DECISION

RIBBLE VALLEY BOROUGH COUNCIL
REPORT TO POLICY & FINANCE COMMITTEE

Agenda Item No 7

meeting date: 28 MARCH 2017
title: TREASURY MANAGEMENT STRATEGY
submitted by: DIRECTOR OF RESOURCES
principal author: TRUDY HOLDERNESS

1 PURPOSE

1.1 To seek member approval for the Council's Treasury Management Strategy for the 2017/18 financial year.

2 BACKGROUND

2.1 The Prudential Code plays a key role in Capital Finance in Local Authorities. Its objectives are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable

2.4 It requires authorities to self-regulate the affordability, prudence and sustainability of their capital expenditure and borrowing plans, by setting estimates and limits and by publishing actuals, for a range of prudential indicators. It also requires them to ensure their treasury management practices are in accordance with good practice.

2.5 The importance of treasury management has increased as a result of the freedoms provided by this Prudential Code. It covers the borrowing and investment activities and the effective management of associated risks. Its activities are strictly regulated by statutory requirements and a professional code of practice the 'CIPFA Code of Practice on Treasury Management'.

2.6 Local authority investments were placed under the national spotlight following the collapse of the Icelandic banks, with almost £1bn invested with the affected banks. Both the Audit Commission and the Department for Communities and Local Government (DCLG) Select Committee reviewed local authority investments and reported a number of recommendations. These have been included the 2011 guidance notes.

2.7 Essentially, a local authority in England, Wales or Northern Ireland may borrow or invest for any purpose relevant to its functions, under any enactment, or '*for the prudent management of its financial affairs'* Under the 2003 act a local authority is required to determine and keep under review how much money it can afford to borrow. Local Authorities are not constrained by law in the types of investments they may make or investment instruments they may use. However they are in practice constrained by DCLG guidance which was updated in 2010, which stress the prudent investment strategy of security, liquidity and yield.

2.8 The result of this is the requirement for greater scrutiny by 'those charged with governance', more transparent reporting requirements and greater emphasis on the requirements for ensuring 'those charged with governance' have sufficient skills to adequately perform their role.

3 THE TREASURY MANAGEMENT STRATEGY

3.1 Local authorities are required to report on specific elements of their treasury management activities, these are included in the Treasury Management Strategy or in its Treasury Management Policy or Practices and are determined by:

The Treasury Management Code of Practice recommends that local authorities should as a minimum report:

- Annually on their treasury management strategy and plan, before the start of the year. This committee approves the strategy and is then formally approved by Full Council.
- The position mid-year
- An annual report on the performance, effects of decisions taken and borrowings executed, and circumstances of non-compliance with their polices, after the year-end

The Prudential Code requires local authorities to set and revise prudential indicators and to publish actuals, the key treasury indicators are:

- Authorised limit for external debt

  The authority will set for the forthcoming financial year and the follow two financial years an authorised limit for its total external debt, excluding investments, separately identifying borrowing from other long term liabilities.

  It should be expressed in the following manner:

  Authorised limit for borrowing + authorised limit for other long-term liabilities'

- Operational boundary for external debt

  The authority will set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities.

  It should be expressed in the following manner:

  Operational boundary for borrowing + operational boundary for other long-term liabilities

- Actual external debt

  After the year end, the closing balance for actual gross borrowing plus other long term liabilities will be obtained directly from the authority's balance sheet.

  It should be expressed in the following manner:

  Actual borrowing as at xx/xx/xx + actual other long-term liabilities as at xx/xx/xx

These indicators focus on the position for gross external debt. In the interest of transparency any significant difference between gross and net debt should be clearly placed before councillors as part of their agreement of the annual treasury management Strategy.

In addition the following treasury management indicators are required:

- Upper limits on the proportion of net debt compared to gross debt
- Upper limits on fixed interest and variable interest exposures
- Upper and lower limits to the maturity structure of its borrowing
- Upper limits to the total of principal sums invested longer than 364 days

The 2010 DCLG investment guidance for England and Wales requires authorities to produce an annual investment strategy and policies for managing investments and for giving priority to the security and liquidity of those investments

The requirements of International Financial Reporting Standard's (IFRS's) require local authorities to follow proper accounting practices as specified in the code of practice on Local Authority Accounting and set out the objectives, policies and processes which are in place for managing and controlling risk specifically when entering into derivative contracts with a counterparty in the expectation that the transaction will eliminate or reduce exposure to a particular risk, such as movements in interest rates.

