Basingstoke and Deane Borough Council

TREASURY MANAGEMENT POLICY STATEMENT 2018/19

1 Introduction

1.1 The council has adopted the key recommendations from the CIPFA Treasury Management Code of Practice. Accordingly the council will create and maintain, as the cornerstone for effective treasury management, a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities.

1.2 The council will receive reports on its treasury management practices and activity 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.

1.3 The council delegates responsibility for the monitoring and scrutiny of treasury management practices and activity to the Audit and Accounts Committee.

1.4 The council has delegated responsibility for the execution and administration of the treasury management policy, strategy, practices and activity to the council's Section 151 Officer – the Executive Director of Finance and Resources. This officer should act in accordance with the council's treasury management policy statement, strategy and Treasury Management Practices (TMP's) and as a member of CIPFA with standards of professional practice on treasury management.

2 Treasury Management Policy Objectives

2.1 The council defines its treasury management activities as:

2.2 "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."

2.3 The council acknowledges that it is responsible for its treasury management decisions and activities.

2.4 The council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the council.

2.5 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 performance measurement techniques, within the context of effective risk management.

2.6 The primary policy objective of the Treasury Management Strategy is:

i) To invest prudently having regard to the security of investments.

2.7 The supplementary policy objectives of the Treasury Management Strategy (in order of importance) are:

i) To maintain liquidity (accessibility) in the investment portfolio to meet the council's spending plans

ii) To aim to achieve the optimum return on investments commensurate with the proper levels of security and liquidity and predictability of returns

iii) To minimise the cost of any temporary borrowing (which may be required for day to day cash flow reasons)

3 <u>The Council's Approach to Ethical Investments</u>

3.1 As an organisation the council does not have an overall ethical policy and has not defined what is, or what is not, ethical. The council does not invest in equities and therefore does not have influence over the activities of companies that part-ownership might provide. However as an investor the council is able to take the following approach:

i) For direct investments the council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have 'Responsible Investment Policies or Environmental, Social and Governance (ESG) policies' in place prior to investing.

ii) For indirect investments the council will seek to ensure that any fund managers used have their own responsible investment policies or have signed up to widely recognised policies such as the United Nations Principles for Responsible Investment.

iii) The council recognises that it has no control or influence over where its counterparties themselves lend money or invest once an investment has been made by the council.

Basingstoke and Deane Borough Council

TREASURY MANAGEMENT STRATEGY STATEMENT

AND

THE INVESTMENT STRATEGY

FOR 2018/19

Contents:

1 Background Information

1.1 This strategy statement has been produced in accordance with:

i) The council's Treasury Management Policy Statement.

ii) The latest Code of Practice on Treasury Management published by the Chartered Institute of Public Finance and Accountancy (CIPFA).

iii) The Local Government Act 2003 and the CIPFA Prudential Code.

iv) The council's constitution which requires the annual production of a Treasury Management Strategy Statement for the forthcoming year.

v) The Government Department guidance on local government investments which requires the production of an Annual Investment Strategy.

1.2 The Council's Treasury Management Strategy is undertaken within the following context:

i) The Local Government Act 2003 introduced a prudential capital system from April 2004 which gave councils greater freedom to borrow to finance capital expenditure within prudential limits. From April 2004 the types of investments allowed are subject to Government Department guidance.

ii) The level of the council's investment balances is one of the highest of all district authorities and has been for some time. The council has therefore been able to take a longer term view on investment decisions.

iii) The income generated from investments is significant to the council and supports the cost of services. The Medium Term Financial Forecast assumes that income from cash investments will be £2.700 million in 2018/19 reducing to £1.9 million by 2021/22 and sets a remaining target to achieve additional income of £1.704 million by 2021/22 from property related investments in order to balance the budget in future years.

2 Risk Management Assessment

2.1 Treasury management involves the management of risk as no treasury management activity is without some risk.

2.2 Due to the size, complexity and importance of the income generated from treasury management activities it is important that all associated risks are assessed and managed.

