South Tyneside Council

item 3

Cabinet
Date: 6th February 2019

Treasury Management Strategy 2019/20 and Revised Code of Practice

Report of the Corporate Director Business and Resources

Cabinet Portfolio/Lead Member: Resources and Innovation/Councillor E. Malcolm

Purpose of Report

1. A Treasury Management Strategy for 2019/20 is attached.

2. The Strategy has been compiled alongside the Council's budget. It is based on interest rate forecasts available at the time of writing and sets out the factors that may affect decision making in 2019/20. The Treasury Management Strategy must be approved by Full Council.

3. The Report also includes an update to the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management. This includes a recommendation for Council to adopt the new 2017 Code of Practice and the Treasury Management Policy Statement contained within it.

4. Cabinet is recommended to recommend Council to:

    - Approve the Treasury Management Strategy for 2019/20.

    - Adopt the 2017 CIPFA Code of Practice on Treasury Management in the Public Service and the Treasury Management Policy Statement contained within it.

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Introduction

5. This report has been prepared to comply with the Local Government Finance Act 1992, the Local Government Act 2003, the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management, the CIPFA Prudential Code for Capital Finance in Local Authorities and guidance on Prudential Investment Practice from the Ministry of Housing, Communities and Local Government.

6. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992 that the Council produces a balanced budget. Section 32 of the Act requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from;

    - increases in interest charges caused by increased borrowing to finance additional capital expenditure, and

    - any increase in running costs from new capital projects

    are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

7. The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy.

8. The Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Service.

9. The Treasury Management Strategy and Annual Investment Strategy contained in this report comply with the CIPFA Code, which requires the Treasury Management Strategy to be approved by the Council prior to the start of the financial year.

10. The Local Government Act 2003 also requires the Council to "have regard to" a further CIPFA Code called "The Prudential Code for Capital Finance in Local Authorities".

11. The key objectives of the Treasury Management Code and the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that Treasury Management decisions are taken in accordance with good professional practice.

12. To demonstrate that local authorities have fulfilled these objectives, the Treasury Management Code and the Prudential Code set out indicators that must be used and factors to be taken into account. The indicators and factors that apply to Treasury Management are contained in the Strategy that is attached to this report.

Overview of the Treasury Management Strategy

13. The Council's Treasury Management Strategy covers two areas:

    - Part 1 - South Tyneside Consolidated Loans Fund – this covers the Council's borrowings and contains the Treasury and Prudential Indicators required by the Treasury Management Code and the Prudential Code.

    - Part 2 – Annual Investment Strategy – this concerns the investment of the cash balances of the Council, the Tyne and Wear Pension Fund and South Tyneside Homes. Priority is given to the security of the capital sum and the liquidity of investments.

CIPFA Treasury Management in the Public Services: Code of Practice 2017

14. CIPFA has developed a Code of Practice on Treasury Management to assist public sector bodies effectively manage and control their Treasury Management Activities.

15. In December 2017, CIPFA amended the 2011 version of the Code. This is due to come into effect from the start of the 2019/20 financial year.

16. The Code re-emphasises the need for organisations to formally adopt a Treasury Management Policy Statement. The Council adopted a Policy Statement in 2011 and under the new Code no changes are proposed. It is however, considered to be good practice to re-affirm this Statement, which is set out below:

    Treasury Management Policy Statement

    The Council defines the policies and objectives of its Treasury Management activities as follows:

    i. The Council defines its treasury management activities as:

       The management of the organisation'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.

    ii. The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on the risk implications for the Council, and any financial instruments entered into to manage these risks.

iii. The Council acknowledges that effective Treasury Management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in Treasury Management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

17. In addition, CIPFA recommends that all public service organisations adopt, as part of their constitution the following four clauses.

i. The Council will create and maintain, as the cornerstones for effective treasury management:

- A Treasury Management Policy Statement, stating the policies, objectives and approach to the 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 Treasury Management in the Public Services – Code of Practice and Cross Sectoral Guidance Notes, subject only to amendment where necessary to reflect the particular circumstances of the Council. Such amendments will not result in the Council materially deviating from the Code's key principles.

ii. The 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.

iii. The 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 Chief Finance Officer, 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.

iv. The Council has nominated the Overview and Scrutiny Co-ordinating and Call-in Committee to be responsible for ensuring effective scrutiny of the Treasury Management strategy and policies.

18. These clauses are already included in the Council's Constitution and have not changed following the update of the CIPFA Treasury Management Code. Therefore, no further action is required in this respect,

19. The only material change to the Code has been to include a new section which covers investments that would not normally be considered to be part of the Treasury Management activity, such as other financial assets and property primarily for financial return. This is to ensure that where such investments are made they should be proportionate to the level of resources available to the organisation and the organisation should ensure that the same robust procedures for the consideration of risk and return are applied to these decisions, as would be applied to Treasury Management decisions.

20. The definition of investments in the Code now covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore, include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code.

