

## Treasury Management Strategy Statement 2019-2020

### 1.0 Introduction

- 1.1 The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice, and to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- 1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act) (included as Appendix 2 of this report), which sets out the Council's policies for managing its investments and in particular for giving priority to the security and liquidity of those investments.
- 1.3 Part of the treasury management operation is to ensure that the Council's cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's approach to risk management, providing adequate liquidity initially before considering investment return.
- 1.4 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.
- 1.5 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General balance.
- 1.6 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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.”

- 1.7 Revised reporting is required for the 2019-2020 reporting cycle due to the revised Codes of Practice and Investment Guidance. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.
- 1.8 The capital strategy will provide the following:
  - a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
  - an overview of how the associated risk is managed.
  - the implications for future financial sustainability
- 1.9 The aim of the capital strategy is to ensure that all elected councillors on Full Council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.
- 1.10 The capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:
  - the corporate governance arrangements for these types of activities
  - any service objectives relating to the investments
  - the expected income, costs and resulting contribution
  - the debt related to the activity and the associated interest costs
  - the payback period (MRP policy)
  - for non-loan type investments, the cost against the current market value
  - the risks associated with each activity.
- 1.11 The recommended strategy for 2019-2020 in respect of the following aspects of the treasury management function is based upon the Director of Finance’s views on interest rates, supplemented with leading market forecasts provided by the Council’s treasury adviser, Link Asset Services.

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- Prudential and Treasury Indicators
- the current treasury position
- the borrowing requirement
- prospects for interest rates
- the borrowing strategy
- policy on borrowing in advance of need
- debt rescheduling

- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the Minimum Revenue Provision (MRP) strategy

### **1.12 Balanced budget requirement**

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority, when calculating its budget requirement for the forthcoming financial year, to include the revenue costs that result from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in interest charges, MRP and other costs associated with borrowing to finance capital expenditure, as well as any increases in running costs from new capital projects, are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

### **1.13 Training**

The CIPFA Code requires the Director of Finance to ensure that councillors with responsibility for treasury management receive adequate training in treasury management. The training needs of councillors and treasury management employees are periodically reviewed to ensure that they have the appropriate level of knowledge for their roles in respect of treasury management.

### **1.14 Treasury management consultants**

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

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

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties and property funds. The commercial type investments require specialist advisers, and the Council uses Knight Frank and CBRE Global Investments in relation to this activity.

## 2.0 Treasury limits for 2019-2020 to 2021-2022

- 2.1 It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.
- 2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council tax and Council housing rent levels is ‘acceptable’.
- 2.3 Whilst termed an “Affordable Borrowing Limit”, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of financing such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit can be found in Appendix 3 of this report.
- 2.4 The revised Treasury Management Code of Practice has removed the interest rate exposure indicator from a formal indicator to a narrative in the Treasury Management Strategy. The Council will continue to manage and monitor its interest rate exposure against the limits set previously:

|                               |      |
|-------------------------------|------|
| Upper limit for fixed rate    | 100% |
| Upper limit for variable rate | 20%  |

## 3.0 Current portfolio position

- 3.1 The Council’s forecast treasury portfolio position at 31 March 2019 is shown below:

|   | Forecast<br>£000 | Average Rate<br>% |
|---|------------------|-------------------|
| <b>External Debt</b>                            |                  |                   |
| Fixed rate borrowing - PWLB / Local Authorities | 687,043          | 3.6456            |
| Fixed rate borrowing - Market                   | 55,800           | 4.4700            |
| Variable rate borrowing - Market                | 48,000           | 4.2823            |
| <b>Total Gross Borrowing</b>                    | <b>790,843</b>   | <b>3.7520</b>     |
| Other Long Term Liabilities                     | 90,671           | -                 |
| <b>Total External Debt</b>                      | <b>881,514</b>   | <b>-</b>          |
| <b>Total Investments *</b>                      | <b>5,000</b>     | <b>0.6152</b>     |

\*It is the policy to use cash balances to fund capital expenditure to avoid the need for borrowing, therefore, the level of cash investments is forecast to be minimal.

## 4.0 Borrowing requirement

4.1 The Council's forecast borrowing requirement is summarised below. The table shows the forecast external debt against the underlying capital borrowing need (the Capital Financing Requirement), highlighting any over or under borrowing:

| External Debt  | 2018-2019        | 2019-2020        | 2020-2021        | 2021-2022        |
|--|------------------|------------------|------------------|------------------|
|  | Forecast<br>£000 | Forecast<br>£000 | Forecast<br>£000 | Forecast<br>£000 |
| Borrowing at 1 April   | 672,947          | 790,843          | 951,677          | 1,018,866        |
| Expected change in borrowing   | 117,896          | 160,834          | 67,189           | 23,747           |
| Other long term liabilities at 1 April                                     | 94,492           | 90,670           | 86,545           | 82,267           |
| Expected change in other long term liabilities                             | (3,822)          | (4,125)          | (4,278)          | (2,611)          |
| Actual debt at 31 March *  | 881,513          | 1,038,222        | 1,101,133        | 1,122,269        |
| Capital Financing Requirement  | 908,914          | 1,038,622        | 1,101,534        | 1,122,669        |
| Under / (over) borrowing   | 27,401           | 400              | 401              | 400              |
| <b>External debt for commercial activities / non-financial investments</b> |                  |                  |                  |                  |
| Actual debt at 31 March  | 27,805           | 44,805           | 62,155           | 62,155           |
| Percentage of total external debt *  | 3%               | 4%               | 6%               | 6%               |

## 5.0 Prospects for interest rates

5.1 The Council has appointed Link Asset Services as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. A more detailed interest rate view can be found in Appendix 2. The following gives Link's central view.

