Report to:	**COUNCIL**
Meeting date:	**27th March 2019**
Title:	**TREASURY MANAGEMENT STRATEGY & MRP POLICY**
Originator:	**BOROUGH TREASURER**
Status	**FOR DECISION**

Purpose

This report outlines the Council's policy for charging unfinanced capital expenditure to revenue (MRP) together with the expected treasury operations for this period. It fulfils a key legislative requirement.

Recommendations

Council is recommended to approve:

- Minimum Revenue Provision Policy, as identified in 2.1
- The Treasury Management Strategy, as identified in 2.2

1.0 BACKGROUND

1.1 Overview

1.1.1 Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

The Council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

The requirement for an investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

1.2 Reporting requirements

1.2.1 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

1.2.2 Minimum Revenue Provision and Treasury Management Strategy (this report) - the first, and most important report covers:

- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the treasury management investments and borrowings are to be organised) including treasury indicators;

1.2.3 A Mid Year Treasury Management Report – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy and investment strtegies are meeting their objectives or whether any policies require revision

1.2.4 An Annual Treasury Report – this provides details of a selection of actual prudential, investment and treasury indicators and actual treasury and investment operations compared to the estimates within the strategy.

The latter two reports are combined and jointly reported in September.

1.3 Annual Minimum Revenue Provision Statement

1.3.1 The Council's policy for calculating the annual amount charged to the revenue budget to repay capital expenditure financed by debt is set out in para 2.1.

1.4 Treasury Management Strategy for 2019/20

1.4.1 The strategy for 2019/20 (set out in section 2.2) includes the following areas:

- Economic Outlook and prospects for interest rates (para 2.2.1)
- Borrowing strategy (para 2.2.2)
- Policy on borrowing in advance of need (para 2.2.3)

- Debt rescheduling (para 2.2.4)
- Investment strategy (Treasury Management Investments) (para 2.2.5)
- Treasury indicators which limit the treasury risk and activities of the Council (para 2.2.6)
- Other Items (para 2.2.7)

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

2.0 REPORT

2.1 MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

2.1.1 Background

Local authorities are required to set aside prudent revenue provision for debt repayment where they have used borrowing or credit arrangements to finance General Fund capital expenditure.

Statutory Guidance covering the Minimum Revenue Provision (MRP) updated by the MHCLG in February 2018 sets out various options for calculating a prudent provision – and while prudent provision is not specifically defined, the guidance suggests that debt should be repaid over a period that is commensurate with that over which the capital expenditure provides benefits.

The updated guidance introduced a maximum useful life of 50 years for MRP purposes including any expenditure incurred on investment properties that provide a revenue stream, except where a longer life is supported by an opinion from a suitably qualified professional adviser.

There is no requirement on the HRA to make a minimum revenue provision.

2.1.2 Policy Statement

The Council’s policy is to calculate MRP on expenditure that is funded by unsupported prudential borrowing by reference to the asset’s useful life using the annuity method, starting in the year after the asset becomes operational.

2.2 TREASURY MANAGEMENT STRATEGY

2.2.1 Economic Outlook and prospects for interest rates

The Council uses Arlingclose Limited as its treasury advisor and the following is their view of the economic outlook and interest rates

The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019/20.

UK Consumer Price Inflation (CPI) for October was up 2.4% year on year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

The rise in quarterly GDP growth to 0.6% in Q3 from 0.4% in the previous quarter was due to weather-related factors boosting overall household consumption and construction activity over the summer following the weather-related weakness in Q1. At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee continues to reiterate that any further increases will be at a gradual pace and limited in extent.

While US growth has slowed over 2018, the economy continues to perform robustly. The US Federal Reserve continued its tightening bias throughout 2018, pushing rates to the current 2%-2.25% in September. Markets continue to expect one more rate rise in December, but expectations are fading that the further hikes previously expected in 2019 will materialise as concerns over trade wars drag on economic activity.