21. The new Section in the Code sets out the following Management Practices and requirements for non-treasury investments:

    - South Tyneside Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

    - South Tyneside Council will ensure that all the organisation's investments are covered in the capital strategy, investment strategy or equivalent, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

    - South Tyneside Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

22. Compliance against these new practices and requirements is covered in the Councils Capital Strategy which will be presented to Council along with the Medium term Financial Plan.

Authorised Limit and Operational Boundary for 2019/20

23. As stated above, the Prudential Code requires the Council to set a number of indicators and factors that apply to Treasury Management. Two of these indicators are the Authorised Limit and the Operational Boundary:

- **Authorised Limit –** This is the maximum amount of external debt that the Council will have. If it appears that the Limit is likely to be breached, there will be a report to Cabinet outlining the reasons for this. It will then be up to Cabinet to determine whether it would be prudent to raise the Limit or, alternatively, to take corrective action to ensure that it is not breached.

- **Operational Boundary –** This is used as a management tool for monitoring the Council's debt levels. It is lower than the Authorised Limit. This indicator is consistent with the Council's plans for capital expenditure and financing. It is not significant if the Operational Boundary is occasionally breached temporarily due to variations in cash flow. However, a sustained or regular trend above the Boundary would be significant and would be reported to Cabinet.

Financial and Value for Money Implications

24. This Strategy has been compiled alongside the Council's budget, therefore, the financial implications are contained within the budget.

Legal Implications

25. The Strategy has been compiled to comply with the Local Government Finance Act 1992, the Local Government Act 2003 and the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. There are no other legal implications.

Risk and Opportunities Implications

26. The risk implications are contained in the report. However, the main risk to the strategy is an adverse movement in interest rates and a change in the economic environment set out on page 16 under the title of "Sensitivity of the Forecast and Possible Strategy Response".

Equality and Diversity Implications

27. An equality check has been carried out and no equality implications were identified.

Environmental and Sustainability Implications

28. There are no environmental and sustainability implications.

Options to be considered

29. There are no options presented for consideration.

Recommendations

30. Cabinet is recommended to recommend Council to:

    - Approve the Treasury Management Strategy for 2019/20.

    - Adopt the 2017 CIPFA Code of Practice on Treasury Management in the Public Service and the Treasury Management Policy Statement contained within it.

Reasons for Recommendations

31. To comply with the Local Government Finance Act 1992, the Local Government Act 2003, the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003, the CIPFA Code of Practice on Treasury Management 2017, the CIPFA Prudential Code for Capital Finance in Local Authorities 2017 and guidance on Prudential Investment Practice from Communities and Local Government.

32. To ensure the Council is adhering to the latest CIPFA guidance on Treasury Management.

South Tyneside Council

Treasury Management Strategy 2019/20

Part 1 - South Tyneside Consolidated Loans Fund

Introduction

This report sets out views on a strategy to be followed for the financial year 2019/20 for the South Tyneside Consolidated Loans Fund (CLF).

The suggested strategy for 2019/20 is based upon Officers' views on interest rates. These have been derived from forecasts prepared by Link Asset Services, the Council's Treasury Advisor and Capital Economics, an independent forecasting company.

CIPFA Prudential Code for Capital Finance in Local Authorities

The key objectives of the Prudential Code are to ensure, within a clear framework, that capital investment plans of local authorities are affordable, prudent and sustainable and that Treasury Management decisions are taken in accordance with good professional practice.

The current system of capital finance allows the Council to have a significant degree of flexibility and freedom over its borrowing. However, it does not provide additional central government support for the cost of borrowing. Consequently, the cost of additional capital expenditure has to be met from revenue and has to be affordable and sustainable in the long term. Therefore, it is necessary to develop the capital and revenue budgets and the Treasury Management Strategy together to ensure that the requirements of the Prudential Code are met.

Delegated Authority

The Council delegates responsibility for the implementation and regular monitoring of its Treasury Management policies and practices to Cabinet, and for the execution and administration of Treasury Management decisions to the Chief Financial Officer, a role that is undertaken within the Council by the Corporate Director Business and Resources. The Head of Pensions assists the Corporate Director with this role.

Treasury Limits for 2019/20 to 2021/22

It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations for the Council to determine and keep under review how much it can afford to borrow.

Within this framework, prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

The Treasury Management Code and the Prudential Code require the Council to set indicators that are used to devise the Treasury Management Strategy. Ongoing monitoring against the indicators takes place and is reported quarterly to Cabinet.

These indicators are:

- **Adoption of the CIPFA Code of Practice on Treasury Management** – The Council adopted the 2011 version of the CIPFA Code at its Council meeting in February 2012. CIPFA issued an amended code at the end of December 2017, with the expectation that it will be adopted for the 2019/20 financial year. This report recommends that the Council adopt the amended code.

- **One Strategy for the whole Council** – The Code includes the requirements of the Housing Self Financing Regime. There is no requirement for individual strategies for the General Fund and the Housing Revenue Account. Therefore, the Council has adopted a one strategy approach.

