



**CLLR JANETTE WILLIAMSON**

**CABINET**

**18 FEBRUARY 2019**

**TREASURY MANAGEMENT STRATEGY  
STATEMENT**

**2019/22**

**Councillor Janette Williamson (Cabinet Member for Finance and Resources) said:**

“Over the past couple of years, we have relied on our innovative investments and revised Treasury Management policy to enable us to release significant amounts of funds to support our revenue budget. Last year in 2018/19 we were able to release over £5m in funding to help support our budget gap from Treasury Management activities.

Our policy of investing surplus cashflow enables us to generate income from interest received that goes towards paying for vital services to the public, and by previously continuing to self-fund our capital programme where we can, we have made significant savings on borrowing. We are confident and innovative in our Treasury Management activities and this strategy is the vehicle in which we undertake these activities, in line with prescribed guidelines. Our strategy for 2019/22 will see us generate £2m income to support the 2019/20 budget process by diversifying our investments and being more commercially judicious by taking advantage of opportunities that present to us.

Our objective is to ensure the long term financial sustainability of the Council while protecting the taxpayers purse and this strategy supports us to do this.”

## **REPORT SUMMARY**

The Authority's treasury management activity is underpinned by CIPFA's 2017 Code of Practice on Treasury Management ("the Code"), which requires the production of annual Treasury Management Indicators and a Treasury Management Strategy Statement on likely financing and investment activity. The Code also recommends that Members are informed of treasury management activities at least twice a year.

This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code. It does not cover the requirements of the 2018 Ministry for Housing, Communities and Local Government (MHCLG Investment Guidance, which mostly refers to non-treasury investments and is the subject of a separate report.

This matter affects all Wards within the Borough.

The decisions in this report are key decisions.

## **RECOMMENDATIONS**

1. That Members approve the Treasury Management and Investment Strategy for 2019/2022.
2. That the Treasury Management Indicators be adopted.
3. That Members approve the Council's Minimum Revenue Provision policy.
4. That the Council Officers listed within Appendix G, of the Strategy Statement, be authorised to approve payments from the Council's bank accounts for all treasury management activities.

## **SUPPORTING INFORMATION**

### **1.0 REASONS FOR RECOMMENDATION/S**

- 1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS) on an annual basis. The TMSS no longer incorporates the Investment Strategy as required under the MHCLG's Investment Guidance, which mostly refers to non-treasury investments.
- 1.2 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) also places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

### **2.0 OTHER OPTIONS CONSIDERED**

- 2.1 No other options have been considered.

### **3.0 BACKGROUND INFORMATION**

- 3.1 Treasury risk management at the Authority 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 Authority to approve a treasury management strategy before the start of each financial year.
- 3.2 Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.
- 3.3 This report fulfils the Authority's legal obligation under the Local government Act 2003 to have regard to both the CIPFA Code.
- 3.4 Wirral 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."*
- 3.5 The Council will create and maintain, as the cornerstones for effective treasury management:
  - A Treasury Management Policy Statement (see Appendix A), stating the policies, objectives and approach to risk management of its treasury management activities.

- Suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 3.6 Treasury Management is about the management of risk. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk.
- 3.7 As per the requirements of the Prudential Code, the Authority has adopted the CIPFA Treasury Management Code of Practice. All treasury activity will comply with relevant statute, guidance and accounting standards.
- 3.8 The purpose of this Treasury Management Strategy Statement is to approve:
- Treasury Management Strategy for 2019/22.
  - Minimum Revenue Provision (MRP) Statement
  - Treasury Management Policy Statement
  - Treasury Management Indicators for 2019/22.
  - Authorised Signatories for Treasury Management Activity
- 3.9 The Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or to the Authority's capital programme or in the level of its investment balance.

## **ECONOMIC BACKGROUND**

- 3.10 **The Economy:** The major external influence on the Authority's treasury management strategy for 2019/20 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements.
- 3.11 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.
- 3.12 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 Bank of England, 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.