3.2 The Councils' Treasury Management Policies and Practices are included in a separate report elsewhere on the agenda.

3.3 The Councils' Treasury Management Strategy is attached at Annex 1, it covers:

- The current treasury position
- A review of the prospects for interest rates
- The Council's borrowing and debt strategy
- The Council's investment strategy
- Capital programme financing strategy
- Limits on treasury management activities and prudential indicators
- Current debt portfolio position
- Annual investment strategy

3.4 The uncertainty around global activity reinforces this Council's policy of first and foremost securing the safety of principal amounts invested, with rate of return a secondary consideration.

3.5 This is achieved by investing only with high rating institutions, including the Debt Management Office (DMO). Any investments with the DMO are guaranteed by HM Government. Although rates are a little lower than the prevailing market rates, these investments offer the least risk and as such the rate reflects the security of the investment.

4 RECOMMENDED THAT COMMITTEE

4.1 Recommend to Council the Treasury Management Strategy as set out in Annex 1.

SENIOR ACCOUNTANT DIRECTOR OF RESOURCES

PF21-17/TH/AC
16 March 2017

MARCH 2017

RIBBLE VALLEY

BOROUGH COUNCIL

TREASURY MANAGEMENT STRATEGY 2017/18

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Introduction

The Council is required to adopt the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes 2011 edition and it is a requirement under that Code of Practice to produce an annual strategy report on proposed treasury management activities for the year.

The purpose of the Treasury Strategy is to establish the framework for the effective and efficient management of the Council's treasury management activity, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

Key Principles
The key principles of the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes are that:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Setting the Treasury Management Strategy for 2017/18

In setting the Treasury Management Strategy, the Council must have regard for the following factors:

- The current treasury position and debt portfolio position
- The prospects for interest rates
- The approved Capital Programme
- Limits on treasury management activities and prudential indicators

The Current Treasury Position and Debt Portfolio Position

The Public Works Loans Board debt is the largest proportion of the Council's borrowing debt, and is gradually decreasing as payments of the principle are made year by year. It estimated that the outstanding principle on all PWLB loans at 31 March 2017 will be £170k. In addition to the PWLB debt there is a bond which will remain unchanged until it is repaid, this relates to the Sidney Whiteside Charity.

Investments at the end of the 2016/17 financial year are anticipated to be £7.1m based on current cash flow forecasts. These investments relate to monies placed with institutions on our counterparty list.

There was no short term borrowing required at the 31 March 2016, and none is forecast for the 31 March 2017. Only very occasionally has the Council utilised short term borrowing in order to temporarily aid cash flow.

A summary of the Council's treasury position at the end of the previous financial year 2015/16 and that anticipated at the end of 2016/17 is summarised below.

	31 March 2016 Actual £	Actual Average Rate %	31 March 2017 Estimate £	Estimated Average Rate %
Borrowing				
Fixed Rate Debt-PWLB	205,057	5.0	169,664	5.1
Other Debt – Bond	7,500	0.4	7,500	0.2
Total Debt	**212,557**		**177,164**	
Investments				
Short Term Investments	-6,030,000	0.4	-7,100,000	0.2
Total Investments	**-6,030,000**		**-7,100,000**	
Net External Debt	**-5,817,443**		**-6,922,836**	

The Council's current treasury position is not at risk from movements in interest rates as all current PWLB borrowing is on fixed rate. Should the council choose to take any future borrowing on variable rates this would expose the council to a greater risk from any adverse movement in interest rates.

The forecast balance of PWLB debt shown above for the 31 March 2017 will comprise the individual loans as shown in the table below:

Original loan Amount £	Term	Interest Rate	Estimated Principal Outstanding at 31 March 2017 £	Year of Final Repayment
250,000	10 years	4.60% Fixed	12,500	2017/18
250,000	15 years	4.75% Fixed	2,164	2022/23
250,000	25 years	4.88% Fixed	155,000	2032/33
		Total PWLB	**169,664**	

The total debt, comprising both PWLB and the bond, is summarised in the table below, showing the estimated debt maturity assuming no further borrowing is undertaken.

ESTIMATED DEBT MATURITY ANALYSIS AS AT 31 MARCH 2017		
Maturity	**£'000**	**%**
Under 12 Months	23	12.92
12 Months and Within 24 Months	10	5.87
24 Months and Within 5 Years	31	17.60
5 Years and Within 10 Years	50	28.33
10 Years and Above	63	35.28
Total PWLB and Bond	**177**	**100.00**

Prospects for Interest Rates

The Monetary Policy Committee (MPC) of the bank of England takes interest rate decisions. It is the banks' core purpose to maintain the integrity and value of the currency. It pursues this core purpose primarily through the conduct of monetary policy and by setting short term interest rates the bank aims to meet the Government inflation targets.