- **Authorised Limit** – This is the maximum amount of external debt that the Council is expected to have. If it appears that the limit is likely to be breached, there will be a report to Cabinet outlining the reasons for this. It will then be up to Cabinet to determine whether corrective action should be taken to ensure that the limit it is not breached or alternatively whether the limit should be raised.

	2018/19 £'m	**2019/20 £'m**	**2020/21 £'m**	**2021/22 £'m**
Authorised Limit for External Debt				
Borrowing	830	840	835	840
Other Long Term Liabilities	140	125	120	115
TOTAL	**970**	**965**	**955**	**955**

- **Operational Boundary** – This is a control indicator for monitoring the Council's debt levels and is lower than the Authorised Limit. This indicator is consistent with the Council's plans for capital expenditure and financing. It is not an issue if the Operational Boundary is occasionally breached temporarily due to variations in cash flow. However, a sustained or regular trend above the Boundary would be of significance and would be reported to Cabinet.

	2018/19 £'m	2019/20 £'m	2020/21 £'m	2021/22 £'m
Operational Boundary				
Borrowing	750	765	760	765
Other Long Term Liabilities	120	110	105	100
TOTAL	**870**	**875**	**865**	**865**

The Authorised Limit and the Operational Boundary are set at suitably high levels to cover exceptional, short term cash flow and debt management requirements.

- **Actual External Debt** – The Actual External Debt is the expected capital financing requirement at the end of each year and is calculated by Finance. It is only comparable to the Authorised Limit and Operational Boundary at that date.

	2018/19 £'m	2019/20 £'m	2020/21 £'m	2021/22 £'m
Actual External Debt				
Borrowing	671	702	724	745
Other Long Term Liabilities	102	99	95	91
TOTAL	**774**	**801**	**819**	**836**

- **Fixed and Variable Rate Exposure Limits** – These limits provide a framework for managing the Council's exposure to fixed and variable interest rates.

	2018/19 %	2019/20 %	2020/21 %	2021/22 %
Upper Limit for Fixed Rate Exposure				
Debt Portfolio	100	100	100	100
Upper Limit for Variable Rate Exposure				
Debt Portfolio	35	35	35	35

- **Maturity Structure of Borrowing –** This establishes parameters that control the percentage of debt needing to be replaced at any time.

Maturity Structure of Fixed Rate Borrowing:	**Upper Limit %**	**Lower Limit %**
Under 12 Months	40	0
From 12 Months to under 24 Months	40	0
From 24 Months to Under 5 Years	50	0
From 5 Years to Under 10 Years	75	0
Above 10 Years	100	25

- **Investments for Periods Longer than 365 days –** The Council can invest for longer than 365 days. The maximum amount to be invested for periods above 365 days will be limited to £5 million. This limit has been set following a review of the Council's reserves and other cash balances, and after taking account of cash flow requirements and future spending plans as set out in the Medium Term Financial Plan.

  The limit has to be viewed alongside the Council's appetite for risk, given the economic environment and the credit worthiness of counterparties at any point in time. At the time of writing, the Council has no organisations on its lending list to which it will lend for periods over one year.

Gross Debt

The Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Chief Finance Officer confirms that the Council complies with this prudential indicator in the current year and future years. This view takes into account current commitments, existing plans, and the proposals in the budget report.

Current Treasury Position

At the end of December the Consolidate Loans Fund (CLF) is £33.1 million underfinanced. At the time of writing the expectation is that the current temporary loans will be repaid by the end of the year and around £10 million of long term borrowing will be arranged to bring the CLF to a £60 million underfinancing position, which is in line with the current strategy.

The forecast structure of the CLF at the year-end is:

		Principal £'m	Principal £'m	Principal %
Fixed Rate Funding	PWLB	573.8		
	Market	8.0	581.8	86
Short Term and Variable Rate Funding	PWLB	30.0		
	Market	0.0	30.0	5
Total Debt			**611.8**	**91**
Capital Financing Requirement			**671.8**	**100**
UNDER FINANCING			**60.0**	**9**

The under-financing position is covered by internal borrowing from the Council's cash balances. This reduces the amount of cash invested through the money markets.

Borrowing Requirement

The table below sets out a basic position for the future borrowing requirement, based on forecasts in the Council's budget and the current maturity structure of the CLF. This may change as restructuring opportunities are taken.

	2018/19 £'m	2019/20 £'m	2020/21 £'m	2021/22 £'m
New Borrowing – General Fund	25.3	42.4	35.1	33.7
Debt Maturing During the Period	16.0	25.0	10.0	20.0
Less: Repayments to the CLF (including Minimum Revenue Provision)	-10.5	-12.0	-12.8	-12.8
TOTAL	**30.8**	**55.4**	**32.3**	**40.9**

Minimum Revenue Provision policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge, the Minimum Revenue Provision (MRP). The policy on the MRP can be found in the Medium Term Financial Plan.

Sources of Finance

Interest rates and expenses charged by the Public Works Loans Board (PWLB) are traditionally lower than those charged on market loans. Therefore, the Council's financing is raised from the PWLB whenever possible.