- 3.13 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.
- 3.14 **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..
- 3.15 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. There were no requirements for any bank to raise additional capital.
- 3.16 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.
- 3.17 **Interest rate forecast:** Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's Monetary Policy Committee (MPC) has maintained expectations for slow and steady rate rises over the forecast horizon. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.
- 3.18 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are

considered firmly to the downside 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 European Central Bank's forward guidance on higher rates.

- 3.19 A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix F.

### **CAPITAL FINANCING REQUIREMENT**

- 3.20 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's strategy will be to minimise and delay external borrowing where possible, through the utilisation of investment balances, sometime known as internal borrowing.
- 3.21 The Authority's current level of debt and investments are set out in Appendix B.
- 3.22 CIPFA's Prudential Code of Practice recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years.
- 3.23 The forecast movement in the CFR in coming years is one of the Prudential Indicators (PIs). The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years.

**Table 1: Balance Sheet Summary Analysis**

	<b>31-Mar-19 Estimate £m</b>	<b>31-Mar-20 Estimate £m</b>	<b>31-Mar-21 Estimate £m</b>	<b>31-Mar-22 Estimate £m</b>
Capital Financing Requirement (CFR)	351	387	383	377
Less: Existing Profile of Long Term Borrowing and Other Long Term Liabilities	217	211	205	190
<b>Cumulative Maximum External Borrowing Requirement</b>	<b>134</b>	<b>176</b>	<b>178</b>	<b>187</b>
Usable Reserves	64	51	47	47
<b>Cumulative Net Borrowing Requirement</b>	<b>70</b>	<b>125</b>	<b>131</b>	<b>140</b>

3.24 Table 1 shows that the capital expenditure plans of the Authority over the next three years cannot be funded entirely from other sources and external borrowing will eventually be required. Useable reserves are subject to review as part of the Financial Strategy.

## **BORROWING STRATEGY**

3.25 The Authority as at 31<sup>st</sup> December 2018 held £174 million of longer term loans, a decrease of £8 million from March 2018, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that in theory the Authority could need to borrow up to £125m in 2019/20. The Authority may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing as per the Capital Strategy.

3.26 The Authority's chief 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 Authority's long-term plans change is a secondary objective.

3.27 Given the significant cuts to public expenditure and in particular to local government funding, the Authority'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.

3.28 By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and/or short term 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 Authority's Treasury Management advisors will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows 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.

3.29 Alternatively, the Authority may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

3.30 In addition, the Authority may borrow short-term to cover unexpected cash flow shortages.

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

- Public Works Loan Board (PWLB) and its successor body

- Any other UK public sector body
- Any institution approved for investments
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (with the exception of Merseyside Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency Plc and other special purpose companies created to enable joint local authority bond issues

3.32 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

3.33 At present, the PWLB remains the Council's preferred source of borrowing given the transparency and control that its facilities continue to provide, however the Authority continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

3.34 UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

### **Type of borrowing**

3.35 As the cost of carry remains high there is a greater reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review.

### **LOBOs**

3.36 The Authority has £114m of exposure to LOBO loans (Lender's Option Borrower's Option) of which £99m of these can be called within 2019/20. A LOBO is called when the lender exercises its rights to amend the interest rate on the loan at which point the borrower can accept the revised terms or reject

them and repay the loan at no additional cost. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion. This refinancing risk is mitigated by the low interest rate climate, which has now been in existence for a number of years.

- 3.37 Any LOBOs called will be discussed with our Treasury Management advisors prior to acceptance of any revised terms. If a lender proposes to exercise their right to amend the interest rate of the loan, the default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted. Should the possibility arise of a LOBO being refinanced, for example by replacing the loan with a new loan arrangement, then the approach detailed below will be adopted.