In order to maintain price stability the government has set the bank's MPC a target for annual inflation rate of the consumer price index (CPI) of 2%. Subject to that, the MPC is also required to support the Government's economic policy including its objectives for growth and employment.

The UK economic activity remained resilient in the second half of 2016. Since late in 2015 there has been an 18% fall in the value of sterling, this is likely to slow growth as households adjust their spending to lower real income growth. The fall in sterling value will raise CPI inflation which is likely to return to around the 2% target by February and then rise above it over the following months. The projected path for inflation over the next three years in large reflects the impact of higher import prices following sterling depreciation.

The projection for CPI (shown in the table below) is slightly lower than three months ago following sterling's recent appreciation. The risks around inflation are balanced, with substantial risks on both the outlook for wage growth and domestic inflation.

Projections for Inflation		
	Nov'16	Feb'17
	%	%
2016 Q4	1.26	
2017 Q1	1.87	2.05
2017 Q2	2.44	2.46
2017 Q3	2.66	2.62
2017 Q4	2..83	2.76
2018 Q1	2.90	2.82
2018 Q2	2.90	2.86
2018 Q3	2.81	2.79
2018 Q4	2.71	2.74
2019 Q1	2.67	2.70
2019 Q2	2.62	2.66
2019 Q3	2.57	2.62
2019 Q4	2.52	2.57
2019 Q1		2.53

The projections for CPI inflation are based on the current bank base rate of 0.25%, and the assumption that the total stock of asset purchases financed by the creation of central bank reserves remains at £435 billion throughout the forecast period.

As households adjust their spending to the lower real income, domestic demand growth is likely to slow over 2017. This slowdown comes a little later than previously assumed. However, fiscal stimulus from the Government's autumn statement and the outlook for global growth being stronger, with credit conditions and equity prices being more supportive, the growth outlook is stronger than thought in November. The projections for growth are based on Bank Rate following a path implied by market interest rates which are higher than previously projected. The implication of this is that bank rates will rise to just under ¾ % by early 2020, around 30 basis points (0.30%) higher than the November MPC report.

	Bank Rates %	
	November 2016	February 2017
2017 Q1	0.2	0.2
2017 Q2	0.2	0.2
2017 Q3	0.2	0.3
2017 Q4	0.2	0.3
2018 Q1	0.2	0.3
2018 Q2	0.2	0.4

	Bank Rates %	
	November 2016	**February 2017**
2018 Q3	0.3	0.4
2018 Q4	0.3	0.4
2019 Q1	0.3	0.5
2019 Q2	0.3	0.5
2019 Q3	0.4	0.6
2019 Q4	0.4	0.6
2020 Q1		0.7

Historically, local authorities have satisfied the bulk of their borrowing needs from the Public Works Loan Board (PWLB). The October 2010 comprehensive spending review increased the PWLB rate to 100 basis points (1%) above the gilt yield. In the Chancellor's Budget in March 2012 councils that provide ' improved information and transparency' on 'borrowing and associated capital spending plans' would be eligible for a certainty rate discount of 20 basis points below the standard rate.

Ribble Valley Borough Council are currently listed as an eligible Council until 31 October 2017, by which time a further return will have to be made and a new eligibility list published for the following 12 months.

PWLB rates show a similar pattern in the near term to bank rates.

	Fixed Rate %	Certainty Rate %
1 –2 years	1.02	0.82
5 - 6 Years	1.22	1.02
20 – 25 Years	2.52	2.32

Projection is therefore that interest rates will rise to only a little under 1% by late 2019.

The Approved Capital Programme

The Council has approved a capital programme for the period 2017/18 to 2021/22. The first 3 Years of this programme is considered as part of this strategy, in line with prudential indicators.

The use of borrowing to support the capital programme has increased kept to an average of £418,337 in the financial years 2017/18 to 2019/20.