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in. The BoE did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting a further increase of 0.25% during 2019 to take official UK interest rates to 1.00%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but appears to have eased a little on the back of slower global and UK growth/inflation expectations. Policymakers are unlikely to raise Bank Rate unless there is a withdrawal agreement and the prospect of a transitionary period.

The UK economic environment appears relatively soft, despite seemingly strong labour market data. Uncertainty surrounding Brexit and global growth is damaging consumer and business sentiment. GDP growth slowed markedly in Q4 2018 and has not recovered in Q1 2019. Our view is that the UK economy faces a challenging outlook as the country exits the European Union and Eurozone/global economic growth softens, notwithstanding a possible short term bounce in activity should a Brexit deal be agreed.

Gilt yields and hence long-term borrowing rates have remained at low levels but some upward movement from current levels is expected based on Arlingclose's interest rate projections, due to the strength of the US economy and the ECB's forward guidance on higher rates. 10-year and 20-year gilt yields are forecast to remain around 1.7% and 2.1% respectively over the interest rate forecast horizon, however volatility arising from both economic and political events are likely to continue to offer borrowing opportunities.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.9% and that new long-term loans will be borrowed at an average rate of 2.4%.

Interest rate forecasts :

	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 year	20 year	50 year
Mar-19	0.75	1.75	2.10	2.50	2.45
Jun-19	0.75	1.75	2.15	2.55	2.50
Sep-19	0.75	1.80	2.20	2.60	2.55
Dec-19	1.00	2.05	2.45	2.80	2.70
Mar-20	1.00	2.10	2.55	2.85	2.80
Jun-20	1.25	2.25	2.70	3.00	2.95
Sep-20	1.25	2.20	2.65	3.00	2.95
Dec-20	1.25	2.20	2.60	3.00	2.95
Mar-21	1.25	2.20	2.60	3.00	2.95
Jun-21	1.25	2.20	2.60	3.00	2.95
Sep-21	1.25	2.20	2.60	3.00	2.95
Dec-21	1.25	2.20	2.60	3.00	2.95
Mar-22	1.25	2.20	2.60	3.00	2.95
Average rate	1.10	2.09	2.52	2.87	2.82

In summary

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Arlinclose's central case incorporates the likelihood of the MPC raising rates in the last quarter of 2019 after an extended period of uncertainty or a delay to Brexit.

- The forecast range encompasses the interest rate responses for various Brexit outcomes, from an immediate no-deal Brexit to remaining in the EU.

- Gilt yields have remained at low levels. Some upward movement is expected from current levels based on a Brexit transitionary period. Interest Rate forecasts are predicated on there being a transitionary period following the UK's official exit from the EU.

2.2.2 Borrowing Strategy

The Council is currently maintaining an under-borrowed position being under borrowed by £7.458 million at the 31/03/2018. The underborrowing is forecast to remain around £7million over the next 3 years. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully financed 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 forecasts are for only a modest increase in interest rates, investment returns remaining low and counterparty risk remaining relatively high.

Objectives: The Council's primary objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

The Council will undertake a 'cost of carry' and breakeven analysis to determine whether to borrow additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Council will include within it's debt portfilio more short-term loans (normally for up to one year) to reduce treasury cost in a low interest rate environment and cover unexpected cash flow shortages.

The approved sources of long term and short term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- Banks or building societies authorised to operate in the UK
- Money Market Loans
- Any other UK public body e.g. other Local Authorities
- UK public and private sector pension funds
- Internal funds – the cash held in internal funds can be used short term to fund capital expenditure or the repayment of debt, thus delaying the need to borrow externally

2.2.3 Policy on borrowing in advance of need

The Council may from time to time borrow in advance of need, where this is expected to provide the best long term value for money and the Council can ensure the security of such funds. The Borough Treasurer may do this under delegated power where, for instance, a sharp rise or fall in interest rates is expected meaning borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Borough Treasurer will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance is expected to be within forward approved Capital Financing Requirement estimates. Exceptionally, should a new Capital Invesment opportunity arise in the year where it would be appropriate to finance through borrowing and where it could be demonstrated that borrowing in advace of need would provide value for money the Council may borrow beyond its forward approved Capital Financing Requirement estimates.