From 2012, the PWLB introduced the "Certainty Rate". This allows councils which annually submit their capital spending plans for the new financial year and the following two years to the Ministry of Housing Communities and Local Government to have the interest rates payable on new PWLB loans reduced by 0.2%. South Tyneside Council has complied with this requirement.

At present, less than 2% of the Council's debt has been borrowed from the money market. This source of borrowing largely dried up as a result of the financial crisis in 2008, although some lenders have since returned to the market. The Council can therefore borrow from the market if appropriate. The use of money market debt will be limited to 40% of the debt portfolio. This limit will apply at the time the borrowing is arranged.

Economic Background and Prospects for Interest Rates

Growth in the UK economy was weak during the first quarter of 2018 but picked up in the following two quarters at 0.4% for quarter two and 0.6% for quarter three. It is expected that the final quarter of the year will be weaker than the previous two quarters and could carry over into 2019. On a global level it is expected that 2019 will see a weakening in growth.

The November Bank of England inflation report had inflation at 2.1%. The latest forecasts suggest it is likley to rise from the current level before reducing thereafter. It is still expected that inflation will be at 2% in two years time.

Interest rate forecasts from a range of financial institutions are monitored. These forecasts are combined into a broad view on rates upon which the Treasury Management Strategy is based.

Representative forecasts are set out in Appendix A. These have been provided by Link Asset Services (the Council's treasury management advisor) and Capital Economics (an independent forecasting consultancy).

At the time of writing, the Bank Base Rate is 0.75%. Link Asset Services have forecasted that it will remain at this level until the second quarter of 2019, when they are forecasting a 0.25% rise will take the rate to 1.00%. Link Asset Services then expect the Bank Rate to remain at 1.00% until the end of 2019 with a further 0.25% rise in the first quarter of 2020, to take the Bank Rate to 1.25% by the end of the financial year. Capital Economics agree that the first rate rise will occur in the second quarter of 2019, but they expect the Bank Rate to rise more quickly thereafter with a 0.25% rate rise in the following three quarters to end the 2019/20 financial year at 1.75%.

For borrowing, Link Asset Services forecast that PWLB rates will rise slowly throughout 2019 and into 2020. Their forecast is that long term rates (50 years) will rise to 2.90% by the end of 2019 and to 3.20% by the end of 2020. Capital Economics also expect rates to rise, although a little quicker initially, and has forecast PWLB rates for 50 years will be 3.40% at end 2019 and 3.40% at the end of 2020.

It should be noted that the current position on Brexit and the ongoing trade wars between the US and China could result in significant changes in the economic environment and the consequently, interest rate forecasts for the next few years.

The PWLB forecasts from Link Asset Services for the year ended 31st March 2019 show:

- Five year borrowing rates remain around 2.10%
- Ten year borrowing rates rise to 2.50%

- Twenty five year borrowing rates rise to 2.90%
- Fifty year borrowing rates rise to 2.70%

CLF Borrowing Strategy - Options

Borrowing rates are expected to rise during 2019/20 although only by around 0.2% throughout the year. As rates are expected to rise slowly throughout the year there is some advantage in timing borrowing early in the year but this will then affect the amount of interest charged.

Forecasts suggest that short term and variable rate borrowing is expected to continue to be cheaper than long term fixed rate borrowing in 2019/20. This makes short term and variable rate borrowing more attractive, although it does carry the risk of having to re-finance at a time when rates may have increased.

Gross and Net Borrowing Position

The Prudential Code requires the Council to explain its policy on gross and net borrowing.

The gross borrowing position is the actual level of external borrowing, whilst the net borrowing position is the gross borrowing position less the Council's investment balances.

The table below shows the forecast gross and net borrowing position for the next three years. It has been assumed that the gross borrowing position is the same as the capital financing requirement for borrowing at the end of each year. The Council's cash balance is the amount assumed in the budget for calculating investment income.

	2018/19 £'m	**2019/20 £'m**	**2020/21 £'m**	**2021/22 £'m**
Gross External Borrowing	671	702	724	745
Less: Cash Balances	30	30	30	30
Net Debt Position	**641**	**672**	**694**	**715**

The table shows that the gross external borrowing position is expected to increase in each of the next three financial years from 2019/20 through to 2021/22. The net debt position follows the same pattern as the cash balances are assumed to be constant.

A breakdown of the Council's cash balances is shown in the Investment Strategy.

External and Internal Borrowing

Before any decisions are taken on external borrowing from either the PWLB or the money markets, a view will be taken on whether the Council should internally borrow from its own cash balances.

As at 31st December 2018, the Council had used £33.13 million of its balances to temporarily finance capital expenditure. It is expected to rise by the year end to £60.0 million underfinanced, which is in line with the planned £60 million under financing position. This is attractive for the following two reasons:

- The investment rates for cash balances have been significantly below the levels of interest rates payable on long term fixed rate debt. Therefore, it has been financially beneficial to use a proportion of the Council's cash balances for internal borrowing.

