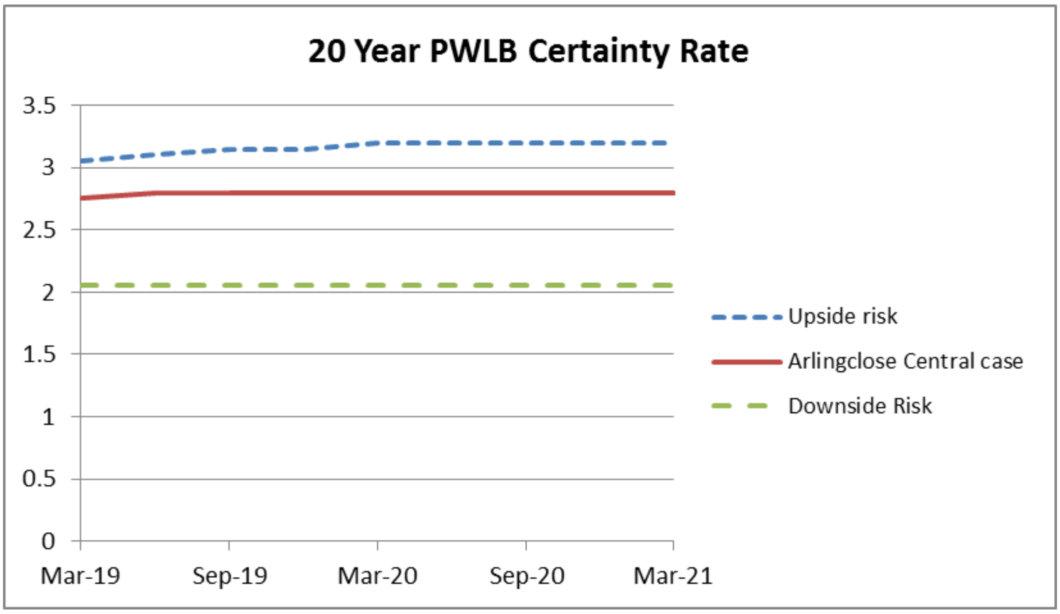
Existing Loans and Investment Portfolio (December 2018) Appendix B

Cheshire West and Chester Council		
	Actual	Actual
Existing Loans and Investment Portfolio	Portfolio	Portfolio
as at 31st December 2018	£m	£m
External Loans - General Fund		
Mainstream Programme		
PWLB - Fixed Rate	112	
Bank - Fixed Rate	10	
Bank - LOBO	7	
Northgate		
PWLB - Fixed Rate	10	
Barons Quay		
PWLB - Fixed Rate	50	
Total - General Fund		**189**
External Loans - HRA		
PWLB - Fixed Rate	62	
PWLB - Variable Rate	18	
Bank - Fixed Rate	5	
Local Councils - Fixed Rate	4	
Total - HRA		**89**
Total External Loans - General Fund and HRA		**278**
Add		
Other Long Term Liabilities, PFI and Finance Leases	32	32
Total Gross External Debt - General Fund and HRA		**310**
Investments		
Short term Deposits		10
Monies on Call		6
Pooled Funds		10
Money Market Funds		39
Total Investments		**65**
Total Net External Debt - General Fund and HRA		**245**


UK Base Rate
1.6
1.4
1.2
1
0.8
0.6
0.4
0.2
0
Mar-19
Sep-19
Mar-20
Sep-20
Mar-21
Upside risk
Arlingclose Central case
Downside Risk


5 year PWLB Certainty Rate
3
2.5
2
1.5
1
0.5
0
Mar-19
Sep-19
Mar-20
Sep-20
Mar-21
Upside risk
Arlingclose Central case
Downside Risk





The key factors underlying the forecast are

- Expectations for further increases in the Bank of England base rate are subdued.
- There are significant downside risks to the interest rate forecasts (ie actual interest rates are more likely to be below the central case forecast than above it).
- The rising price of oil and a shortage of workers in the UK may result in inflation remaining above the target rate of 2% for longer than expected.
- Long term interest rates are expected to remain on a stable path although there may be some short term volatility around this general trend.

