

## **Appendix 2 - Treasury Management Strategy**

### **Treasury Management Policy Statement, Treasury Management Strategy Statement and Annual Investment Strategy for 2018-19**

#### **Treasury Management Policy Statement**

Treasury management within the Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services (“the TM Code”).

The Council defines treasury management activities as:

“the management of the organisation’s financial 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.”

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. 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.

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.

The investment policy objective for this Council is the prudent investment of its treasury balances. The Council’s investment priorities are security of capital and liquidity of its investments so that funds are available for expenditure when needed. Both the CIPFA Code and the Ministry of Housing, Communities and Local Government (MHCLG) guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The Council’s borrowing objective, being debt free and with resources still available for its capital investment spending plans, means that it does not intend to borrow any monies, except for short term cash flow purposes for revenue and capital commitments.

The generation of investment income to support the Council’s spending plans is an important, but secondary objective. Other than income from the Council’s investment in the Local Authority Property Fund or other long term pooled funds, returns are generally used to fund one-off expenditure or capital investment.

## **Treasury Management Strategy Statement**

In February 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

The Department for Communities and Local Government issued *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the MHCLG Guidance.

The Treasury Management Strategy Statement including the Annual Investment Strategy are underpinned by the CIPFA Code of Practice and Treasury Management Practices (TMPs) which provide prescriptive information as to how the treasury management function should be carried out.

In accordance with current MHCLG guidance, the Council will be asked to approve a revised Treasury Management Strategy 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 in the Council's capital programme or in the level of its investment balances. For 2018-19 a revised strategy may be necessary as a result of updated MHCLG guidance or the CIPFA Code which are both due to be issued early in 2018.

## **Risk Appetite Statement**

As a debt free authority the Council's highest priority in its treasury management function is the security of those investments in accordance with the priorities set out in the CIPFA Code. However, whilst fundamentally risk adverse, the Council will accept some modest degree of risk.

The use of different investment instruments and diversified high credit quality counterparties along with country, sector and group limits, as set out in this Strategy, enables the Council to mitigate the nature and extent of any risks.

Relevant risks are described in Treasury Management Practices (TMP) 1.

When investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including certain unrated building societies, money market funds. The Council may also invest surplus funds through tradable instruments such as gilts, treasury bills, certificates of

deposit, corporate bonds and pooled funds. The duration of such investments will be carefully considered to limit that risk of them having to be sold (although they may be) prior to maturity, mitigating the risk of the capital sum being diminished through price movements.

## Local Context

As at December 2017, the Council held £61.6m of investments, which comprised a diversified range of investments as set out in table 1, below

**Table 1: Investment Portfolio Position – 31 December 2017.**

<b>Investments</b>	<b>£000</b>	<b>Annualised Return %</b>
Short term Investments (cash, call accounts, deposits)	29,500	0.41
Money Market Funds	6,100	0.36
Corporate Bonds	3,057	0.73
<b>Total Liquid Investments</b>	<b>38,657</b>	<b>0.43</b>
Medium and Long term Investments	5,000	1.63
Pooled funds – Local Authority Property Fund (LAPF)	10,000	4.88
Pooled Funds – Other	7,950	2.95
<b>TOTAL TREASURY INVESTMENTS</b>	<b>61,607</b>	<b>1.67</b>

The Council monitors the return on its treasury investments against that achieved by other English non-met District Councils. This information is included within the Council's performance management suite of key performance indicators (KPI) maintained on Covalent.

The figure of £60.6m is expected to fall over the next few months due to the Council's ongoing capital programme and reduced local taxation receipts in February and March 2018.

The Council's latest resource projection, indicates the following movements in resources, including funds available for investment, over the medium term.

**Table 2: Resource projection to 31 March 2022**

	<b>31.3.17 Actual £m</b>	<b>31.3.18 Estimate £m</b>	<b>31.3.19 Estimate £m</b>	<b>31.3.20 Estimate £m</b>	<b>31.3.21 Estimate £m</b>	<b>31.3.22 Estimate £m</b>
Reserves:						
<i>Earmarked and specific</i>	15.1	9.8	10.0	10.2	10.4	10.7
<i>New Homes Bonus</i>	9.4	11.2	10.9	10.6	10.3	9.9
<i>Asset Replacement</i>	6.6	4.8	5.3	5.6	5.7	5.8
<i>General Fund</i>	12.3	9.4	12.1	11.3	11.6	11.1
Section 106 balances	5.3	4.2	4.0	3.9	3.9	3.9
Working capital	6.5	5.2	5.6	5.5	5.6	5.5
<b>Total Resources</b>	<b>55.2</b>	<b>44.6</b>	<b>47.9</b>	<b>47.1</b>	<b>47.5</b>	<b>46.9</b>

Represented by:

Internal investments	37.2	26.6	27.9	27.1	27.5	26.9
External Investments	18.0	18.0	20.0	20.0	20.0	20.0
<b>Total Investments</b>	<b>55.2</b>	<b>44.6</b>	<b>47.9</b>	<b>47.1</b>	<b>47.5</b>	<b>46.9</b>

	<b>31.3.17</b>	<b>31.3.18</b>	<b>31.3.19</b>	<b>31.3.20</b>	<b>31.3.21</b>	<b>31.3.22</b>
Capital financing requirement	(1.38)	(1.40)	(1.43)	(1.43)	(1.43)	(1.43)
Debt	(0.1)	(0.1)	(0.05)	0	0	0

Apart from a small lease liability for the Council's multi-function printer/copiers, the Council is currently debt free and its capital expenditure plans do not currently imply any need to borrow over the forecast period.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. As the Council does not expect to incur any debt (other than for temporary cash management purposes) over the next three years, table 2 demonstrates that the

Council expects to comply with this recommendation.

## **Borrowing Strategy**

The Council is currently debt-free and has no borrowing other than that which might occur as part of routine working capital management. Under the Council's current resource projections, there are no plans to borrow to finance new capital expenditure over the medium term but this remains an option if deemed to be prudent.

This section describes the Council's policy should the need arise for any borrowing to be undertaken.

Short term internal borrowing (for schemes that pay back within the 5 year time frame of the capital programme) can be accommodated without incurring external interest charges, provided the resulting savings are recycled into reserves.

Longer term pay back periods will have to accommodate both the external interest and a minimum revenue provision (MRP) in accordance with the Council's MRP policy, which links repayment of the debt to the life of the asset.

Borrowing would add pressure on the revenue budget as MRP and interest would become payable. The capacity to make these payments would need to be identified in advance, namely the further efficiency savings generated by the investment in the assets.

## **Borrowing Objective**

If it considers it necessary to borrowing money, the Council's chief objective is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

## **Borrowing Sources**

The Council may need to borrow money in the short term to cover unexpected cash flow shortages, (normally up to one month) within the limits shown in tables 3 and 4.

The Council will, where possible, take advantage of the 20 basis points (0.20%) reduction in borrowing costs available from the Public Works Loan Board (PWL) to those authorities who provide information on their plans for long-term borrowing and associated capital spending. The earliest this opportunity can be taken is Autumn 2018.

## Operational Boundary for External Debt

The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring.

**Table 3: Operational boundary for external debt**

Operational Boundary	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Borrowing	5	5	5	5	5	5
Other long-term liabilities	0	0	0	0	0	0
Total Debt	5	5	5	5	5	5

## Authorised Limit for External Debt

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe.

The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

**Table 4: Authorised limit for external debt**

Authorised Limit	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m	2021/22 Limit £m	2022/23 Limit £m
Borrowing	10	10	10	10	10	10
Other long-term liabilities	0	0	0	0	0	0
Total Debt	10	10	10	10	10	10

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

- PWLB and any successor body
- Any institution approved for investments (see below, Table 5)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the West Sussex Pension Fund)

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

- Operating and finance leases
- Hire purchase
- Private Finance Initiatives
- Sale and leaseback

## **Investment Strategy**

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the 12 months to 30 November 2017, the Council's financial investment balance has ranged between £49.6m and £68.2m, but this is expected to reduce to lower levels in the forthcoming year due to the anticipated capital spending programme including any property investment commitments.

## **Investment Objective**

The Council has a duty to safeguard the public funds and assets it holds on behalf of its community. The CIPFA Code and MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The Council's objective when investing money is to comply with the principles stated in this strategy document, striking an appropriate balance between risk and return in line with the Council's risk appetite statement

## **2018-19 Strategy**

Given the increasing risk and remaining low returns from short-term unsecured bank investments, the Council will continue to diversify using secure and/or higher yielding asset classes.

The Council may invest its surplus funds with any of the counterparties in table 5 below, subject to the cash limits (per counterparty) and time limits shown.