- Concern over certain counterparties and with the availability of other counterparties in the market has made it difficult to find suitable investment opportunities. This position has eased over recent years with new additions to the counterparty list.

It is expected that low investment rates and higher borrowing rates will continue to apply in 2019/20 and the following two years. This supports a continuation of the current strategy of using the Council's cash balances to temporarily finance capital expenditure. This approach would provide short term savings.

Whilst this strategy may be beneficial in the short term, it should be weighed against the potential for incurring extra costs in the long term from delaying external borrowing until later years, when PWLB long term rates are forecast to be higher.

Pool Rates and Estimates

The Council's budget includes an estimate of the interest payments to be made on the debt portfolio.

The Council will adopt a borrowing strategy for the General Fund and the Housing Revenue Account that is consistent with the Medium Term Financial Plan.

It is assumed that the average rate of new borrowing will be 3.0% in 2019/20 with an increase to 3.5% for 2020/21 and 2021/22.

The debt estimates forecasted for the next three years are:

	2019/20		2020/21		2021/22	
	Pool Rate %	**Interest £'m**	**Pool Rate %**	**Interest £'m**	**Pool Rate %**	**Interest £'m**
General Fund	2.93	11.7	2.97	12.7	3.04	13.6
Housing	3.80	10.9	3.77	10.8	3.77	10.8
TOTAL		**22.6**		**23.5**		**24.4**

CLF Borrowing Strategy to be adopted

The 2018/19 strategy was set based on the Council internally borrowing £60 million of the Council's borrowing requirement from its cash balances. It looks likely that this position will be broadly met at the end of 2018/19. For 2019/20 it is planned that the £60 million under-financing positon will continue.

Whilst the Council has a strategic target of a £60 million underfinancing position, in reality this figure may be either reduced or increased in response to interest rate movements. Whilst there are risks with adopting this strategy, the forecast structure of interest rates suggests that this strategy should produce lower costs to the Council in the short term. This internal borrowing position is forecast to reduce over future years. The budget has been based on this strategy.

As the Housing Revenue Account maintains relatively low cash balances of around £20 million, the Council will maintain a policy of keeping the Housing Revenue Account fully financed at the year-end, or in line with the business plan during the year.

Based on current interest rate forecasts, new borrowing is likely to be focussed on a combination of longer term fixed rates and short term and variable rate borrowing. Rates across all maturities will continue to be monitored. As rates are expected to rise slowly throughout the year there may be some advantage in borrowing early in the year. The exact timing of borrowing decisions will depend on short term fluctuations of interest rates.

Opportunities to borrow from the money market will be considered.

The Head of Pensions and the Corporate Director Business and Resources will monitor movements in interest rates and the borrowing requirement and will adopt a pragmatic approach to meeting changing circumstances. All actions will be reported retrospectively to Cabinet.

Sensitivity of the Forecast and Possible Strategy Response

The Officers and the Treasury Advisor will monitor interest rates and forecasts and may adopt the following responses to a change in sentiment:

- If it was felt that there was a significant risk of a sharp rise in long and short term rates, perhaps arising from a greater than expected increase in world economic activity, then the position would be re-appraised. The likely response is that fixed rate finance would be raised whilst interest rates were still relatively cheap. If this occurred, the internal borrowing position would be reduced.

- If it was felt that there was a significant risk of a sharp fall in long and short term rates, perhaps due to economic growth weakening more than is currently forecast, then long term borrowing would be deferred. Rescheduling of existing fixed rate borrowings into variable or short term fixed rate borrowings might take place.

Borrowing in Advance of Need

The Council will not borrow more than, or in advance of, its need purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need, the Council will:

- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.

- Ensure the ongoing revenue liabilities created and the implications for the future plans and budgets have been considered.

- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

Debt Rescheduling

The introduction in November 2007 of different PWLB rates for new borrowing and repayment of debt has meant that debt restructuring opportunities are now very limited.

Prior to these changes, the Council had made interest savings through restructuring PWLB debt. The changes have made it significantly more difficult to generate such savings.

With long term borrowing rates forecast to be more expensive than short term rates, there may be opportunities to generate some savings by switching from long term to short term debt. The potential for making short term savings needs to be considered against the risk of having to re-finance short term borrowings when they mature.

All rescheduling activity will be reported retrospectively to Cabinet.

South Tyneside Council

Treasury Management Strategy 2017/18

Part 2 – Annual Investment Strategy

Introduction

The Council will have regard to Ministry of Housing, Communities and Local Government's (MHCLG) Guidance on Local Government Investments ("the Guidance") and the Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management and Cross Sectoral Guidance Notes.

The guidance from MHCLG on Prudential Investment Practice makes the Annual Investment Strategy central to the framework in which the investment activity takes place. As part of this Strategy, the Council has to determine which investment products may be used during the year and classify these under the headings of Specified Investments and Non–Specified Investments.

When investing the cash balances, the prime objectives are the security of the capital sum and the liquidity of investments. The risk appetite of the Council is low, in order to give priority to security of its investments. The Council will aim to achieve the optimal return on its investments that is commensurate with the achievement of these objectives.