Investments to be used in 2019-20 **Appendix D**

The types of investments to be use by the Council during 2019-20 are

1 Unsecured lending to banks:

1.1 This heading includes instant access bank accounts, notice accounts, fixed term deposits, certificates of deposit and unsecured bonds.

1.2 Such investments are subject to the risk of credit loss via bail in should the bank fail.

1.3 The maximum amount that can be invested with any single bank in an unsecured form at any single point in time is £10 million (£12.5 million for Lloyds Bank).

2 Secured lending to banks:

2.1 This heading includes covered bonds issued by banks and reverse repurchase agreements (repos).

2.2 Such investments are secured on collateralised assets held by the bank. Such assets are exempt from bail in. Consequently the risk of credit loss is very low.

2.3 The credit rating assigned to such investments will be the lower of the credit rating assigned to the bank to which monies are lent and the credit rating assigned to the collateralised asset.

2.4 The maximum amount that can be invested with any single bank in secured form at any single point in time is £20 million (£22.5 million for Lloyds Bank).

2.5 The maximum amount that can be invested with any single bank in both unsecured form and secured form at any single point in time is £20 million (£22.5 million for Lloyds Bank) of which no more than £10 million (£12.5 million for Lloyds Bank) may be in unsecured form.

3 Lending to Government:

3.1 This heading includes loans to Government bodies (whether national, regional or local), together with bonds and bills issued by, or guaranteed by, Government bodies, (whether national, regional or local).

3.2 Such investments are not subject to bail in. Consequently the risk of loss when investing is such investments is low.

3.3 There is no limit on the amount that can be invested with the UK National Government. The maximum amount that can be invested with any single regional or local government body, any regional or local government pension fund, any other UK public sector body or any single Multi-Lateral Development bank is £10 million.

4 Lending to Corporates:

4.1 This heading includes loans, bonds and commercial paper issued by limited companies (other than banking companies).

4.2 Such investments are not subject to bail in. The risk of loss is dependent of the continuing solvency of the company concerned.

4.3 The Council will only lend to those corporates that have a credit rating assigned to them or where the bond / commercial paper being invested in has a credit rating assigned to it.

4.4 The maximum amount that can be invested with any one corporate body is £10 million.

5 Pooled Funds:

5.1 Pooled fund investments comprise of shares or units in investment vehicles that invest in investment types 1 to 4 above along with investments in shares and property.

5.2 These investments benefit from being able to offer diversifiation of investment risk while at the same time offering the expertise of a professional fund manager.

5.3 In their simplest form (ie money market funds) they offer a highly liquid type of investment alongside a very low level of credit risk. Money market funds provide a very useful home for short term investment balances and can be seen as an alternative to short term deposits and instant access / notice accounts.

5.4 In their more strategic form (ie property funds, equity funds and bond funds) they offer the potential of higher rates of returns. Such returns do, however, require a council to expose itself to greater risk in particular price risk (the risk that the investment will fall in price at some point after it has been purchased) and liquidity risk (ie the risk that the investment needs to be sold quickly in order to provide the council with enough money to pay its creditors).

5.5 The maximum amount that can be invested with any one pooled fund is £10 million.

6 <u>Real Estate Investment Trusts (REITs):</u>

6.1 REIT comprise of shares in companies that mainly invest in property assets and pay out most of their net rental income as dividends to their shareholders.

6.2 Like property funds, equity funds and bond funds REITs offer the potential of higher rates of returns. Again such returns do require a council to expose itself to greater risk in particular price risk (the risk that the share price of the REIT will fall at some point in the future) and liquidity risk (ie the risk that the shares need to be sold quickly in order to provide the council with enough money to pay its creditors).

