Appendix 1

TREASURY MANAGEMENT STRATEGY 2019/20

1. The Treasury Management Strategy forms an integral part of the overall managerial framework for treasury management and the responsibility for its approval lies with the Council.

2. The treasury management function is an important part of the overall management of the Council's financial affairs. The Prudential Indicators which are detailed in **Appendix 2** consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. This forms part of the process that ensures the Council meets the balanced budget requirement under the Local Government Finance Act 1992. The Prudential Indicators require approval by Council in conjunction with the approval of the budget and setting of the Council Tax.

3. The Council's treasury activities are strictly regulated by statute and by the provisions contained within the CIPFA Treasury Management Code of Practice in the Public Services

4. The Treasury Management Code of Practice requires that, each year, a treasury management strategy is presented for approval by Council which outlines the proposed strategy to be pursued for the forthcoming year. A key requirement of the strategy is that it should show that proper arrangements have been put in place to identify, and effectively manage, all of the risks associated with the treasury service. The Treasury Management Code of Practice places strong emphasis on the need for close and ongoing scrutiny of treasury management operations and, as such, Councillors will receive regular treasury management monitoring reports throughout the year as well as a report after the year-end on actual activity for the year.

5. The strategy is intended to cover:-

   - the current treasury portfolio position;
   - the Council's debt and investment projections;
   - the economic outlook and the expected movement in interest rates;
   - the Council's borrowing and investment strategies;
   - treasury performance indicators;
   - specific limits on treasury activities.

Current investments

6. The Council currently (January 2019) holds just under £70m in cash balances (excluding the CCLA Property Fund (£5m) and CCLA Diversified Income Fund (£2,5m)), although cash flow projections estimate that this will fall to approximately £53m by the end of the financial year 2018/19.

7. The overall rate of return for the cash element of our investments in 2018/19 is expected to outturn at 0.8%. This will be approximately 0.2% above the average benchmark 7 day LIBOR (London Inter-bank Offer Rate) for the year. In 2017/18 the rate of return outperformed 7 day LIBOR by 0.33%.

8. Wychavon's cash investment portfolio is managed in-house and it is now expected that the Council will receive £1.796m from its cash, CCLA Diversified Income Fund and property investments in 2018/19 of which £0.485m is from its cash and CCLA Diversified Income Fund investments. Income from the CCLA Property Fund is currently being held in an Earmarked Reserve in order to offset potential losses in value of the initial investment following changes in accounting rules. However the MHCLG have agreed a 5 year statutory override for this so the current practice of transferring income to this Earmarked Reserve will be reviewed at the year end.

9. As interest rate levels have remained heavily suppressed for several years it is clear that the Council has been well served by the decision to diversify some of its cash investments into property assets such as the Waitrose Supermarket development in Droitwich and the Pershore Health Centre project. The lease income from these returns alone is £1.311m per annum, yielding an equivalent rate of return approaching 9% on the capital invested in the development of these assets. This diversification has continued with the Waitrose Supermarket recently constructed and opened as part of the Evesham town centre re – development project.

10. Due to the fact that the Council continues to retain healthy cash balances it is not currently planning to externally borrow to fund any of its expenditure.

Treasury Management Advisors and Interest rate forecasts

11. The Council uses Link Asset Services as its treasury management consultants. The company provides a range of services which include:

    - technical support on treasury matters, capital finance issues and the drafting of reports;
    - economic and interest rate analysis;
    - debt services which includes advice on the timing of borrowing;
    - generic investment advice on interest rates, timing and investment instruments;
    - credit ratings/market information service and monitoring the risks attached to our current counterparty list.

12. Link Asset Services have provided the following information (paragraphs 13 to 15) to support the Council's Treasury Management Strategy:

The UK economy and short term interest rates

13. At their November quarterly Inflation Report meeting, the Monetary Policy Committee (MPC) repeated their well worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary) than before the crash. However, with so much uncertainty around Brexit, they warned that the next move could be up, or down.

14. Putting Brexit to one side fundamental economics show a tightening labour market causing increasing wage inflation pressure. Earnings are expected to rise helping household inflation, whilst falling from recent highs, to continue at levels above the 2% target level. All this supports the view that the economy will continue to grow in the coming months.

15. Overall the MPC took a hawkish stance at their November meeting with their view being that the next increase in Bank Rate would be in May 2019 (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 rising again to 2.0% in February 2022.

Longer term interest rates

16. Our Treasury Management Advisors project longer term interest rates to be as follows:

YEAR	PROJECTED BANK RATE
2019/20	0.75%
2020/21	1.25%
2021/22	1.50%
2022/23	2.00%
2023/24	2.00%

17. The forecasts within this Strategy and the Revenue year Money Plan have been based on these projections and have been used as the basis for estimating investment returns that the Council should receive from its cash investments over the life of the current Money Plan. The following average rates of return have been used to support these estimates:-

2019/20	1.00%
2020/21	1.60%
2021/22	1.90%
2022/23	1.90%
2023/24	2.15%

18. Clearly there is scope for variation to arise against these forecast levels as we progress through the life of the five year Money Plan. The actual

level of treasury management performance will continue to be closely monitored.