The borrowing of monies specifically to invest or to on-lend to make a return is unlawful and the Council will not engage in such activity.

The Investment Office of the Pensions Service is responsible for managing the cash balances of the Council, the Tyne and Wear Pension Fund and South Tyneside Homes. These sums of money are invested separately.

This report sets out views on the Investment Strategy to be adopted for the Council, the Pension Fund and South Tyneside Homes in 2019/20.

Specified Investments

Specified Investments are those that are considered to offer the highest levels of security and liquidity. All such investments in this category must be denominated in Sterling and with a maturity of no more than one year. They include investments with the UK Government, local authorities and with bodies or schemes that meet the Council's high creditworthiness criteria.

Appendix B details the investments that fall into this category and which the Council, the Pension Fund and South Tyneside Homes may make use of in 2019/20.

Non-Specified Investments

These are investments that do not fall into the category of a Specified Investment. The maximum amount of the Council's investment portfolio that will be invested in Non-Specified Investments at any one time is £5 million. This will allow the Council to lend out a proportion of its cash balances for periods of over 365 days, should it be appropriate to do so.

The Pension Fund and South Tyneside Homes are not expected to make use of these investment products as their balances are only lent out for short periods in order to preserve liquidity.

Appendix C lists the investments in this category that the Council may use in 2019/20.

Investment Counterparty List and Credit Criteria

The Head of Pensions and the Corporate Director Business and Resources have delegated authority to set and revise criteria for compiling the list of counterparties that the Council lends money to and to set individual limits within the criteria.

The Council uses the creditworthiness service provided by Link Asset Services, its Treasury Advisor. This service has been enhanced in recent years and now uses a modelling approach with credit ratings from the three main rating agencies (Fitch, Moodys and Standard and Poors) forming the core element. However, it does not rely solely on credit ratings but combines these with credit watches, credit outlooks and credit default swap spreads into a weighted scoring system. The end product is a series of colour coded bands that indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the period for investment.

The Council is satisfied that this service gives a much improved level of assurance of security for its investments.

The Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthiness as there has been a tendency at any one time for one of the agencies to be much more aggressive in giving low ratings. This could, therefore, be unworkable and leave the Council with an even more limited lending list. The Link Asset Services creditworthiness service uses ratings from all three agencies, but in a scoring system which does not give an undue weighting to just one agency.

Sole reliance will not be placed on the use of the Link Asset Services creditworthiness service. In addition, the Council will form its own views on creditworthiness and risk by using market data, information on government support for banks and the likelihood of government support. Where the Council's approach differs from that of Link Asset Services creditworthiness service, it is usually due to the placing of additional constraints on lending to organisations.

At present, the Council will only make fixed term deposits with UK banks, other local authorities, UK government organisations and selected overseas financial institutions that are domiciled in a country with a AAA credit rating. This position is kept under review.

Potential revisions to the Council's approach to setting credit ratings are monitored and changes to the counterparty list or the criteria are reported retrospectively to Cabinet, as are breaches of the limits.

The Council will only lend to organisations which it believes have a high level of creditworthiness. This is defined as meeting Link Asset Service's creditworthiness criteria, combined with the Council's in-house views.

Investment Balances

At the end of December 2018, the Council had £37.50 million cash invested in the money markets. In addition, it had £33.13 million internally invested in the Councils CLF, which gives a total investment balance of £70.63 million. The Pension Fund's cash balance was £139.66 million and the South Tyneside Homes balance was £3.13 million. A breakdown of these amounts is shown below:

	£'m
Council	
Reserves	57.32
Provisions	1.32
Capital Receipts and Unapplied Funding	7.15
Underfinancing of the CLF	-33.13
Cash Flow	4.84
Cash Invested in Money Markets	37.50
Balances internally invested	33.13
Total Investment Balance	70.63
Tyne and Wear Pension Fund	
Balances Held Pending Investment	139.66
South Tyneside Homes	3.13
TOTAL	213.42

The Council's £70.63 million balance relates to the following three elements:

- The first element is comprised of reserves, provisions and capital receipts that are held for a specific purpose such as school balances, liabilities or to partly finance the Council's capital programme.

- The second element is cash flow. This is comprised of balances not yet used for the capital programme, monies received in advance and cash held to cover the Council's regular cash flow requirements such as payroll, housing benefit and supplier payments. These monies are not available to increase the budget available to the Council.

- The third element is the internal investment of balances in the Councils CLF, which is generally referred to the underfinancing position.

The balances invested in the money markets are managed in-house by the Investment Office of the Pensions Service. Investment is achieved primarily by placing money with approved institutions for fixed periods, in accordance with the Council's counterparty list.

The Councils balances and those of the Pension Fund and South Tyneside Homes are managed separately.

Liquidity

As noted above, liquidity is one of the prime objectives when investing surplus balances. This is to ensure that the cash flow requirements of the Council, the Pension Fund and South Tyneside Homes can be met on a daily basis.