6.3 The maximum amount that can be invested with any one REIT is £10 million.

Treasury Management Prudential Indicators 2019-20 to 2022-23 Appendix E

1. **Background:**

1.1 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. **Liquidity Risk:**

2.1 The Council's choice of indicator of liquidity risk is the amount of cash available to meet unexpected payments within a rolling three month period. This indicator is set with a lower limit of £20 million. There is no upper limit.

2.2 Investments that will fall to be treated as being available within three month will include

- Amounts held in instant access accounts
- Amounts held in money market funds
- Amounts held in notice accounts where the notice period is less than 95 days
- Fixed term money market deposits maturing in the next three months

Liquidity Risk	2019-20 Target
Total cash available within 3 months (minimum)	£20 million

3. **Interest Rate Risk:**

3.1 The Council's choice of indicator of interest rate risk is a measure showing the impact on the Council's revenue budget of a 1% movement in interest rates.

3.2 Most of the Council's long term loans are fixed rate loans. Conversely all of the Council's investments earn interest at variable rates. Changes in interest rates therefore predominantly impact on the amount of interest earned by the Council on its investments.

3.3 An increase in interest rates will increase the amount of interest earned on the Council's investments but will leave the amount of interest paid on its long term loans unchanged. Conversely a reduction in interest rates will reduce the amount of interest earned on the Council's investments but again will leave the amount of interest paid on its long term loans unchanged.

3.4 Based on the Council's expected portfolio of investments and loans for the year 2019-20 the impact of a 1% change in interest rates is estimated at £990,000. This means that if interest rates rise by 1% the impact on the Council will be a reduction of

£990,000 in the amount of net interest payable (ie interest payable on long terms loans less interest receivable on investments).

3.5 The impact of a change in interest rates is calculated assuming that the interest rate change takes place prior to 1st April 2019 and remains in place for the whole year.

Interest Rate Risk	2019-20 Target
Maximum impact of a 1% change in interest rates	£990,000

4. Re-financing Risk:

4.1 The Council's choice of indicator of re-financing risk is the maturity profile of its fixed interest rate long term loans portfolio.

4.2 Profiling the maturity dates of the Council's existing long term loans portfolio will highlight the existence of any large concentrations of fixed rate loans maturing at a single point in time / close together. It is designed to protect the Council from being too heavily exposed to an unfavourable interest rate environment (ie relatively high interest rates) in any one period / point in time.

4.3 The indicator is calculated as the amount of projected fixed rate borrowing that is maturing in each period as a percentage of total projected fixed rate borrowing. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

4.4 Separate indicators are calculated for the General Fund (which includes major infrastructure projects) and the HRA.

General Fund

Maturity structure of fixed rate borrowing	2018-19 %	Lower Limit for 2019-20 %	Upper Limit for 2019-20 %
under 12 months	6	0	15
12 months and within 24 months	6	0	15
24 months and within 5 years	4	0	50
5 years and within 10 years	7	0	50

10 years and within 20 years	31	0	70
20 years and within 30 years	24	0	60
30 years and within 40 years	22	0	60
40 years and within 50 years	0	0	45

HRA

Maturity structure of fixed rate borrowing	2018-19 %	Lower Limit for 2019-20 %	Upper Limit for 2019-20 %
under 12 months	8	0	15
12 months and within 24 months	3	0	15
24 months and within 5 years	9	0	50
5 years and within 10 years	16	0	55
10 years and within 20 years	42	0	75
20 years and within 30 years	22	0	65
30 years and within 40 years	0	0	45
40 years and within 50 years	0	0	45

5. Market (or Price) Risk:

5.1 The choice of indicator here is the amount of principal invested for periods of more than a year.

5.2 By placing a maximum limit on the amount of principal that can be invested for longer than a year the Council is looking to contain its exposure to the possibility that a loss may arise as a result of the Council having to seek early repayment / sale of the amounts invested.

5.3 The upper limit on this amount has been increased for the years post 2018-19 to give it the ability to be able to make further long term investments in strategic pooled funds should the Council's treasury management advisers consider this to be in the best interests of the Council.

	2018-19 Estimate £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m
Upper Limit for total principal sums invested for longer than a year	10	40	40	40	40