2.3 The main risks associated with treasury management are as follows:

i) **Credit and counterparty risk** (risk to capital) – the risk that a third party will fail to meet its contractual investment obligation resulting in a loss of the council's capital investment or the risk that there will be a permanent reduction in the capital value of the investment.

ii) **Liquidity risk** – the risk that the council will commit too much of its investments in fixed term investments and might have to recall investments prematurely resulting in possible additional costs or losses upon disposal of tradable securities.

iii) **Market or interest rate risk** – the risk that fluctuating interest rates will have an adverse impact on the council's investment income or the value of its investments.

iv) **Other risks** – this includes risks associated with cash management, legal requirements and fraud.

2.4 These risks are managed as follows:

i) Credit and Counterparty Risk (risk to capital)

Wherever possible the council will attempt to externalise the management of credit risk through the use of pooled funds and fund managers who have the required knowledge, experience and resources needed to assess and monitor credit risk effectively.

For any remaining internally managed credit risk the council's exposure to this risk is controlled by limiting the maximum sum invested with any single counterparty and by restricting investments to only those counterparties considered to be of high credit quality, as agreed in the council's Treasury Management Practices.

The Council's treasury advisors (Arlingclose Ltd) provide advice on the security of the council's investments which includes credit ratings and other factors such as sovereign guarantees, country of origin, credit default swaps, share prices and market sentiment.

The assessment of security also includes credit ratings produced by the international credit rating agencies which are used throughout the banking and investment industry. Credit ratings are continuously monitored.

The market prices of the council's tradable investments are also monitored as these give an indication of market sentiment which can include credit concerns.

If the credit rating of a counterparty or a security held by the council is downgraded with the result that it no longer meets the council's minimum acceptable credit quality or other factors give cause for serious concern then potential opportunities to dispose of the security will be investigated.

The council requires the necessary flexibility in its investment strategy to enable it to move a proportion of the portfolio into safer investment instruments during times of general concern about credit risk.

ii) Liquidity Risk

This risk is managed by maintaining a minimum proportion of investments in the short term for cash flow purposes and by setting a maximum amount that can be invested long term (more than 364 days).

When investing in external funds the council will have regard to each fund's access requirements (daily, monthly, quarterly etc.) and will ensure that a suitable mix of fund liquidity is available to meet planned expenditure.

When the council is using fixed long term investments it sets limits on the maximum amount that can be invested in each future year to ensure that the maturity structure for its investments results in a significant amount of investments maturing each year. The maturities can be used (rather than being re-invested) if required for short term cash requirements.

The council also has the option to borrow short term funds in order to meet its commitments if necessary.

iii) Market or Interest Rate Risk

The Treasury Management Strategy attempts to control interest rate risk by spreading investments across different financial instruments and for different time periods.

When using external funds consideration is given to the interest rate risk characteristics of each fund as part of the selection process. The fund manager's ongoing effectiveness in managing the risk is monitored on a regular basis with the assistance of the council's treasury advisors.

The council uses a mix of instruments in order to spread the risk and reduce the overall volatility. Limits are set on the maximum amount in each type of investment.

A proportion of investments in long term fixed rate instruments would provide the council with stable and known amounts of income for a sustained period of time.

A proportion of investments at variable interest rates would enable the council to benefit from future increases in interest rates.

Internally managed investments that have a fluctuating market price are purchased with the intention that they will be held to maturity ('buy to hold'), thereby reducing the impact of market risk.

In addition the council currently has an interest rate risk reserve (estimated to be £2.3 million as at 31 March 2018) in order to reduce the impact of adverse in-year returns from interest income.

When the council uses investment instruments that could produce negative returns or where the accounting treatment for certain investment instruments does not allow the gains to be treated as income then it will adjust the level of the risk reserve to provide some degree of protection from losses and enable the smoothing out of any adverse or favourable variances against budgeted income.

iv) Other Risks

These risks are managed through the council's adoption of standard Treasury Management Practices (TMPs) which are reviewed annually. These cover all aspects of treasury management procedures including cash flow forecasting, documentation, monitoring, reporting and division of duties.

All treasury management procedures and transactions are subject to annual inspections by both internal and external auditors.