The Council, the Pension Fund and South Tyneside Homes have different liquidity requirements, which are summarised below:

- **Council**

  Overall, there is a need to stay liquid in order to meet cash flow requirements. The main account offers interest at base rate less 0.10% and therefore on occasion it is beneficial to hold funds in the main account.

  As most of the Council's investments will be term deposits, liquidity will be maintained by having a minimum of 40% of its investment portfolio maturing within three months. This limit can only be applied at the time the investment decision is made.

  The Council can legally invest for longer than 365 days. The maximum amount to be invested for periods above 365 days has been set following a review of the Council's reserves and other cash balances, and after taking account of cash flow requirements and future spending plans as set out in the Medium Term Financial Plan. For 2019/20 the limit is set to £5 million, due to the Council expecting to have low cash balances during the year.

This limit is based on a prudent view of the level of balances the Council could lend out for these periods and still maintain suitable liquidity. This limit has to be viewed alongside the Council's appetite for risk, given the economic environment and the creditworthiness of counterparties at any point in time. At the time of writing, the Council has no organisations on its lending list to which it will lend for periods over one year.

- **Pension Fund**

  Most of the Pension Fund's cash balances will be held in call accounts and money market fund accounts with any surplus funds being invested in short term fixed deposits. This ensures that the balances are highly liquid and available for investment in other types of assets.

- **South Tyneside Homes**

  All of the cash balances will be held in the main account as its low cash balances mean investments are not possible.

Investment Strategy - Council

When determining the investment strategy, a view on short term interest rates is taken. Lending is then undertaken in accordance with a strategy derived from that view, subject to cash flow requirements.

The budgeted income from investments is taken into account when the strategy is being devised. For 2019/20, it is assumed that 0.83% will be earned on an average cash balance invested in the money markets of £30 million. This is the estimated cash position after allowing for the internal investment of cash balances as set out in the borrowing strategy.

A range of interest rate forecasts is shown in Appendix A. At the time of writing, the Bank Base Rate is 0.75%. Link Asset Services have forecasted that it will remain at this level until the second quarter of 2019, when they are forecasting a 0.25% rise will take the rate to 1.00%. Link Asset Services then expect the Bank Rate to remain at 1.00% until the end of 2019 with a further 0.25% rise in the first quarter of 2020, to take the Bank Rate to 1.25% by the end of the financial year. Capital Economics agree that the first rate rise will occur in the second quarter of 2019, but they expect the Bank Rate to rise more quickly thereafter with a 0.25% rate rise in the following three quarters to end the 2019/20 financial year at 1.75%.

At the time of writing, the Council had 74% of its investment portfolio lent out for a period of up to three months to meet cash flow requirements. The remaining 26% are longer term deposits which will mature during 2019/20.

The strategy for next year will be to invest over a range of periods ensuring sufficient funds are available to meet every day cash flow needs as it is expected that the Council's cash flow position will be similar to those experience in 2018/19.

Interest earned on Housing Revenue Account balances will be credited at the three month rate.

The view on rates and the investment strategy are continually reviewed and, if necessary, revised in the light of current and forecast market conditions.

Investment Strategy – Pension Fund

The Pension Fund cash balance is kept very short in order to match cash flow requirements and to keep balances available for reinvestment. Consequently, maximum use will be made of short term deposit and money market fund accounts. The Fund is currently holding more cash than usual due to concerns about the valuation of other assets such as equities, bonds and property. Cash will be held until suitable investment opportunities have been identified. The Fund's Investment Adviser is comfortable with the approach being taken.

Investment Strategy – South Tyneside Homes

It will be necessary to keep this money very short in order to match cash flow requirements. Consequently, all cash balances will be held in the main account.

Delegated Authority

The Council delegates responsibility for the implementation and regular monitoring of its Treasury Management Policies and Practices to Cabinet, and for the execution and administration of Treasury Management decisions to the Chief Financial Officer, a role that is undertaken within the Council by the Corporate Director Business and Resources. The Head of Pensions assists the Corporate Director Business and Resources with this role.

The Council has nominated the Overview and Scrutiny Co-ordinating and Call-In Committee to be responsible for ensuring effective scrutiny of the Treasury Management strategy and policies.

Policy on use of external service providers

The Council uses Link Asset Services, Treasury Solutions as its external Treasury Management adviser. Link Asset Services is authorised and regulated by the Financial Conduct Authority for the provision of the investment advisory service it provides as part of its Treasury Management service.

The Council recognises that responsibility for Treasury Management decisions remains with it at all times and will ensure that undue reliance is not placed upon the external service providers.

INTEREST RATE FORECASTS APPENDIX A

The tables below set out forecasts from Link Asset Services (the Council's Treasury Advisor) and Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources and from Officers' own views.