Investment strategy and control of risk

19. The overriding objectives of the Council's investment strategy will be to focus on ensuring the security of its investments and that sufficient liquidity is maintained to meet operational needs going forward. Only when these two objectives have been met will attention be given to yield levels.

20. The difficulties which the financial markets have experienced make it essential that close regard is given to the management and control of counterparty risk. We will continue to maintain documented records regarding the standing of the counterparties used and their credit standing and ratings will be closely monitored on a daily basis by our treasury management advisors.

21. In order to continue to minimise the risk of counterparty default, investments will only be made in those counterparties which are detailed in paragraphs 31 and 32 of this report.

22. The Treasury Management Code of Practice also requires the development of risk benchmarks to evidence security of the Council's investments. Whilst it encourages us to "have regard" to the use of credit ratings, the Code of Practice also strongly advises local authorities to make extensive use of other information from such sources as the quality financial press, market data and a wider range of economic reports and forecasts.

23. Therefore we have moved away from placing absolute reliance on the credit ratings of the organisations with which we invest. In order to establish risk the Council monitors credit rating details supplied by its Treasury Management advisers on a daily basis as well as using other information sources. Independently produced Treasury Management 'Monthly Investment Management' reviews are also provided to Councillors, which give an economic summary, recent credit rating changes and outline the maturity details of deposits, the investment risk and the rating exposure of the Council's current investment portfolio.

24. We will continue to keep fully documented records relating to the credit standing of counterparties that we use and the Deputy Managing Director, in conjunction with the Portfolio Holder for Resources, will take immediate action to suspend or delete organisations from our approved counterparty list if the need should arise. In addition individual officers will refuse any deal on discovery of adverse information about that counterparty on the approved list.

Liquidity considerations

25. Of the total cash sum of £53m, which we estimate we will have invested at the end of March this year, it is likely that £13m will be needed over the remainder of the life of the Money Plan to support net revenue and

capital spending. Other cash balances relate to Earmarked Reserves, a good proportion of which is held in 'Developer Contributions' Earmarked Reserves and will eventually be passed over to the County Council and other bodies. In addition we will need to retain sufficient liquidity for day to day operational purposes. We maintain a detailed cash flow analysis which is reviewed by the Financial Services Manager on a daily basis. This is highly effective in managing and monitoring our liquidity needs.

Investments – interest rate risk

26. Current economic conditions suggest there will be gradual rate rises until March 2023. However changing factors have the potential to prompt an earlier rate rise or delay a rate rise.

Statutory Investment Guidance

27. In order to follow CLG Investment Guidance the Council is required to have close regard to the Treasury Management Code of Practice and to apply the principles contained within that Code to all of its investment activities.

28. The Treasury Management Code of Practice and CLG Investment Guidance state that the Council should set out its annual investment strategy paying regard to:-

- the **strategy guidelines** for decision making on investments, particularly non-specified investments;
- the **principles to be used** to determine the maximum periods for which funds can be committed;
- the **specified investments** that the Council may use. These have high levels of security and are highly liquid investments in sterling and with a maturity of no more than a year;
- the **non-specified investments** that the Council may use which clarify the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time;

29. **The investment strategy** needs the approval of the Council and the suggested strategy for 2019/20 is set out in paragraphs 30 to 37.

Strategy Guidelines

30. Investments will only be made in the counterparties listed in the tables in paragraphs 31 and 32. Investment maturity profiles will be maintained within the defined limits set out.

Specified Investments

31. These are Sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk

assets determined by 'high credit quality' and where the possibility of loss of principal or investment income is extremely small. These would include the following investments:-

Specified Investment Category		(£m limit, duration less than 1 year)
1.	The UK Government (such as the Debt Management Office, UK Treasury Bills or Gilt with less than one year to maturity).	No limit
2.	Pooled investment vehicles (such as money market funds that have been awarded an AAA credit rating by a credit rating agency and ***have either a Constant or Low Volatility Net Asset Value.***	Maximum of £5m per money market fund
3.	The Council's current account with HSBC Bank PLC.	Maximum of £1m to cover circumstances when it is uneconomic or not possible to invest elsewhere.