### Link Bank Rate forecast for financial year ends (March)

- 2018-2019 0.75%
- 2019-2020 1.25%
- 2020-2021 1.50%
- 2021-2022 2.00%

5.2 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is

forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

- 5.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.
- 5.4 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 5.5 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.
- 5.6 Investment and borrowing rates:
- Investment returns are likely to remain low during 2019-2020 but to be on a gently rising trend over the next few years.
  - Borrowing interest rates have been volatile so far in 2018-2019 and while they were on a rising trend during the first half of the year, they have back tracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in

the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns) to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

## 6.0 Borrowing strategy

### 6.1 Borrowing rates

The Link forecast for the PWLB new borrowing rate is as follows:

| Link Asset Services Interest Rate View |        |        |        |        |        |        |        |        |        |        |        |        |        |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
|  | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
| Bank Rate View                         | 0.75%  | 1.00%  | 1.00%  | 1.00%  | 1.25%  | 1.25%  | 1.25%  | 1.50%  | 1.50%  | 1.75%  | 1.75%  | 1.75%  | 2.00%  |
| 3 Month LIBID                          | 0.90%  | 1.00%  | 1.10%  | 1.20%  | 1.30%  | 1.40%  | 1.50%  | 1.50%  | 1.60%  | 1.70%  | 1.80%  | 1.90%  | 2.00%  |
| 6 Month LIBID                          | 1.00%  | 1.20%  | 1.30%  | 1.40%  | 1.50%  | 1.60%  | 1.70%  | 1.70%  | 1.80%  | 1.90%  | 2.00%  | 2.10%  | 2.20%  |
| 12 Month LIBID                         | 1.20%  | 1.30%  | 1.40%  | 1.50%  | 1.60%  | 1.70%  | 1.80%  | 1.90%  | 2.00%  | 2.10%  | 2.20%  | 2.30%  | 2.40%  |
| 5yr PWLB Rate                          | 2.10%  | 2.20%  | 2.20%  | 2.30%  | 2.30%  | 2.40%  | 2.50%  | 2.50%  | 2.60%  | 2.60%  | 2.70%  | 2.80%  | 2.80%  |
| 10yr PWLB Rate                         | 2.50%  | 2.60%  | 2.60%  | 2.70%  | 2.80%  | 2.90%  | 2.90%  | 3.00%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.20%  |
| 25yr PWLB Rate                         | 2.90%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.30%  | 3.30%  | 3.40%  | 3.40%  | 3.50%  | 3.50%  | 3.60%  | 3.60%  |
| 50yr PWLB Rate                         | 2.70%  | 2.80%  | 2.90%  | 2.90%  | 3.00%  | 3.10%  | 3.10%  | 3.20%  | 3.20%  | 3.30%  | 3.30%  | 3.40%  | 3.40%  |

**When undertaking any new borrowing the Director of Finance will give consideration to the following to ensure the best deal is obtained for the Council:**

1. Internal / external borrowing.
2. Temporary borrowing (less than 1 year).
3. Variable / fixed rate.
4. Short / long term borrowing.
5. PWLB / market debt.

When considering the above, the balance and spread of debt in the Council's portfolio will be taken into account along with the financial implications for the medium term financial strategy.

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy has been prudent since investment returns have been low and counterparty risk is still an issue that needs to be considered, however the Director of Finance will keep this strategy under review and consider opportunities to secure higher returns on investment where the balance of risk, return, security and liquidity are considered acceptable.

6.2 Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Council employees, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

### 6.3 External versus internal borrowing

The general aim of this treasury management strategy is to maintain cash balances at a reduced level, keeping under review the level of forecast reserves and therefore anticipated cash balances and opportunities for longer term investment, whilst maintaining an appropriate level of risk; therefore keeping to a minimum the credit risk incurred by holding investments. Measures taken over the last few years have already reduced the level of credit risk and the difference between borrowing rates and investment rates has been carefully considered to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

Where investment rates are below long term borrowing rates, the Council can minimise its overall net treasury costs in the short term by continuing to avoid new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing).

However, short term savings by avoiding new long term external borrowing will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be higher.

### 6.4 Policy on borrowing in advance of need

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

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

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need
- ensure the ongoing revenue costs created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use
- consider the impact of borrowing in advance on temporarily increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, having regard to the controls in place to minimise such risks.

## **7.0 Debt rescheduling**

- 7.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which was compounded in 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds in using replacement PWLB refinancing. However, some interest savings might still be achievable through using other market loans, as the source of replacement financing.
- 7.2 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the treasury strategy, and
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.3 Consideration will continue to be given to identifying any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

7.4 All rescheduling will be reported to the Cabinet (Resources) Panel, at the earliest meeting following its action.

## **8.0 Municipal Bond Agency**

8.1 It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Council may make use of this new source of borrowing as and when appropriate.