2.2.4 Debt rescheduling

The PWLB allows authorities to repay loans before they mature and either pay a premium or receive a discount according to a set formula based on current interest rates. The authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

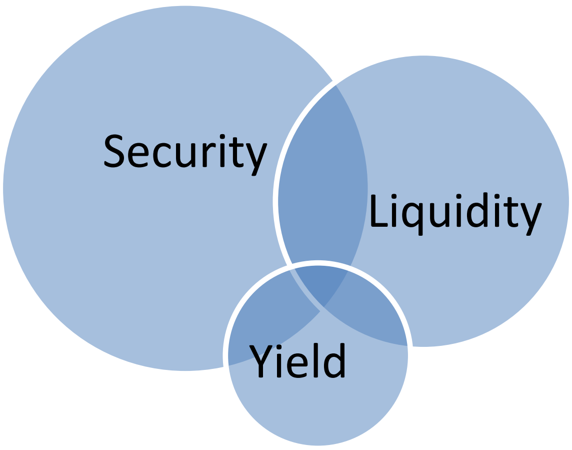
Any rescheduling undertaken will be reported to Policy and Organisation Board.

2.2.5 Investment Strategy (Treasury Management Investments)

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy.

In the past 12 months, the Council's investment balance has ranged between £10m and £17m and similar levels are expected to be maintained in the forthcoming year.

The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of retrun or yield.



The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the 3 month LIBID rate.

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and higher yielding asset classes during 2019/20, this is especially the case for an estimated amount of £4m which is expected to be available for longer term investments. The balance of the Council's surplus cash will be invested in short-term unsecured bank deposits, deposits with other local authorities and money market funds. This diversification will represent a change in strategy over the coming year.

Approved Counterparties: The Council may invest surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Credit Rating	Banks / Building Societies Un Secured	Banks / Building Societies Secured	UK Government / Local Authorities	Corporates	Registered Providers
UK GOVT	n/a	n/a	Unlimited 5 years	n/a	n/a
AAA	£2m 2 years	£3m 5 years	£3m 5 years	£2m 5 years	£2m 5 years
AA+	£2m 2 years	£3m 5 years	£3m 5 years	£2m 5 years	£2m 5 years
AA	£2m 2 years	£3m 5 years	£3m 5 years	£2m 5 years	£2m 5 years
AA-	£2m 2 years	£3m 3 years	£3m 5 years	£2m 3 years	£2m 5 years
A+	£2m 2 years	£3m 3 years	£3m 5 years	£2m 3 years	£2m 5 years
A	£2m 13 months	£3m 2 years	£3m 5 years	£2m 2 years	£2m 5 years
A-	£2m 6 months	£3m 13 months	£3m 5 years	£2m 13 months	£2m 5 years
None	None	None	£3m 5 years[1]	None	None
Pooled Funds	Local Authorities Property Fund £4m Money Market Funds £3m per fund Other Pooled Funds (Long Term) £2m per fund				

Credit Rating: Investment decisions are made by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

The Council has determined that it will only use approved counterparties from the UK or a foreign country with a sovereign rating of AA or higher for direct investment.

[1] Not all Local Authorities are credit rated by the credit rating agencies; however from a credit perspective Local Authorities are considered low risk.

No country limit will apply to investments in UK banks or building society. It is recommended that an aggregate limit for Investments outside the UK be applied of £8million and that in order to minimise the sytemic credit risk of investments in any region it is recommended that a £4million limit be applied to the following geographical areas where investments can be made in foreign countries.

- Asia & Australia
- Americas
- Eurozone
- Continental Europe outside the Eurozone

Banks / Building Societies Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Banks / Building Societies Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank / building society will not exceed the cash limit for secured investments.