Non-specified investments

32. These are other types of investment for which, in accordance with the Code of Practice, the Council sets additional criteria relating to the maximum amounts that should be invested in each body and the time limits for the duration of such investments. In view of the need to minimise exposure to risk and to maintain the Council's liquidity requirements we will be restricting the duration of any of our non-specified investments as follows:-

<u>Non-Specified Investment Category</u> (Organisations to include wholly-owned Subsidiaries ***unless stated otherwise***)	**(£m Limit and duration)**
<u>The main UK High Street Banks:-</u> ***HSBC UK Group (mainly comprised of the ring-fenced HSBC UK Bank Plc and the non ring-fenced HSBC Bank Plc)**** ***Lloyds Banking Group (mainly comprised of the ring-fenced Lloyds Bank Plc which includes the brands Bank of Scotland, Halifax and Birmingham Midshires and the non ring-fenced Lloyds Bank Corporate Markets Plc)*** ***Royal Bank Of Scotland Group (mainly comprised of the ring-fenced banks RBS Plc and Natwest Bank and the non-ring fenced RBS International and Natwest Markets)*** ***Barclays Bank PLC (comprising the ring-fenced Barclays Bank UK and the non ring-fenced Barclays Bank.***	Maximum of £15m***** in each group for no longer than 3 years duration.*******For HSBC this is **in addition** to the limit for the current account (See para. 32)* ***<u>For information</u> - "ring-fencing" is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure.*** ***In general, simpler, activities offered from within a ring-fenced bank will be focussed on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed into a separate entity – a non ring-fenced bank.***
<u>Building societies – with assets of more than £100bn:-</u> Nationwide Building Society	Maximum of £5m for no longer than 1 year duration.
<u>Building societies – with assets of more than £10bn:-</u> Yorkshire Building Society Coventry Building Society Skipton Building Society Leeds Building Society	Maximum of £3m for no longer than 1 year duration.
<u>Other UK Banks:-</u> ***Santander UK Group Holdings – Ring-fenced Santander UK Plc only***	Maximum of £10m for no longer than 1 year duration
<u>Other UK Banks:-</u> ***Handelsbanken Plc***	Maximum of £5m for no longer than 1 year duration.
<u>Other Overseas Banks domiciled in AAA credit rated nations:-</u> Commonwealth Bank of Australia DBS Bank Ltd United Overseas Bank Ltd Toronto Dominion Bank Australia and New Zealand Banking Group Ltd	Maximum of £5m for no longer than 1 year duration.
<u>Other Overseas Banks domiciled in AA credit rated nations:-</u> First Abu Dhabi Bank PJSC	Maximum of £3m for no longer than 1 year duration.
<u>Other Organisations:-</u> UK Local Authorities (including Fire & Rescue and Police Authorities)	Maximum of £5m per authority for no longer than 3 years duration.
<u>Collective Investment Schemes</u> CCLA Local Authorities Property Fund CCLA Diversified Income Fund	Maximum of £5m per fund (no maximum duration as this is a call account)

33. In the normal course of the Council's treasury operations it is expected that both Specified and Non-specified investments will be utilised for the control of liquidity as both categories allow for short-term investments.

34. The use of longer term instruments (greater than one year from inception to repayment) will fall into the Non-specified investment category. These instruments will only be used having given due regard to prevailing market conditions, which may include seeking further information about a counterparty other than it's credit rating; and liquidity requirements are to be safeguarded with regard to the cash flow forecasts, with due allowance for any risk.

Borrowing Strategy 2019/20

35. Continuing economic uncertainty and low interest rates increase the risks associated with treasury activity. As a result the Council will take a cautious approach in its dealings under the prudential borrowing regime. The Council have previously agreed to use internal borrowing of £9m for the Evesham Town Centre redevelopment project and the impact of this borrowing only has been included in the prudential indicators and limits for 2019/20 to 2023/24.

Performance Indicators

36. The Treasury Management Code of Practice also requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Our investment returns will be benchmarked against the average 7 day LIBOR for the year. The following Treasury Management performance indicators will also be used to systematically benchmark performance and it is proposed that the 2018/19 benchmarks remain in 2019/20:

- Average Rate of Return on Investments (18/19 benchmark is average 7 day LIBOR);
- Investment management costs per average sum invested (18/19 benchmark is £0.50 per '000);
- Annual External Fund management costs (if appropriate);
- Annual Debt management cost (if appropriate);
- FTE staff involved in Treasury Management function (18/19 benchmark is 0.4 FTE).

Sensitivity to Interest Rate Movements

37. The Council's accounts are required to disclose the impact of risks associated with the Council's treasury management activity. Whilst most of the risks facing the treasury management service are addressed elsewhere in this report (credit risk, liquidity risk, market risk, maturity profile risk) the impact of interest rate risk has been discussed but not quantified. The table below highlights the estimated impact of a 1% increase/decrease in interest rates on the estimated treasury management income for next year.

Interest rate sensitivity Impact on Revenue budget	2019/20 Estimated + or - 1%
Interest on Borrowing	**0**
Net General Fund Borrowing Cost	**0**
Investment income	**£519k**