### **Debt Rescheduling**

- 3.38 The Authority's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.
- 3.39 The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. 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 saving or reduction in risk. The rationale for undertaking debt rescheduling would be one or more of the following:
- Savings in risk adjusted interest costs
  - Rebalancing the interest rate structure of the debt portfolio
  - Changing the maturity profile of the debt portfolio
- 3.40 Borrowing and rescheduling activity will be reported to Cabinet in the Annual Treasury Management Report and the regular treasury management reports.

### **INVESTMENT STRATEGY**

- 3.41 The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. As at 31st December 2018, the Authority held £31 million of invested funds. In the past 12 months, the Authority's investment balance has ranged between £20 and £60 million. A similar range in investment level is expected in the forthcoming year, depending on the levels of grant received and the payment profiles.
- 3.42 The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority'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.

- 3.43 The Authority and its advisors continually assess economic and market conditions for signs of credit or market distress that might adversely affect the Authority.
- 3.44 **Negative Interest Rates:** If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.
- 3.45 Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This is especially the case for funds that are available for longer-term investment. The majority of the Authority's surplus cash is currently invested in short-term unsecured bank deposits and money market funds.
- 3.46 The Authority may invest its surplus funds with any of the counterparties shown in Appendix C, subject to the cash and time limits shown.
- 3.47 **Business models:** Under the new IFRS 9 accounting standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.
- 3.48 **Banks Unsecured Investments:** 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.
- 3.49 **Banks Secured Investments:** 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 highest 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 will not exceed the cash limit for secured investments.
- 3.50 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the

UK Central Government may be made in unlimited amounts for up to 50 years.

- 3.51 **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 either following an external credit assessment or as part of a diversified pool in order to spread the risk widely.
- 3.52 **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), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
- 3.53 **Pooled Funds:** Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares 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.
- 3.54 Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority 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 Authority's investment objectives will be monitored regularly.
- 3.55 **Real estate investment trusts (REITs):** Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.
- 3.56 **Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be minimised as part of daily Treasury Management procedures. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

- 3.57 **Other Organisations:** The Authority may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment.
- 3.58 **Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Authority'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 investments will be made,
  - existing investments 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.
- 3.59 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") 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. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.
- 3.60 **Other Information on the Security of Investments:** The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support 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.
- 3.61 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected immediately in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

- 3.62 **Investment Limits:** In order that the risk to the Authority's finances is further minimised in the case of a single default, a group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries. Group Investment and Industry Sector Limits can be found in Appendix C.
- 3.63 When calculating counterparty limits, the investment portfolio may be grossed up to include amounts that are being utilised by the Authority in lieu of borrowing (internally borrowed), as per the Authority's external advisor.
- 3.64 **Liquidity management:** The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.
- 3.65 The Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements. Decisions taken on the core investment portfolio will be reported to Cabinet meetings.

#### **OTHER ITEMS OBLIGED BY CIPFA TO BE INCLUDED IN THE TREASURY MANAGEMENT STRATEGY**

- 3.66 **Financial Derivatives:** Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.
- 3.67 The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

- 3.68 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.
- 3.69 The local authority will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.
- 3.70 **Markets in Financial Instruments Directive:** The Authority has opted up to professional client with its 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 Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

### **INTEREST RATE FORECAST**

- 3.71 The economic interest rate forecast provided by the Authority's treasury management advisor is attached at Appendix F. The Authority will reappraise its strategies from time to time in response to evolving economic, political and financial events.

### **POLICY ON DELEGATION**

- 3.72 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 Director of Finance & Investment who will act in accordance with the Council's Strategy Statement, Treasury Management Practices (TMPs) and CIPFA's Standard of Professional Practice on Treasury Management.
- 3.73 On a day to day basis the Treasury Management Team within Finance undertake the treasury management activities.
- 3.74 Decisions on short term investments and short term borrowings may be made on behalf of the Section 151 Officer by the Principal Accountant with the responsibility for investments or any other members of that team who are empowered to agree deals subject to their conforming to the Authority's Treasury Management Strategy and policies outlined in this report.
- 3.75 Actual authorisation of payments from the Authority's bank account will be made by those listed in Appendix G.
- 3.76 Decisions on long term investments or long term borrowings (i.e. for periods greater than one year) may be made on behalf of the Section 151 Officer by the Principal Accountant (or equivalent) or the Senior Accountant (or equivalent) on the Treasury Management function and will be reported to Cabinet.