The council also employs external financial advisors to provide information on market trends, credit rating alerts, lending criteria advice and investment opportunities.

The council will ensure that all staff and elected members tasked with treasury management responsibilities will receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

3 Interest Rate Forecast

3.1 In order to put an investment strategy into context it is necessary to appreciate the current forecasts for interest rates.

3.2 The UK Central Bank Official Rate (base rate) is currently at 0.50%. The average of forecasts from independent city forecasters is that the official rate will average 0.65% in 2018, 0.98% in 2019 and 1.41% in 2020.

3.3 The council's treasury advisors (Arlingclose Ltd) are forecasting that the Bank of England will hold rates at this level throughout 2018/19.

3.4 The council's advisors' forecasts for interest rates for future years are shown in Table 1:

Table 1 – Arlingclose's Forecast for Interest Rates (Jan 2018)

	Upside Risk	Central Case	Downside Risk	Upside Risk	Central Case	Downside Risk
	%	%	%	%	%	%
Mar-18	0.00	**0.50**	0.00	+0.25	**0.75**	-0.20
Jun-18	0.00	**0.50**	0.00	+0.25	**0.80**	-0.25
Sep-18	+0.25	**0.50**	0.00	+0.25	**0.80**	-0.25
Dec-18	+0.25	**0.50**	0.00	+0.30	**0.80**	-0.25
Mar-19	+0.25	**0.50**	-0.25	+0.35	**0.85**	-0.35
Jun-19	+0.25	**0.50**	-0.25	+0.35	**0.90**	-0.40
Sep-19	+0.25	**0.50**	-0.25	+0.35	**0.90**	-0.40
Dec-19	+0.25	**0.50**	-0.25	+0.35	**0.95**	-0.40
Mar-20	+0.25	**0.50**	-0.25	+0.35	**0.95**	-0.40
Jun-20	+0.25	**0.50**	-0.25	+0.35	**1.00**	-0.40
Sep-20	+0.25	**0.50**	-0.25	+0.35	**1.05**	-0.40
Dec-20	+0.25	**0.50**	-0.25	+0.40	**1.10**	-0.40
Mar-21	+0.25	**0.50**	-0.25	+0.40	**1.15**	-0.40

3.5 Arlingclose's forecasts are based on the following assumptions:

i) Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

ii) The 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.

4 Overall Resources and the Investment Portfolio

4.1 The council's Balance Sheet as at 31 March 2017 shows that it had overall net resources of approximately £400 million. This included £253 million of investment property and £170 million of cash resources in the form of long and short term investments.

4.2 The council's Medium Term Financial Forecast estimates that the council will have cash resources of £145 million at the beginning of 2018/19. The latest forecast is for this to increase by £15 million in the early part of the year before reducing to £108 million at the end of the year. This results in an average balance for the year of £148 million and this is expected to generate £2.700 million of interest income in 2018/19.

4.3 The council's existing investment portfolio reflects the effect of previous treasury management strategies. Investments have been made for a combination of short and long term periods using different investment instruments.

4.4 A breakdown of the forecast investment portfolio position as at 31 March 2018 shows total investments of £145 million (at cost) as shown in Table 2.

Table 2 – Forecast Treasury Investment Portfolio 31 March 2018

Instruments	£'m	%	Maximum Limit
Government Gilts	34.0	24%	91%
Supranational Bonds	15.0	10%	£50m
Local Authority Deposits/Bonds	12.0	8%	£50m
Money Market Funds	9.0	6%	£25m
Short Term Cash Funds	10.0	7%	£25m
Collective Investment Funds	65.0	45%	£80m
Total Investments	**145.0**	**100%**	

5 The Annual Investment Strategy for 2018/19

Background

5.1 The Investment Strategy is drawn up in order to comply with central government guidance on Local Government Investments and CIPFA's Treasury Management Code of Practice.

5.2 The Investment Strategy sets out the ranges and limits within which the treasury management function can operate. It states which investments the council may use for the prudent management of its treasury balances during the financial year and sets limits on the different types of investment.