A summary of the approved capital programme and its financing are provided in the table below

	2017/18 £	**2018/19** £	**2019/20** £
Disabled Facilities Grants - DCLG	-161,000	-161,000	161,000
VAT Shelter Earmarked Reserve	-234,000	-69,500	-127,880
New Homes Bonus Earmarked Reserve	-242,000	-209,000	-313,600
Borrowing	-250,010	0	-1,230,000
Other Earmarked Reserve	-241,300	-466,500	-96,020
Usable Capital Receipts	0	0	-89,080
Potential External Funding for Castle Keep Repointing	0	0	-222,240
Estimated Total Available Resources	***-1,128,310***	***-906,000***	***-1,917,820***
Less Total of Approved Capital Programme	1,128,310	906,000	1,917,820
Estimated Resources to Carry Forward	***0***	***0***	***0***

Limits on Treasury Management Activities and Prudential Indicators

The Local Government Act 2003 required the Council to have regard to the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

A key indicator of prudence is to ensure that over the medium term net debt will only be for a capital purpose and that net debt does not, except in the short term, exceed the total capital financing requirement in the preceding year plus the estimates of any additional capital financing requirements for the current and the next two financial years.

The council has agreed a capital programme for the period 2017/18 to 2021/22 financial years. The first three years of which are considered here in line with prudential indicators. The prudential indicators are prepared based on the approved capital programme. The capital financing requirement for the authority for the current and future years is:

Capital Financing Requirement				
31/03/16 Actual £'000	31/03/17 Revised Estimate £'000	31/03/18 Estimate £'000	31/03/19 Estimate £'000	31/03/20 Estimate £'000
3,710	3,580	3,698	3,564	4,664

The authorised limit for our total external debt, gross of investments for the next three financial years is detailed in the table below.

Authorised Limit for External Debt			
	2017/18 £'000	2018/19 £'000	2019/20 £'000
Borrowing	29,031	29,154	30,347
Other Long-Term Liabilities	0	0	0
Total	**29,031**	**29,154**	**30,347**

These limits have been estimated taking into account the Council's current commitments, existing plans and proposals for capital expenditure and financing with sufficient headroom to allow for operational management, for example unusual cash movements. This limit factors in the worst-case scenario implications around this council being the lead authority of the Lancashire business Rates Pool. It reflects the level of borrowing, which while not desired, could be afforded but may not be sustainable. Any breach must be reported to council, indicating the reasons for the breach and the corrective action undertaken or required to be taken.

In addition to the authorised limits for external debt an operational boundary for external debt was approved as part of the annual budget. The proposed operational boundary is based on the same estimates as the authorised limits but without the additional headroom. Unlike the Authorised Limit, the council's role as the lead authority of the Lancashire Business Rates Pool does not impact on the setting of the Operational Boundary. The operational boundary for our external debt for the next three years is shown in the table below.

Operational Boundary for External Debt			
	2017/18 £'000	2018/19 £'000	2019/20 £'000
Borrowing	6,976	6,980	7,997
Other Long Term Liabilities	0	0	0
Total	**6,976**	**6,980**	**7,997**

The aim of the prudential indicators is to contain the activity of the treasury function within certain limits thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decisions that could impact negatively on the Council's overall financial position.

There are four further indicators that are considered here.

- Upper limits on variable rate exposure. This indicator identifies a maximum limit for variable interest rates based upon the debt provision net of investments.
- Upper limits on fixed rate exposure. Similar to the previous indicators, this covers a maximum limit on fixed interest rates
- Total principal funds invested (excluding shareholdings in the Local Government Bonds Agency) for a period longer than 364 days. These limits are set to reduce the need for early sale of an investment and are based on the availability of investments after each year-end.
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing.

LIMITS ON INTEREST RATE EXPOSURE			
	2017/18 £'000	2018/19 £'000	2019/20 £'000
Maximum Principal Sums Borrowed >364 days	6,976	6,980	7,997
Limits on fixed interest rates	100%	100%	100%
Limits on variable interest rates	20%	20%	20%
Maximum Principal Sums Invested >364 days (excluding shareholdings in Local Government Bond Agency)	0	0	0

MATURITY STRUCTURE OF BORROWING		
	Upper Limit %	**Lower Limit %**
Under 12 Months	20	0
12 Months and Within 24 Months	20	0
24 Months and Within 5 Years	40	0
5 Years and Within 10 Years	30	0
10 Years and Above	90	0

NB. No change proposed

Borrowing and Debt Strategy 2017/18 – 2019/20

The introduction of the Prudential Code and uncertainty over future interest rates increases the risks associated with the treasury strategy should the council need to increase its use of short term borrowing or make further longer term borrowing on a variable rate. As a result the Council needs to take a cautious approach to its treasury strategy.