- 3.77 All officers will act in accordance with the policies contained within this document.

## **PERFORMANCE MONITORING AND REPORTING**

- 3.78 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.
- 3.79 The Council will produce an Outturn Report on its treasury activity no later than 30 September after the financial year end.

## **4.0 FINANCIAL IMPLICATIONS**

- 4.1 Approval and implementation of this strategy will limit financial risks while helping to minimise financing costs and maximise investment returns.

## **5.0 LEGAL IMPLICATIONS**

- 5.1 The MHCLG Guidance is issued by the Secretary of State under section 15(1)(a) of the Local Government Act 2003. Under that section local authorities are required to “have regard” to “such guidance as the Secretary of State may issue”. The Council’s has adopted the requirement of the MHCLG to produce a Treasury Management Strategy. The Council would be putting its financial standing at risk, as well as failing to meet the requirements of the Local Government Act 2003, if it failed to follow the revised Treasury Management Code and the associated guidance. The Council has adopted the CIPFA Code of Practice on Treasury Management. This requires the annual production of a Treasury Management Strategy Statement, which this report fulfils and the reporting of treasury management activities at least twice a year.

## **6.0 RESOURCE IMPLICATIONS: ICT, STAFFING AND ASSETS**

- 6.1 There are none arising out of this report.

## **7.0 RELEVANT RISKS**

- 7.1 The Council is responsible for treasury decisions and activity and none of these decisions are without risk. The successful identification, monitoring and control of risk are important and the main risks are:-

- Liquidity Risk (Inadequate cash resources).
- Market or Interest Rate Risk (Fluctuations in interest rate levels).
- Inflation Risk (Exposure to inflation).
- Credit and Counterparty Risk (Security of investments).
- Refinancing Risk (Impact of debt maturing in future years).
- Legal and Regulatory Risk.

## **8.0 ENGAGEMENT/CONSULTATION**

8.1 This strategy report has been written in consultation with the Council's external treasury management advisors, Arlingclose Ltd. There has been no further consultation undertaken or proposed for this strategy report. There are no implications for partner organisations arising out of this report.

## **9.0 EQUALITY IMPLICATIONS**

9.1 There are none arising directly from this report

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## **APPENDICES**

- A. Treasury Management Policy Statement
- B. Existing Investment and Debt Portfolio Position
- C. Approved Investment Counterparties
- D. Treasury Management Indicators 2019/20 – 2021/22
- E. 2019/20 Minimum Revenue Provision (MRP) Statement
- F. Interest Rate Outlook
- G. Authorised Signatories

## **SUBJECT HISTORY**

<b>Meeting</b>	<b>Date</b>
<b>Treasury Management Strategy Statement 2018-19</b>	<b>19<sup>th</sup> February 2018</b>
<b>Treasury Management Mid-Year Report 2018-19</b>	<b>26<sup>th</sup> November 2018</b>

## APPENDIX A

### TREASURY MANAGEMENT POLICY STATEMENT

#### 1. Introduction and background

- 1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.
- 1.2 Accordingly, 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 risk management of its treasury management activities
  - Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 1.3 The Council (i.e. full 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.
- 1.4 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 Section 151 Officer who will act in accordance with the Council's Strategy Statement, Treasury Management Practices (TMPs) and CIPFA's Standard of Professional Practice on Treasury Management.

#### 2. Policies and objectives of treasury management activities

- 2.1 The Council defines its treasury management activities as:

“The management of the Council'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.”
- 2.2 This 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 their risk implications for the organisation, and any financial instruments entered into to manage these risks.