Investment Objectives

5.3 The investment policy objectives for this council are to invest prudently having regard to all of the associated risks including the security of investments and to maintain liquidity in the investment portfolio to meet the council's spending plans.

5.4 Statute maintains that the speculative procedure of borrowing purely in order to invest or lend on and make a return is unlawful and this council will not engage in such activity.

Fund Selection

5.5 The selection of collective investment schemes or pooled funds will be determined following a selection process that will include evaluation of certain criteria including the size, duration, credit worthiness of the underlying investments, income distribution levels, past performance, management fees and risk and reward profiles.

5.6 The council will seek to ensure that any fund managers used have their own responsible investment policies or have signed up to widely recognised policies such as the United Nations Principles for Responsible Investment.

5.7 Any selection of funds or fund managers by the council would be made with the assistance of its treasury management advisors Arlingclose Ltd and KPMG Investment Advisory.

Counterparty Selection

5.8 For in-house specified investments the council has determined that the minimum allowable credit rating for investments that are not with the UK Government or a UK local authority will be a long term rating of : A- (Fitch); A3 (Moody's); A- (Standard & Poor's).

5.9 The council will seek to ensure that counterparties (excluding the UK Government and other UK Local Authorities) have 'Responsible Investment Policies or Environmental, Social and Governance (ESG) policies' in place prior to investing.

5.10 The lowest available counterparty credit rating will be used to determine credit quality, unless an investment specific rating is available.

5.11 In the event that the credit rating of the council's contracted provider of banking services or any of its current overnight call accounts falls below the council's minimum credit rating criteria the bank will continue to be used for business continuity and short term liquidity requirements (overnight and weekend) and the council will ensure that balances are kept at the minimum amount practicable.

5.12 Currently, the council's banking services are provided by HSBC Bank Plc.

5.13 For long term investments with other UK local authorities the council will consider their financial strength by assessment of their financial statements and other external indicators where available.

5.14 For externally managed investments minimum credit ratings shall be determined by the fund managers as part of their own investment policy and this policy will be considered fully by the council as part of the fund selection process prior to investment in any fund.

5.15 The council understands that credit ratings are not perfect predictors of investment default. Full regard will therefore be given to other available information on credit quality including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press.

5.16 All credit ratings and other factors detailed above are monitored in-house and by Arlingclose Ltd (the council's treasury advisors) and the council is alerted to any changes.

5.17 The council will consider the use of counterparties outside of the United Kingdom where the country of origin has a sovereign rating of not lower than AA+ or equivalent. The council may also have exposure to non-UK investments indirectly through the use of money market funds and collective investment funds.

Investment Balances / Liquidity of Investments

5.18 Based on cash flow forecasts, the council anticipates its fund balance at the end of 2018/19 will be £108 million. Of this, £10 million is required for cash flow requirements. This would leave £98 million available for short and long term investment.

5.19 Giving due consideration to the council's level of balances over the next three years, the need for liquidity and its spending commitments, the council has determined that £98 million of its overall fund balances could be prudently committed to investments beyond 364 days.

5.20 Where investments are made in longer term instruments, the council will have regard to liquidity by using funds with appropriate withdrawal policies or by spreading fixed term investments over future years ensuring that significant amounts mature each year.

Allowable Investment Types for 2018/19

5.21 In deciding which types of investment to use the council has regard to its treasury management advisors. This year's strategy has been produced following consultation with the council's advisors, Arlingclose Ltd and KPMG Investment Advisory, and with assessment of the risks and returns of the different instruments used.

5.22 The investment types that this council will allow to be used for new investment in 2018/19 are as follows and are categorised under the headings of specified and non-specified in accordance with the government's statutory guidance:

<u>Specified Investment Instruments (maximum period 1 year)</u>

- Bank overnight call account deposits
- Reverse repurchase agreements with banks and building societies (subject to minimum quality of collateral)
- Loans to UK local authorities
- UK treasury stock (Gilts)
- Treasury Bills
- Money Market Funds
- Debt Management Agency Deposit Facility

<u>Non-specified Investment Instruments</u>

- Bank overnight call account deposits
- Reverse repurchase agreements with banks and building societies up to 3 years (subject to minimum quality of collateral)
- Loans to UK local authorities up to 5 years
- Bonds issued by UK local authorities up to 10 years
- UK treasury stock (Gilts) up to 10 years
- Supranational bonds up to 10 years
- Collective investment schemes (unitised pooled funds)*

*Includes Diversified Credit Funds, Absolute Return Bond Funds, Property Funds and Short Term Cash Funds

5.23 For Non-specified Investments there is a specific requirement to consider all of the associated risks before using them. The risks are set out in Annex A.