Long term fixed interest rates and base rates are both expected to remain very volatile in the short term and difficult to predict. Taking into account the interest rates shown in the table above, the most appropriate form of borrowing will be undertaken.

We intend to continue the current policy of meeting our long term borrowing requirements from the Public Works Loan Board.

The October 2010 comprehensive spending review increased the PWLB rate to 100 basis points (1%) above the gilt yield. In the Chancellor's Budget in March 2012 councils that provide ' improved information and transparency' on 'borrowing and associated capital spending plans' would be eligible for a certainty rate discount of 20 basis points below the standard rate.

Ribble Valley Borough Council are currently listed as an eligible Council until 31 October 2017, by which time we intend to submit a further return to continue as an eligible body.

We will engage in short-term borrowing from the money market if necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. Wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable.

Investment Strategy 2017/18 – 2019/20

Expectations on shorter-term interest rates, on which investment decisions are based, show likelihood that rates will remain at their current low levels, but again may change sharply as government act to deal with the economy changes. The most appropriate form of investments will be undertaken depending on the prevailing interest rates at the time, taking into account any associated rate risks.

All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations. The council's investment priorities are the security of capital and the liquidity of its investments

Annual Investment Strategy

Strategy Guidelines

The main principle governing the Council's investment criteria is the security and liquidity of its investments before yield, although the yield or return on the investment will be a consideration, subject to adequate security and liquidity. The Council must ensure:

- It has sufficient liquidity in its movements. For this purpose we will maximise the use of the council's online HSBC facility to place money either overnight or on a short-term basis.
- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counter parties with adequate security, and monitoring of their security.

A counter party list is maintained in compliance with this criteria and it will be revised and submitted to Council for approval as necessary. In accordance with new legislation, the proposed criteria detailed above are shown in the following subsections.

Liquidity of Investments

The Council expects to maintain average investment balances of ~~£5.3m~~ £6.9m. The Council will continue to invest these in accordance with the Council's investment polices' and prevailing legislations and regulations.

Specified Investments

These investments are sterling investments of not more than one-year maturity. These are low risk assets and the possibility of loss of principal or investment income is very low. The investments are defined as:

- The UK Government (such as the Debt Management Office, UK Treasury Bills or gilts with less than one year to maturity).
- A local authority, parish council or community council.
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society). These bodies will have a minimum rating as set out in our counter party criteria and as listed in our Treasury Management Policy.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested with these bodies. This criterion is also specified within the approved counter party criteria.

Non-Specified Investments

Non-specified investments include any other type of investments, i.e. not defined as specified above. These are sterling investments with:

- Securities admitted to the Officials List of the Stock Exchange that is guaranteed by the UK Government (such as supranational bonds).
- Gilt edged securities with a maturity of greater than one year.
- Institutions not meeting the basic security requirements under the specified investments.
- A body that has been awarded a high credit rating by a credit rating agency (such as a bank or building society) for deposits with a maturity of greater than one year.
- Shareholding in the Local Government Bonds Agency.

At the present time the Council has no immediate plans to invest in non-specific investments other than a maximum share in the Local Government Bonds Agency of £10k.

Policy on the Use of Financial Derivatives

Many local authorities have previously made use of financial derivatives embedded in loans and investments both to reduce interest rate risk (i.e. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk. However, previous legislation was understood to prevent the use of such tools where they were not embedded in other instruments.

The Localism Act 2011 includes a general power of competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives. The latest CIPFA Code requires local authorities to clearly detail their policy on the use of derivatives in their annual strategy.

The Council has not and does not plan to use derivatives.

The Monitoring of Investment Counter parties

The credit rating of counter parties is monitored monthly. Any counter party failing to meet the criteria will be removed from the list immediately and, if required, new counter parties, which meet the criteria, will be added to the list.

Fitch credit ratings are monitored and are used as an indication of the probability of organisations defaulting on our investments. Whilst they only show an indication of the current credit position, they are being monitored on a regular basis and any significant changes will be reported to Policy and Finance Committee.

The banks and building societies the Council use are reviewed annually as part of the Treasury Management policies and practices to take into account their Fitch IBCA long-term and short-term credit rating. The Council has a policy to only use institutions with a short term Fitch rating of F2 or above.

In addition to the building societies and banks we use for investments, also approved for use is the United Kingdom Debt Management Office, where the Government guarantees investments.

Use of External Fund Managers

It is the Council's policy not to use an external fund manager.