**Table 5: Approved Investment Counterparties**

<b>Sector Limits/ Credit Rating</b>	<b>Banks Unsecured<sup>1</sup> £20m</b>	<b>Banks Secured<sup>1</sup> Unlimited</b>	<b>Government Unlimited</b>	<b>Corporates £10m</b>
UK Govt.	n/a	n/a	£ Unlimited 25 years	n/a
AAA	£2.5m 5 years	£5m 10 years	n/a	£2.5m 10 years
AA+	£2.5m 5 years	£5m 7 years	£5m 7 years	£2.5m 7 years
AA	£2.5m 4 years	£5m 5 years	£5m 5 years	£2.5m 5 years
AA-	£2.5m 3 years	£5m 4 years	£5m 4 years	£2.5m 4 years
A+	£2.5m 2 years	£5m 3 years	£2.5m 3 years	£2.5m 3 years
A	£2.5m 13 months	£5m 2 years	£2.5m 2 years	£2.5m 2 years
A-	£2.5m 6 months	£5m 13 months	£2.5m 13 months	£2.5m 13 months
UK Local Authorities			£5m 10 Years	
None (excludes pooled funds)	£1m 6 months	n/a	n/a	n/a
Pooled Funds	£5m per money market fund (MMF), subject to a maximum of 2% of MMF fund value and a total limit of £20m across all MMF £5m per pooled investment fund, to a maximum of £15m (excludes the Local Authority Property Fund). £10m in the Local Authority Property Fund			

This table must be read in conjunction with the details notes below and the limits stated in tables 6 and 7

**Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's.

Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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

**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 kept below £2.5m in total across all operational accounts. 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.

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

**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 an insignificant risk of insolvency.

**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 following a credit assessment as part of a diversified pool in order to spread the risk widely.

For corporate bonds, the limits referred to in table 5 will apply to the sum of bond principal (par value) and any premium or discount paid to acquire the bond in the secondary market. The limit will exclude the accrued interest element paid to secure a secondary bond as this is recoverable on maturity of the Bond.

**Pooled Funds:** Shares in diversified investment vehicles consisting of the 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 volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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

Where investments in pooled funds or other financial assets have prices or values that can vary according to fund performance and other factors, the investment limits in table 7 will operate to regulate the initial purchase cost (total initial investment) only.

**Risk Assessment and Credit Ratings:** Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in the 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,
- any 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.

If in the case of a decision to recall or sell an investment at a cost which is over the approved investment limits, the Council's urgent action procedure in its Constitution would be invoked by officers.

Where a credit rating agency announces that a credit 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 in a timely manner 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.

**Other Information on the Security of Investments:** The Council 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. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit

ratings, but can be seen in other market measures. In these circumstances, the Council 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 Council'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.

**Specified Investments:** The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+.

For clarity, under this Strategy, no sovereign rating criteria for investments made with institutions domiciled in the UK is required. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

**Non-specified Investments:**

Any investment not meeting the definition of a specified investment is classed as non-specified. Limits on non-specified investments are shown in table 6 below.

The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to medium and long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality.

**Table 6: Non-Specified Investment Limits**

	<b>Cash limit</b>
Total medium and long-term investments	£40m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£40m
Total non-specified investments	£55m

**Investment Limits**

Investment limits are set out in Table 7

The Council's uncommitted revenue reserves available to cover investment losses are forecast to be £30.8m on 31st March 2018. These uncommitted reserves include the following items; General Fund Balance (£9.4m), earmarked revenue reserves (£9.8m) and New Homes Bonus (£11.1m); as stated in the current estimated Resources Statement. In order that no more than 25% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and LAPF) will be £5 million. 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 investments in brokers' nominee accounts, foreign countries and industry sectors as set out in Table 7. 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.

**Table 7: Investment Limits**

	<b>Cash limit</b>
Any single organisation, except the UK Central Government and the LAPF	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Pooled funds (excluding MMF and LAPF) under the same management	£5m per manager, other than the LAPF, to a maximum of £15m in total
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£5m per country
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£2m in total

	Cash limit
Money Market Funds	£5m per money market fund (MMF), subject to a maximum of 2% of individual MMF fund value and £20m in total
Property Funds (1)	£10m in total

(1) The limit on Property Funds in table 7 does not apply to any element of a multi-asset pooled fund which is subject to the separate limit under 'Pooled funds'

**Liquidity Management:** The Council uses purpose-built cash flow forecasting software 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 Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast. To ensure adequate liquidity is maintained, 'worst case' estimates of cash flows are used when considering the Council's medium term investment position.

### Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the MHCLG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes.

Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

### Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators. All comparative data is taken from benchmarking exercises conducted by the Council's Treasury Management advisors.

### Security

The Council will use the voluntary measures set out in Table 8 to control its exposure to credit risk and to monitor and assess overall security

**Table 8: Security management indicators**

Measure	Target
Average Credit Score (time-weighted)	Less than the average of other District Councils (AAA=1, D=24)*
Average Credit Rating (time weighted)	Maintain below the time weighted average of other District Councils
Proportion Exposed to Bail-in (%)	Less than the average of other District Councils

**Liquidity**

The Council will use the voluntary measures set out in Table 9 to control its exposure to liquidity risk.

Officers will continue to manage the Council's treasury management investments ensuring that sufficient cash is available to accommodate known payments. In the unlikely circumstance that a large unexpected cash payment is required and the Council does not have sufficient liquidity immediately available, the Council will use its facility to borrow temporarily for cash management purposes.