5.24 All investments will be denominated in pounds sterling.

5.25 For Specified Investments the Authority defines “high credit quality” organisations and securities as:

- UK Government
- UK Local Authorities
- AAA rated Supra-national bonds
- Constant Net Asset Value (CNAV) or Low Volatility Net Asset Value (LVNAV) Money Market Funds
- Banks and building societies with a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher.

5.26 The code requires the council to state its position regarding the use of derivative investments. The council does not intend to use standalone financial derivatives directly. However, the use of derivatives by fund managers or collective investment schemes (pooled funds) is permitted.

5.27 The council will allow all previously purchased investments which are held as a result of investment decisions made under an earlier year’s approved strategy to be held during 2018/19.

5.28 For each type of investment that might be used during 2018/19 the maximum amounts allowed (actual amount or percentage of the overall portfolio) are shown in Table 3.

Table 3 - Limits for Types of Investment

Type of Investment	**Counter-party Limit 2018/19**	**Maximum Limit £'s/ % age of Portfolio**
Government Gilts	None	91%
Treasury Bills	None	91%
H M Treasury (DMADF)	None	100%
Supranational Bonds	£20m	£50m
Local Authority Loans/Bonds	£5m	£50m
Money Market Funds	£5m	£25m
Short Term Cash Funds	£5m	£25m
Collective Investment Funds [1]	£25m	£80m
Bank and Building Society Repurchase Agreements[2]	£10m	£25m
Bank Overnight Call Accounts[2]	£5m	£15m

[1]Counterparty limit is per fund. Collective Investment Funds include Diversified Credit Funds, Absolute Return Funds and Property Funds.
[2]Includes a £20 million limit on each allowable foreign country.

5.29 For bank and building society investments counterparties will be chosen in conjunction with the council’s treasury advisors and will be approved by the Chief Finance Officer. A group of banks under the same ownership will be treated as a single organisation for counterparty limit purposes.

6 Annual Minimum Revenue Provision Statement for 2018/19

6.1 The council's underlying need to borrow for capital purposes is measured by reference to its Capital Financing Requirement. This council's Capital Financing Requirement is currently zero.

6.2 Councils with borrowing requirements are required to make provision within their revenue budgets for the redemption of their debts. This provision is called the Minimum Revenue Provision (MRP).

6.3 The council expects that its Capital Financing Requirement will be nil at 31 March 2018 and in line with government guidance it will therefore charge no MRP in 2018/19.

6.4 For future years, the prudential indicators for capital expenditure (see Table 4) indicate that the council may have a Capital Financing Requirement of £10 million at the end of 2018/19 that would require a Minimum Revenue Provision to be made in 2019/20 and beyond.

6.5 This requirement is due to potential investments in the council's Invest to Grow Fund which are likely to take the form of loans to developers.

6.6 For capital expenditure loans to third parties that are repaid over the short to medium term (up to 5 years) the council will probably not make an MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead, subject to interpretation of new MRP guidance issued on 2nd February 2018.

7 Borrowing Requirement and Strategy for 2018/19

7.1 The council has no plans or intentions to carry out any long term external borrowing during 2018/19.

7.2 The council has however taken steps to secure preferential borrowing rates (called the preferred certainty rate) from the PWLB in case the borrowing position changes.

7.3 Although the council is a major investor it is occasionally necessary to borrow on a short term basis for cash flow reasons. All borrowing during 2018/19 will be temporary (i.e. for less than 365 days).

