APPENDIX B

Treasury Management Statement and Annual Investment Strategy 2017/18

1.1 Background

The Authority is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. A key part of the treasury management operation is to ensure that this 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 Authority's low risk policy, providing adequate liquidity before considering investment return.

The second main function of the treasury management service is the funding of the Authority's (Investment) plans. These capital plans provide a guide to the borrowing needs of the Authority, essentially the longer term cash flow planning to ensure that the Authority 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.

Treasury Management is defined by the Chartered Institute of Public Finance and Accountancy (CIPFA) as:

"The management of the local authority's investments and cash flows, its banking, money market and capital transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

1.2 Reporting Arrangements

In line with best practice, the Treasury Strategy is considered as part of the budget approval process. This includes the approval of the Prudential and Treasury Indicators.

There are two other main reports each year, which incorporate a variety of policies, estimates and actuals which are approved by Cabinet. These reports are:

- **A Mid - Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and indicate whether the Authority is meeting the strategy or whether any policies require revision; and

- **An Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.3 Treasury Management Strategy for 2017/18

The proposed strategy for 2017/18 in respect of the following aspects of the treasury management function is based upon the treasury management officers' view on interest rates, supplemented with market forecasts provided by the Authority's treasury advisor, Capita Asset Services. This strategy covers:

- The current treasury portfolio position;
- Prospects for interest rates;
- Economic Outlook;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness; and,
- Policy for the use of external service providers.

These elements, along with the treasury indicator which limit the treasury risk and activities of the Council (detailed in Appendix E), cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Communities and Local Government (CLG) Minimum Revenue provision (MRP) Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Current Treasury Portfolio Position

The Authority's debt and investment position at 19 December 2016 is set down in Table 1 below.

Table 1: Current Treasury Portfolio Position as at 19 December 2016

	Principal Outstanding	Average Rate
	£m	%
Fixed Rate Funding		
PWLB*	183.850	4.98
PWLB – (HRA Self Financing)	128.193	3.49
Market Loans	20.000	4.35
Temp Loans	69.857	0.60
Total External Debt	**401.900**	
Less **Investments**		
(UK) DMO**	12.600	0.25
Total Investments	**12.600**	
Net Position	**389.300**	

***Public Works Loan Board**
****Debt Management Office**

1.5 Prospects for Interest Rates

The Authority has appointed Capita Asset Services as its external treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. Table 2 below sets out Capita Asset Services' professional view of interest rates.

Table 2: Capita Asset Services forecast interest rates – (30 November 2016)

	Bank Rate %	5 year PWLB %	10 year PWLB %	25 year PWLB %	50 year PWLB %
Dec 2016	0.25	1.60	2.30	2.90	2.70
Mar 2017	0.25	1.60	2.30	2.90	2.70
Jun 2017	0.25	1.60	2.30	2.90	2.70
Sep 2017	0.25	1.60	2.30	2.90	2.70
Dec 2017	0.25	1.60	2.30	3.00	2.80
Mar 2018	0.25	1.70	2.30	3.00	2.80
Jun 2018	0.25	1.70	2.40	3.00	2.80
Sep 2018	0.25	1.70	2.40	3.10	2.90
Dec 2018	0.25	1.80	2.40	3.10	2.90
Mar 2019	0.25	1.80	2.50	3.20	3.00

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August 2016 in order to counteract what it was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut bank rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half of 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant fall in economic growth.

1.6 Economic Outlook

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically low levels after the referendum and then further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen due to a rise in

concerns around Brexit, the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any borrowing undertaken that results in an increase in investments and will incur a revenue loss between borrowing costs and investment returns.

1.7 Borrowing Strategy

The Authority's capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

The Authority's borrowing strategy will give consideration to new borrowing in the following order of priority:

- The cheapest borrowing and lowest risk approach is internal borrowing. By continuing to maintain a relatively low level of cash balances the risk of investment is reduced. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years;

- Temporary borrowing from the money markets or other local authorities;

- Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintain an appropriate balance between PWLB and market debt in the debt portfolio;

- PWLB borrowing for periods under 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt; and

- PWLB borrowing for periods of longer than 10 years may be explored.

Municipal Bond Agency – It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the PWLB. This Authority intends to explore the options of this new source of borrowing as and when appropriate.

In addition to the above mentioned Municipal Bond Agency source of borrowing, the Authority will look to explore the general use of Bonds as part of the Treasury Management Strategy, in consultation with the Authority's treasury advisor, Capita Asset Services.