**Table 9: Liquidity management indicators**

Measure	Target
Proportion of investments available within 7 days (%)	Compare and explain against District Council average
Proportion available within 100 days (%)	Compare and explain against District Council average
Average days to maturity	Compare and explain against District Council average

**Interest Rate Exposures**

The Council will use the indicators set out in Table 10 to control its exposure to liquidity risk.

This indicator is set to control the Council's exposure to interest rate risk. Under the TM Code the upper limits on fixed and variable rate interest rate exposures, should be

expressed as the amount or proportion of net principal borrowed or interest payable, with investments counting as negative borrowing. As the Council is debt free and to provide a meaningful indicator the limits on fixed and variable rate interest rate exposures are expressed as an amount in £ of net principal invested. Any borrowing would count as negative investment. Strictly this is contrary to the TM Code definition.

**Table 10: Interest rate exposure management indicators**

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposure	£28m	£24m	£22m
Upper limit on variable interest rate exposure	£70m	£60m	£55m

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

### **Maturity Structure of Borrowing**

As the Council is debt free it currently holds no fixed long term borrowing for which a maturity profile exists.

### **Principal Sums Invested for Periods Longer than 364 days**

Limits on the long-term principal sum invested to final maturities beyond the period end are established in Table 11

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments in response to adverse economic or market conditions or credit rating downgrades.

**Table 11: Limits on investment periods**

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£40m	£35m	£30m

### **Other Items**

There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

## Policy on Use of Financial Derivatives

The Council 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 Council is exposed to.

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).

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.

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.

## Investment Training

To address the training need of members, training will be provided to members of both Cabinet and the Corporate Governance and Audit Committee in advance of them considering the forthcoming year's strategies.

Member and officer training is an essential requirement in terms of understanding roles, responsibilities and keeping up to date with changes and in order to comply with the CIPFA Treasury Management Code of Practice.

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

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

## Investment Advisers

The Council currently contracts with Arlingclose Limited as its treasury management adviser and receives specific advice on investment, debt and capital finance issues. However, responsibility for final decision making remains with the Council and its officers.

The quality of this service is controlled and monitored against the contract by the Accountancy Services Manager, which is in place until the 30th June 2018.

## Investment of Money Borrowed in Advance of Need

Although not envisaged at this stage, the Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money.

Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £10 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

## Reporting

The Council/Cabinet will receive as a minimum:

- An annual report on the strategy and plan to be pursued in the coming year and on the need to review the requirements for changes to be made to the Treasury Management Strategy Statement.
- A mid-year review
- An annual report on the performance of the treasury management function, on the effects of decisions taken and the transactions executed in the past year, by 30th September in the next financial year, including any circumstances of non-compliance with the organisation's treasury management policy statement and Treasury Management Practices.

The body responsible for scrutiny of treasury management policies and practices is the Corporate Governance and Audit Committee. Monitoring reports on Treasury performance and compliance with this strategy will be prepared and presented to this Committee as a minimum for the half year to September and the full year to March.

The Leader of the Council, the Cabinet Member for Corporate Services and the members of the Corporate Governance & Audit Committee receive weekly monitoring reports of the investments held. Corporate Governance & Audit Committee will receive half yearly monitoring reports.

## **Appendix 1 to Treasury Management Strategy – Arlingclose Economic & Interest Rate Forecast November 2017**

### **Economic background**

The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

### **Credit outlook**

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

## Interest rate forecast

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.19
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside risk	0.00	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.25	-0.15

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

### Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

## **Appendix 2 to Treasury Management Strategy – Benchmarking Definitions**

The benchmarking compares various measures of risk and return, which are calculated as follows:

### **Investment Value**

For internal investments, the value is the sum initially invested. For external funds, the value is the fund's bid price on the quarter end date multiplied by the number of units held.

### **Rate of Return**

For internal investments, the return is the effective interest rate, which is also the yield to maturity for bonds. For external funds (LAPF) this is measured on an offer-bid basis less transaction fees. For external funds the income only return excludes capital gains and losses.

Average returns are calculated by weighting the return of each investment by its value. All interest rates are quoted per annum.

### **Duration**

Average duration is calculated by weighting the duration of each investment by its value. Higher numbers indicate higher risk.

### **Credit Risk**

Each investment is assigned a credit score, based where possible on its average long-term credit rating from Fitch, Moody's and Standard & Poor's. This is converted to a number, so that AAA=1, AA+=2, etc. Higher numbers therefore indicate higher risk. Unrated local authorities are assigned a score equal to the average score of all rated local authorities.

Average credit risk is measured in two ways. The value-weighted average is calculated by weighting the credit score of each investment by its value. The time-weighted average is calculated by weighting the credit score of each investment by both its value and its time to final maturity. Higher numbers indicate higher risk.