8 Prudential Indicators

8.1 Part 1 of the Local Government Act 2003 established a duty for the council to determine and keep under review how much money the council can afford to borrow for capital expenditure. This, together with the relevant regulations, introduced the new prudential capital finance system which replaced the previous capital control system from April 2004.

8.2 The key feature of the system is that local authorities are free to determine their own levels of affordable borrowing (subject exceptionally to any national limits imposed) in support of their capital expenditure plans.

8.3 The prudential capital finance regulations specify that local authorities must have regard to the "Prudential Code for Capital Finance in Local Authorities" issued by CIPFA when setting and reviewing their affordable borrowing limit.

8.4 The objectives of the CIPFA Prudential Code are to ensure that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice.

8.5 The recommended prudential indicators for 2017/18 to 2020/21 are categorised by type of indicator and are as follows:

Capital Expenditure Indicators (see Table 4)

8.6 The total capital expenditure indicator is taken from the proposed capital programme detailed in the budget report plus any treasury management investments which are deemed to count as capital expenditure under the prudential code.

Table 4 – Capital Expenditure Indicators

	Revised 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000
Total Capital Expenditure	**34,050**	**82,446**	**31,127**	**15,870**
Financing:				
Capital Receipts	26,785	55,936	11,132	4,122
Grants and Contributions	4,478	11,837	5,727	3,008
Revenue Contributions	2,787	4,673	4,268	3,740
	34,050	**72,446**	**21,127**	**10,870**
Capital Financing Requirement	**0**	**-10,000**	**-10,000**	**-5,000**

8.7 The capital financing requirement indicator is a measure of the council's underlying need to borrow for a capital purpose taken from the balance sheet. This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits. The council is currently debt free and this indicator for 2017/18 is therefore nil. The proposed future capital programme will be financed without borrowing, however the planned Capital Investments (which relate to the Invest to Grow Strategy) are not being financed from existing resources because they are likely to take the form of repayable loans. Any unfinanced capital expenditure is deemed to be "borrowing" even if the council does not need to externally borrow.

Affordability Indicators (see Table 5)

8.8 The key indicator of affordability for the council to consider in setting the capital programme is the impact on the council tax that will result. This council has been debt free since April 1995 and the capital expenditure and financing proposals detailed in the budget report are based on the continuation of this policy (i.e. no external long term debt). The proposed capital programme is therefore fully financed from revenue contributions, revenue and capital reserves, external contributions and short term internal borrowing with no future requirement for external borrowing.

Table 5 – Affordability Indicators

	Revised 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000
Additions to Capital Programme	- 18,113	60,834	10,925	6,719
Incremental Impact of New Capital Investment Decisions on the Council Tax	-£4.86	£17.09	£2.87	£1.34
Ratio of Financing Costs to Net Revenue Stream	-20%	-15%	-10%	-8%

8.9 The estimate of the incremental impact of the new capital investment decisions on the council tax indicator shows the revenue impact of the new schemes added to the proposed capital programme. The impact is measured on a band D council tax payer. For this council it currently represents the loss of investment income by spending available resources rather than the costs of any borrowing.

8.10 The ratio of financing costs to net revenue stream indicator is used to show the change over time in the level of debt financing costs (net of investment income) compared to the council's net income from council tax payers and government grant. For this council the ratio is negative as investment income significantly exceeds the financing costs associated with temporary cash flow borrowing. It does however indicate that at least 20% of the council's net operating expenditure is supported by investment income.

External Debt Indicators (see Table 6)

8.11 The external debt indicators relate to the amount that the council can prudently borrow.

<u>Table 6 – External Debt Indicators</u>

	Revised 2017/18	Estimate 2018/19	Estimate 2019/20	Estimate 2020/21
Authorised Limit for External Debt	£50m	£50m	£50m	£50m
Operational Boundary for External Debt	£25m	£25m	£25m	£25m

8.12 Under section 3(1) of the Local Government Act 2003 the council is required to set an authorised limit for external debt. This limit is a statutory limit and is gross of investments. For this council it represents the maximum limit for external temporary borrowing for cash flow and treasury management purposes and for any possible finance lease “borrowing”. The limit is based on a prudent but not worse case estimate with sufficient headroom to allow for operational management.