- 2.3 This 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 performance measurement techniques, within the context of effective risk management.
- 2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- 2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

## APPENDIX B

### EXISTING INVESTMENT & DEBT PORTFOLIO POSITION

	<b>Current Portfolio as at 31 Dec 18 £m</b>
<b>External Borrowing (Long &amp; Short Term)</b>	
Public Works Loan Board	16
Local Authorities Temporary Loans	74
LOBO Loans	114
Other Loans	44
<b>Total External Borrowing</b>	<b>248</b>
<b>Other Liabilities</b>	
PFI	44
<b>Total Other Long-Term Liabilities</b>	<b>44</b>
<b>Total External Debt</b>	<b>292</b>
<b>Investments:</b>	
<i>Managed in-house</i>	
Deposits with Banks & Building Societies	9
Deposits with Money Market Funds	13
Deposits with Community Interest Companies	2
<i>Managed Externally:</i>	
Royal London	1
Payden Sterling Reserve	4
Columbia Threadneedle	1
CCLA Property Fund	1
<b>Total Investments</b>	<b>31</b>
<b>Net Borrowing Position</b>	<b>261</b>

## APPENDIX C

### APPROVED INVESTMENT COUNTERPARTIES

#### Investment Limits

<b>Credit Rating</b>	<b>Banks/ Building Societies Unsecured</b>	<b>Banks/ Building Societies Secured</b>	<b>Government</b>	<b>Corporates</b>	<b>Registered Providers</b>
<b>UK Govt</b>	n/a	n/a	£ Unlimited 50 years	n/a	n/a
<b>AAA</b>	£5m 5 years	£10m 20 years	£10m 50 years	£5m 20 years	£5m 20 years
<b>AA+</b>	£5m 5 years	£10m 10 years	£10m 25 years	£5m 10 years	£5m 10 years
<b>AA</b>	£5m 4 years	£10m 5 years	£10m 15 years	£5m 5 years	£5m 10 years
<b>AA-</b>	£5m 3 years	£10m 4 years	£10m 10 years	£5m 4 years	£5m 10 years
<b>A+</b>	£5m 2 years	£10m 3 years	£5m 5 years	£5m 3 years	£5m 5 years
<b>A</b>	£5m 13 months	£10m 2 years	£5m 5 years	£5m 2 years	£5m 5 years
<b>A-</b>	£5m 6 months	£10m 13 months	£5m 5 years	£5m 13 months	£5m 5 years
<b>None</b>	£1m 6 months	n/a	£10m 25 years	£1.5m 5 years	£5m 5 years
<b>Pooled funds</b>	£10m per fund				
<b>Real Estate investment Trusts</b>	£10m per fund				
<b>Asset backed pooled funds unrated</b>	£10m per fund				

### Group Investment and Industry Sector Limits

	<b>Cash limit</b>
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Any group of pooled funds under the same management	£25m per manager
Negotiable instruments held in a broker's nominee account	£25m per broker
Foreign countries	£10m per country
Registered Providers and Registered Social Landlords	£25m in total
Unsecured investments with Building Societies	£10m in total
Loans to unrated corporates	£10m in total
Money Market Funds	50% in total
Real Estate Investment Trusts	£25m in total

## APPENDIX D

### TREASURY MANAGEMENT INDICATORS 2019/2020

#### 1. Background

Treasury management indicators are not in the 2017 edition of the CIPFA Treasury Management Code itself but in the separate Treasury Management Code guidance notes for local authorities, which was last published in 2011. The Authority measures and manages its exposures to treasury management risks using the following indicators.

#### Treasury Management Indicators

#### 1. Security

The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A-

#### 2. Liquidity

The Authority has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount it can borrow each quarter without giving prior notice.