The principal risks that impact on the strategy are the security of the Authority's investments and the potential for sharp changes to long and short term interest rates. Officers, in conjunction with the Authority's treasury advisor, will continue to monitor the financial standing of banks and building societies, and the level of interest rates, both those prevailing and forecast.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Head of Finance will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to Cabinet or full Council, as appropriate, at the next available opportunity. Such circumstances include a situation where:

- If it were felt that there was a significant risk of a sharp fall in long and short term interest rates, perhaps due to 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 funding will be considered; or

- If it were felt there was a significant risk of a sharp rise in long and short term rates than that currently forecast in the United Kingdom (UK), an increase in world economic activity or a sudden increase in inflation risks. If this is the case, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

1.8 Policy on borrowing in advance of need

The Authority 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 forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Authority can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

1.9 Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term 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). Any position taken via rescheduling will be in accordance with the strategy position outlined above.

In order to generate the most attractive debt rescheduling opportunities, it is proposed that the strategy for 2017/18 should remain flexible. The reason for any rescheduling to take place may include:

- the generation of cash savings and / or discounted cash flow savings at minimum risk;

- to help fulfil the strategy outlined above; and

- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

All rescheduling will be reported to Cabinet as part of the next financial management report at the meeting following its action.

1.10 Annual Investment Strategy

This Authority has regard to the Communities and Local Government's (CLG's) Guidance on Local Government Investments and the 2011 revised Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Authority's investment priorities are:

a) the security of capital;
b) the liquidity of its investments; and,
c) return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Authority applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentrated risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Treasury officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis in relation to the economic environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Authority will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources will include the financial press, share prices and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The intention of the strategy is to provide security of investments and minimisation of risk. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

Bank Rate is forecast to remain unchanged at 0.25% before starting to rise from quarter 2 of 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

Table 3: Bank Rate Forecast for Financial Year Ends

Year End (March)	Bank Rate Forecast (%)
2017/18	0.25
2018/19	0.25
2019/20	0.50

There is a downside risk to these forecasts (i.e. the start of increases in the Bank Rate occurs later) in view of the uncertainty over the final terms of Brexit. However, should the pace of growth quicken or forecasts for increases in inflation rise, there could be an upside risk.

The strategy for 2016/17 agreed on 18 February 2016 was set against a background of uncertainty and a prudent approach was taken with nearly all investments being made on a short term basis. In the current economic climate it is essential that a prudent approach is maintained. This will primarily be achieved through investing with selected banks and funds which meet the Authority's credit rating criteria, set out in Appendix D.

The Authority will avoid locking into longer term deals while investment rates are down at low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the full Council.

It is also important to recognise that movements within the money markets can happen with no notice and the Head of Finance may have to amend this strategy in order to safeguard the funds of the Authority. Any such actions will be reported to Cabinet as part of the next financial management report at the meeting following this action.

The Head of Finance will undertake the most appropriate form and duration of investments depending on the prevailing interest rate at the time, taking into account the risks shown in the interest rate forecast.

All investments will be made in accordance with the Authority's investment policies and prevailing legislation and regulations.

At the end of the financial year, the Authority will report on its investment activity as part of its Annual Treasury Report.

1.11 Creditworthiness

Changes to the credit rating methodology - The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a rating uplift due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these uplifts with the timing of the process determined by the regulatory progress at a national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have netted each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

In keeping with the agencies' new methodologies, the rating element of the credit assessment process now focuses solely on the Short and Long Term ratings of an institution. The other key elements of their process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, local authorities typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions.

It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution, merely a reassessment of their methodology in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean they are suddenly less credit worthy than they were formally. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the support phase of the financial crisis.

Credit ratings will continue to be monitored regularly. The Authority is alerted to changes to ratings through its use of the Capita Asset Services creditworthiness service who notify the Authority of any changes as soon as they receive the information. Where an institution has its credit rating downgraded so that it fails to meet the Authority's credit criteria then:

- no new investments will be made after the date of notification, and,
- investments on call will be recalled immediately.

Where an institution is placed on negative rating watch (notification of a possible rating downgrade) deposits will continue to be made up to approved limits so long as the institution's credit quality is above the Authority's minimum criteria.

1.12 Policy on the use of external service providers

The Authority uses Capita Asset Services, Treasury solutions as its external treasury management advisor.

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

The Authority 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 Authority will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented and subject to regular review.