8.13 To support day to day treasury management activity it is recommended that Council approve an authorised borrowing limit of £50 million for 2018/19. This is to enable short term cash flow management and not to provide funding for capital expenditure.

8.14 The operational boundary for external debt is based on the same estimates as the authorised limit for external debt but represents the estimate of normal activity without the additional headroom included in the authorised limit.

8.15 The code of practice specifies that over the medium term net borrowing will only be for a capital purpose. This is demonstrated by ensuring that, except in the short term, net external borrowing should not exceed the total Capital Financing Requirement in the previous year plus the estimates of any additional Capital Financing Requirements for the current and the next two financial years. No medium term external borrowing is proposed and therefore this requirement is met.

8.16 The code of practice requires councils to have an indicator identifying the differences between gross debt and the Capital Financing Requirement (CFR). However, because this council’s gross debt and the CFR are both zero there is no difference to identify.

Treasury Management Indicators (see Table 7)

8.17 These indicators are based on estimates of the council's total resources and estimated cash flow requirements. The council follows best practice and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services. Adopting the code of practice is one of the indicators.

8.18 In addition to the limits set for each type of investment the Prudential Code requires the setting of specific indicators for treasury management. The indicators for 2017/18 to 2020/21 are shown in Table 7.

Table 7 – Treasury Management Indicators

	Revised 2017/18	Estimate 2018/19	Estimate 2019/20	Estimate 2020/21
Upper Limits				
Fixed Rate Exposure - as %age	100%	100%	100%	100%
Variable Rate Exposure - as %age	100%	100%	100%	100%
Principal Sums invested over 364 days	£135m	£98m	£62m	£49m
Maturity of Investments (maximum per year)				
Years 1 to 5	£25m			
Years 6 to 10	£15m			

8.19 The upper limit on fixed rate exposure indicator represents the maximum level (as a percentage) of the council's investments that will be invested in fixed interest instruments. The upper limit on variable rate exposure indicator represents the maximum level of the council's investments that will be invested in variable rate instruments. This has been set to ensure that the council is not exposed to interest rate falls which could adversely impact on the revenue budget. These limits are designed to provide the necessary flexibility within which decisions will be made for new investments; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the investment strategy.

8.20 This means that fixed rate investments will be managed within a range of 0-100% of total investments and variable rate investments will be managed within a range of 0-100%. These indicators allow the council to manage the extent to which it is exposed to changes in interest rates.

8.21 The upper limit on principal sums invested for periods longer than 364 days indicator sets the maximum total value of investments made for periods of 1 year and beyond.

8.22 The upper limits for maturity of investments indicator sets the maximum amount of investments fixed in each year beyond 1 year. This helps to ensure a balanced maturity profile and reduces the risk of being forced to realise an investment before it reaches maturity for cash flow reasons.

Monitoring and Revision of Prudential Indicators

8.23 These prudential indicators will be monitored throughout the year by the Executive Director of Finance and Resources (Section 151 Officer) and will be reported quarterly to the Audit and Accounts Committee and half-yearly to Cabinet and Council. Any revision of the indicators required will be submitted to the Council for approval.

9 Investment Performance Monitoring and Reporting

9.1 Performance of the council's investments will continue to be monitored monthly and will be reported quarterly to the Audit and Accounts Committee. Half year and outturn reports on treasury management activities and performance will also be prepared for the Cabinet and Full Council.

9.2 The council participates in quarterly portfolio benchmarking provided by its treasury advisors Arlingclose. This benchmarking includes measures of the level of risk taken and the corresponding returns. Results of the benchmarking exercise are included in all of the reports detailed above.

10 Training

10.1 The Treasury Management Code of Practice requires the Chief Financial Officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the function, have access to appropriate training relevant to their needs and understand fully their roles and responsibilities.

10.2 Treasury workshops are provided for members of the Audit and Accounts Committee and are open to all members of the council. The workshops are delivered by a combination of external training providers, council officers and the council's treasury advisors.

10.3 Officers responsible for treasury management attend external workshops and seminars as part of their continued professional development.