Liquidity risk indicator	Target
Total sum borrowed in past 3 months without prior notice	£15m

#### 3. Maturity Structure of Borrowing

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

<b>Maturity Structure of Borrowing</b>	<b>Lower Limit 2019/20 %</b>	<b>Upper Limit 2019/20 %</b>
Under 12 Months	0	90
12 Months and within 24 months	0	50
24 Months and within 5 years	0	50
5 years and within 10 years	0	50
10 years and over	0	100

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment, including LOBO loans, many of which have repayment options every six months.

#### **4. Principal Sums Invested For Periods Longer Than a Year**

The Council has placed an upper limit for principal sums invested for periods longer than a year. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

<b>Price risk indicator</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>
<b>Limit on principal invested beyond year end</b>	£30m	£30m	£30m

## APPENDIX E

### 2019/20 MINIMUM REVENUE PROVISION (MRP) STATEMENT

- 1.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Ministry for Housing, Communities and Local Government's (MHCLG) Guidance on Minimum Revenue Provision most recently issued in 2018.
- 1.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 1.3 The MHCLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.
- 1.4 For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined by charging the expenditure based on the expected useful life of the relevant assets using an annuity method, (Option 3 in England and Wales).
- 1.5 For unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset or as the principal repayment on an annuity with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the expenditure has been incurred.
- 1.6 For assets acquired by finance leases or the Private Finance Initiative and for the transferred debt from Merseyside County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- 1.7 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts to be offset by the matching MRP liability amount.
- 1.8 With regards to loans granted by the Council no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans.
- 1.9 Capital expenditure incurred during 2019/20 will not be subject to a MRP charge until 2020/21.

- 2.0 The MRP Statement will be submitted to Council before the start of the 2019/20 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

Based on the Authority's estimate of its Capital Financing Requirement on 31st March 2019, the budget for MRP has been set as follows:

	<b>31.03.2019 Estimated CFR £m</b>	<b>2019/20 Estimated MRP £m</b>
Supported Capital Expenditure	170.1	2.5
Unsupported Capital Expenditure	104.7	3.0
Finance leases and Private Finance Initiative	42.7	2.6
Transferred debt	34.7	4.9
<b>Total General Fund</b>	<b>352.2</b>	<b>13.1</b>

## APPENDIX F

### Arlingclose's Economic and Interest Rate Outlook

#### Underlying assumptions:

- Our central interest rate forecasts are predicated on there being a transitional period following the UK's official exit from the EU.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider that: 1) tight labour markets will prompt inflationary pressure in the future, 2) ultra-low interest rates result in other economic problems, and 3) higher Bank Rate will be a more effective policy weapon if downside risks to growth crystallise.
- Both our projected outlook and the increase in the magnitude of political and economic risks facing the UK economy means we maintain the significant downside risks to our forecasts, despite the potential for slightly stronger growth next year as business investment rebounds should the EU Withdrawal Agreement be approved. The potential for severe economic outcomes has increased following the poor reception of the Withdrawal Agreement by MPs. We expect the Bank of England to hold at or reduce interest rates from current levels if Brexit risks materialise.
- The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in the middle quarters of 2018, but more recent data suggests the economy slowed markedly in Q4. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures are easing but inflation is forecast to remain above the Bank's 2% target through most of the forecast period. Lower oil prices have reduced inflationary pressure, but the tight labour market and decline in the value of sterling means inflation may remain above target for longer than expected.
- Global economic growth is slowing. Despite slower growth, the European Central Bank is conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. More recent US data has placed pressure on the Federal Reserve to reduce the pace of monetary tightening – previous hikes and heightened expectations will, however, slow economic growth.
- Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.



## **APPENDIX G**

### **AUTHORISED SIGNATORIES**

The following officers are authorised to make payments, either via the Council's online banking system or by signing cheques, and issue other instructions relating to Treasury Management transactions on behalf of Wirral Borough Council:

Director of Finance & Investment – Shaer Halewood

Assistant Director of Finance & Investment – Daniel Kirwan

Senior Finance Manager – Peter J. Molyneux

Senior Finance Manager – Jenny Spick

Senior Finance Manager - Peter McCann