Please note that the forecasts shown below and throughout the report have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Asset Services interest rate forecast – January 2019

(%)	*Q1 2019*	*Q2 2019*	*Q3 2019*	*Q4 2019*	*Q1 2020*	*Q2 2020*	*Q3 2020*	*Q4 2020*
Bank Rate	0.75	1.00	1.00	1.00	1.25	1.25	1.25	1.50
5yr PWLB	2.10	2.20	2.20	2.30	2.30	2.40	2.50	2.50
10yr PWLB	2.50	2.60	2.60	2.70	2.80	2.90	2.90	3.00
25yr PWLB	2.90	3.00	3.10	3.10	3.20	3.30	3.30	3.40
50yr PWLB	2.70	2.80	2.90	2.90	3.00	3.10	3.10	3.20

Capital Economics interest rate forecast – January 2019

(%)	*Q1 2019*	*Q2 2019*	*Q3 2019*	*Q4 2019*	*Q1 2020*	*Q2 2020*	*Q3 2020*	*Q4 2020*
Bank Rate	0.75	1.00	1.25	1.50	1.75	2.00	2.00	2.00
5yr PWLB	2.00	2.20	2.40	2.70	2.70	2.80	2.80	2.90
10yr PWLB	2.40	2.60	2.80	3.10	3.10	3.10	3.10	3.10
25yr PWLB	3.00	3.10	3.30	3.60	3.50	3.50	3.40	3.40
50yr PWLB	2.80	2.90	3.20	3.40	3.40	3.40	3.40	3.40

SCHEDULE OF SPECIFIED INVESTMENTS APPENDIX B

The investments listed in the table below are all Sterling denominated investments which are repayable/redeemable within twelve months and which can be used by the in house investment team.

Investment	**Security/ Minimum Credit Criteria**
Debt Management Agency Deposit Facility	Government Backed
Term Deposits with the UK Government or with Local Authorities with maturities up to one year	High Security, although local authorities are not credit rated
Term deposits with credit rated deposit takers (banks and building societies) with maturities up to one year	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.
Certificates of deposit issued by banks and building societies	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.
Callable deposits with credit rated deposit takers (banks and building societies) with maturities up to one year	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.
Forward deals with credit rated deposit takers (banks and building societies) where the negotiated deal period plus the period of deposit does not exceed 1 year	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.
Money Market Funds. These funds do not have any maturity date, although money can be withdrawn as required	Minimum AAA rated by one of the rating agencies.
Business Reserve Accounts and Deposit Accounts with credit rated deposit takers (banks and building societies)	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.

SCHEDULE OF NON SPECIFIED INVESTMENTS APPENDIX C

The investments listed in the table below are all Sterling denominated investments which can be used by the in house investment team. These investments are considered to carry additional risk, either because the term of investment is in excess of one year or because of the structure of the product. The reasons for using them and the risks associated with them are detailed below. These investments are classified as Non Specified Investments.

Investment	Why use it and the Associated Risks	Security / Minimum Credit Criteria	Max. Maturity
Term Deposits with the UK Government or with Local Authorities with maturities greater than one year and up to five years	**Why use it?** • Certainty of rate of return over the period of investment • No movement in the capital value of the deposit despite changes in the interest rate environment. • Provides for opportunities to take advantage of interest rate movements **Associated Risks** • Illiquid, cannot be traded or repaid prior to maturity • Interest rates may rise after arranging the deposit • Potential for deterioration in credit quality if an investment is over a longer period	High Security, although local authorities are not credit rated	5 Years
Term Deposits with credit rated deposit takers (banks and building societies) with maturities greater than one year.	**Why use it?** • Certainty of rate of return over the period of investment • No movement in the capital value of the deposit despite changes in the interest rate environment. • Provides for opportunities to take advantage of interest rate movements **Associated Risks** • Illiquid, cannot be traded or repaid prior to maturity • Interest rates may rise after arranging the deposit • Potential for deterioration in credit quality if an investment is over a longer period	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.	5 Years
Callable Deposits with credit rated deposit takers (banks and building societies) with maturities greater than one year.	**Why use it?** • Potentially, a higher return than using a term deposit with a similar maturity **Associated risks** • Illiquid, only the borrower has the right to pay back the deposit • Interest rate risk as the borrower will not pay back the deposit if interest rates rise after the deposit is made. • Potential for deterioration in credit quality if an investment is over a longer period.	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.	5 years

Forward deals with credit rated deposit takers (banks and building societies) where the negotiated deal period plus the period of deposit does not exceed one year.	**Why use it?** • Known rate of return over the period of investment, which aids forward planning • Provides for opportunities to take advantage of interest rate movements **Associated Risks** • Credit risk is over the whole period, not just when monies are actually invested. • Potential for deterioration in credit quality if an investment is made for longer than one year. • Interest rates may rise after arranging the deposit	Based on the Link Asset Services creditworthiness service. This uses information from all three rating agencies – Fitch, Moodys and Standard and Poors - as the core element. It combines this with information on credit watches, credit outlooks and credit default swaps, to produce an overall ranking. This is subject to ongoing review by Link Asset Services and the Council.	5 years

Treasury Management Strategy 2019/20

The following is a list of the background papers (excluding exempt papers) relied upon in the preparation of the above report:

Background Paper	**File Ref:**	**File Location**
Treasury Management File 2019/20		Investments Office, South Shields Town Hall