11 Use of Investment Consultants/Treasury Advisors

11.1 The council has contracted Arlingclose Ltd. as treasury advisors. Under the contract Arlingclose provide the following services:

- Advice on counterparty selection and creditworthiness
- Assistance in compliance with codes of practice
- Economic and interest rate forecasts
- Strategy and review meetings
- An annual report on the council's investment strategy and portfolio
- Advice and guidance on treasury management issues
- Benchmarking and performance monitoring
- Seminars and training events

11.2 The council has also contracted KPMG Investment Advisory to provide asset allocation advice and monitoring services for the externally managed collective investment schemes (pooled funds) that are used by the council.

ANNEX A – Risks with Non-Specified Investments

In deciding which type of non-specified investment instruments to use the reasons and associated risks were assessed and are detailed below:

Investment Type	**Why use it?**	**Associated risks?**
Fixed deposits with UK local authorities with maturities greater than 1 year	• High credit quality. • Certainty of rate of return over period invested which aids forward planning. • No movement in capital value of deposit despite changes in interest rate environment.	• Illiquid: cannot be traded or repaid prior to maturity. • Return will not increase if interest rates rise after making the investment. • Returns are lower than comparative investments with banks.
Reverse Repurchase Agreement (Repo)	• Investment is secured with collateral. Quality of collateral can be specified prior to agreement. • Tri-party repos involve an agent who values and manages the collateral during the time of the agreement. • Certainty of rate of return.	• Collateral needs to be monitored to ensure its value remains adequate for security of the loan. • Collateral received in the event of a default could be subject to potentially negative market conditions if not sold immediately.
Gilts (UK sovereign bonds). Custodial arrangement required prior to purchase	• Liquid, unlike fixed deposits. • Most secure asset class. • Fixed return if held to maturity	• 'Market or interest rate risk': Yield subject to movement during life of bond which could negatively impact on price of the bond.
Local Authority Bonds Custodial arrangement required prior to purchase	• Fixed return if held to maturity • High credit quality. • Better return than gilts • Can be sold if liquidity is required	• Scarcity of supply. • 'Market or interest rate risk': Yield subject to movement during life of bond which could negatively impact on price of the bond. • Less liquid than gilts.
Supranational Bonds Custodial arrangement required prior to purchase	• Excellent credit quality. • Relatively liquid (not as liquid as gilts). • Fixed return if held to maturity • Potential for capital gain through appreciation in value if sold before maturity.	• 'Market or interest rate risk': Yield subject to movement during life of bond which could negatively impact on price of the bond i.e. potential for capital loss. • The price of these bonds can be more volatile than gilts.
Short Term Cash Funds Collective Investment Schemes	• High credit quality. • Highly Diversified. • Liquid, unlike fixed deposits. • Likely to provide higher returns than Money Market Funds and short term deposits.	• Potential for capital loss. • Potentially more volatile than Money Market Funds due to longer maturities of assets held.
Overnight Call Accounts with Banks That are not "High Credit Quality"	• Day to day operational cash management. • Higher returns than government deposits	• Potential for capital loss, mitigated by limited overnight exposure.
Diversified Credit Funds Collective Investment Schemes	• Highly diversified portfolio of assets. • Liquid, unlike fixed deposits. • Likely to provide higher returns than traditional fixed income investments. • Can remove interest rate risk to provide positive returns in both rising and falling interest rate environments.	• Potential for capital loss. • Credit risk; exposure to some sub-investment grade assets. • Increased credit risk requires expertise in the management of credit quality. • Potential for volatility over the short term.
Absolute Return Bond Funds Collective Investment Schemes	• Highly diversified portfolio of assets. • Liquid, unlike fixed deposits. • Lower volatility than diversified credit funds • Better return than cash	• Potential for capital loss. • Credit risk; exposure to some sub-investment grade assets. • Increased credit risk requires expertise in the management of credit quality.
Property Funds Collective Investment Schemes	• Highly diversified portfolio of assets. • Stable income generation • Potential for capital growth	• Potential for capital loss. • Infrequent, but potentially large volatility. • Illiquid • High cost of entry/exit