Government / Local Authorities: Loans, bonds and bills issued or guaranteed by UK government, regional and local authorities. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing and registered social landlords, formerly known as Housing Associations. These bodies are tightly regulated by the Regulator of Social Housing (in England) and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled Funds: Shares or units in diversified investment vehicles consisting of any of the above investment types and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's Investment objectives will be monitored regularly.

Operational bank accounts: The Authority will incur operational exposures, through operation of it's current account with National Westminster Bank (credit rating below A-). These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £750,000 which may for operational reasons be occassionally exceeded.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Councl's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investment will be made
- any existing investment that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

Where a credit rating agency announces that a credit rating is on review for possible downgrade so that it may fall below the approved rating criteria, then only investments that can be withdrawn (on the next working day) will be made with that organisation until the outcome of the review is announced.

Other Information on the Security of Investments : the Council understands that credit ratings are useful, 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 swaps, share prices, information on government support for banks and reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

2.2.6 Treasury Management Code Indicators

2.2.6.1 Interest Rate Exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on one-year revenue impact of a 1% rise or fall in interest rates will be:

Interest rate exposures	2019/20 £'000
Limits on one-year revenue impact of a 1% rise in interest rates	(45)
Limits on one-year revenue impact of a 1% fall in interest rates	45

The impacts of a change in interest rates is calculated on the assumption that maturing loans and investments will be replaced at current rates.

2.2.6.2 Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Maturity structure of borrowing	2019/20 Lower	2019/20 Upper
Under 12 months	0%	25%
12 months to 2 years	0%	25%
2 years to 5 years	0%	30%
5 years to 10 years	0%	35%
10 years and above	35%	55%

(NB Time periods start on the first day of each financial year)

2.2.6.3 Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the year end will be:

Maximum principal sums invested >365 days	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Principal sums invested > 364 days	9.0	9.0	9.0

2.2.7 Other Items

2.2.7.1 Investment Training

The training needs of the officers involved on treasury management are identified through the annual personal review process, and additionally when the responsibilities of individual members of staff change. Staff attend relevant training courses, seminars and conferences.

Member training and briefing sessions have taken place in September 2011 (delivered by officers), January 2012 (delivered by Capita) and most recently in February 2015 (delivered by Capita).

2.2.7.2 Treasury management consultants

The Council have appointed Arlingclose Limited as its external treasury management advisors and they provide a range of services to the Council including:

- Investments advice
- Borrowing advice
- Technical support on treasury matters and capital finance issues

- Economic and interest rate analysis
- Training and briefing sessions

The contract with Arlinclose commenced July 2016 and is for an initial period of 3 years with an option to extend for a further year.

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.

2.2.7.3 Policy on Apportioning Interest to the HRA

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools the later included £57million borrowed on the 28th March 2012 to make a payment to the Government under the HRA Self Financing scheme. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. Differences between the value of the HRA loans and the HRA's underlying need to borrow will be charged an interest from the General Fund equivalent to the General Funds average interest on borrowing. HRA balance sheet resources available for investment will result in a notional cash balance which will receive the Council's average interest rate on investments.

2.2.7.4 Markets in Financial Instruments Directive:

The Council has opted up to professional client status with it's providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the S151 Officer believes this to be the most appropriate status.

3.0 CONCLUSION

The effect of the proposals set out in this report is to allow the Council to effectively and efficiently manage cash balances in line with the relevant CIPFA and CLG guidance. The low risk nature of the Council's current policy is consistent with the current economic climate.

Financial implications:	As contained in the report.
Legal implications:	It is a legal requirement that an annual Treasury Management report is considered by the Council.
Service Improvement Plan implications:	This report is required in order that to fulfil statutory requirements associated with the achievement of both service improvement plan and corporate plan targets.
Corporate Plan:	
Risk Assessment:	As contained in the report
Background papers:	
Author:	Borough Treasurer