Part I – Release to Press

Agenda item: ##

Meeting Audit/ Executive/ Council

Portfolio Area Resources

Date 04 February/ 13 February/ 27 February 2019

ANNUAL TREASURY MANAGEMENT STRATEGY INCLUDING PRUDENTIAL CODE INDICATORS 2019/20

NON KEY DECISION

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1 PURPOSE

1.1 To recommend to Council the approval of the Treasury Management[1] Strategy 2019/20 including its Annual Investment Strategy and the prudential indicators following considerations from Audit and Executive committees.

2 RECOMMENDATIONS

2.1 That subject to any comments from Audit Committee, the Treasury Management Strategy is recommended to Executive and Council for approval.

[1] CIPFA definition of treasury management and investments as “ the management of the Local Authority’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”.

2.2 That Members approve draft prudential indicators for 2019/20.

2.3 That Members approve the minimum revenue provision policy.

2.4 That it be noted that no changes are being proposed to treasury limits contained within the Council's treasury management policies.

2.5 That Member's note the investment services provide to Queensway Properties LLP (see para 4.12.3)

3 BACKGROUND

3.1 The Council is required to receive and approve (as a minimum) three main treasury reports each year. The annual treasury management strategy including the Prudential Indicators (this report), is the first and most important of the three and includes:

- Treasury Management Strategy
- Investment Strategy
- Capital Plans and prudential indicators
- Minimum Revenue Provision (MRP) policy

3.1.1 Before being recommended to Council the report is required to be adequately scrutinised and this is undertaken by the Audit Committee and Executive.

3.2 **Treasury Management Strategy**

3.2.1 The key principle and main priority of the Treasury Management Strategy (TMS) is to maintain security of principal invested and portfolio liquidity. With regard to this, the aims of the strategy are:

i) To ensure that there is sufficient counter party availability and to maintain required levels of liquidity so that the Council has cash available to meet its payment obligations to its suppliers.

ii) To look for possible changes to the TMS which would increase returns on investments made including alternative investment opportunities with the aim of increasing returns on investments whilst maintaining the security of the monies invested.

3.2.2 The 2018/19 Prudential Code Indicators and TMS Report were approved by Council on the 28 February 2018. That report noted that CIPFA proposed to make changes to the Treasury Management Code and Prudential Code and that government changes to the minimum revenue provision was under consultation at the time of approving the 2018/19 Treasury Management Strategy.

3.2.3 Following this consultation all local authorities must consider the risk and implications for non-treasury investments[2] (for example commercial property purchases) decisions. The Council has purchased commercial properties, however this has been to deliver regeneration and support economic growth in the borough of Stevenage and within the economic area as defined in Stevenage's Local Plan. Risk considerations and implications of commercial property purchases can be included in the annual TMS or, as is the case for Stevenage, in the Capital Strategy 2018/19-2023/24 report presented to Executive (23 January 2019). The Capital Strategy (section 4.5 – 4.6) provided:

- High level overview of how capital strategy, capital financing and treasury management activities contribute to council services,
- how the associated risk is managed,
- and implications for the future financial sustainability of the council.

3.2.4 The returns achievable on the Council's investments are currently modest based on the low Bank of England base rate and the risk appetite of the TM Strategy, which is compliant with the advice from the Council's treasury advisors, Link Asset Management. On 2 November 2017 the Monetary Policy Committee (MPC) approved the first increase in the base rate in eight years to 0.5% (from 0.25%) and a further increase to 0.75% on 2 August 2018. In 2018/19 investment returns of 0.9% are forecast with a target of 1.15% for 2019/20.

3.2.5 The impact of a no deal EU exit on sterling may result in higher borrowing costs in future PWLB (Public Works Loan Board) rates as these rates are linked to gilts. The HRA and General Fund capital strategies both have significant borrowing requirements over the next few years and officers continue to monitor movements in the borrowing rates. Further information on the potential impact of Brexit on the Council and its borrowing and investment activities was included in the Brexit report to the 23 January 2019 Executive.

4 REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

4.1 LEGISLATIVE AND OTHER CHANGES IMPACTING ON THE TREASURY MANAGEMENT STRATEGY

4.1.1 The revision to CIPFA Prudential Code and CIPFA Treasury Management Code came into force from 1st April 2018 and this is the first revision of the TMS under the new requirements.

4.1.2 The main changes introduced by CIPFA are:

[2] Non-financial, or non-treasury investments tend to relate to s 1 expenditure powers under the Act and be either: Policy type investments, whereby capital or revenue cash is advanced for a specific council objective or commercial type investments whereby the primary aim is to generate capital or revenue resources to facilitate council services.

- Removal of the following prudential indicators:

  Incremental impact of capital investment decisions on council tax and HRA rents

  Upper limit on fixed and variable interest rate exposure

  Upper and lower limits on maturity structure of borrowing

  Upper limit on total principle sums invested for over 364 days

- Capital Strategy to include investment decisions. This authority already complies as the Capital Strategy is approved by Council as part of the budget setting process.

- Inclusion of non-treasury investments (such as investment properties) in the Treasury Management Practices and publication of a Member approved list of non-treasury Investments.

4.2 **MiFIDII**

4.2.1 January 2018 saw the implementation of the EU legislation that regulates firms who provide financial services - the Markets in Financial Instruments Directive II (MiFID). This impacted on the Council as by placing investments and borrowing with other financial institutions the Council became a counterparty. The council gained “professional” status which enabled the Council to maintain its existing relationships with financial institutions and ability to use alternative financial instruments. There has been no change to the Council’s professional status.

4.3 **Comments from the Audit Committee and Executive**

4.3.1 The Assistant Director (Finance and Estates) advised Audit Committee that the proposed 2019/20 Treasury Management Strategy and Prudential Codes incorporated the revisions to the CIPFA Prudential and Treasury Management Codes, which came into force on 1 April 2018. The Committee noted that, for the 2018/19 financial year to 31 December 2018, returns on investment had averaged 0.82%, and a total of £421,000 interest had been earned. The use of planned resources over the coming years would mean that the Council’s cash for investment was projected to reduce from £59.6Million at 31 March 2019 to £30.3Million by 31 March 2023. The Assistant Director (Finance and Estates) explained that it was recommended that the operational borrowing limit be increased to reflect the uncertainty regarding the release of Growth Deal 3 monies and the finance arrangements for the mixed use Queensway redevelopment project.

4.3.2 The comments from the Audit Committee were verbally updated to the Executive at their meeting on the 1 February 2019. The Executive noted that the whole of the £60Million cash reserves set out in the pie chart in Paragraph 4.4.6 of the report had been allocated and that the Council made loans to other Local Authorities, but these were repaid with interest.

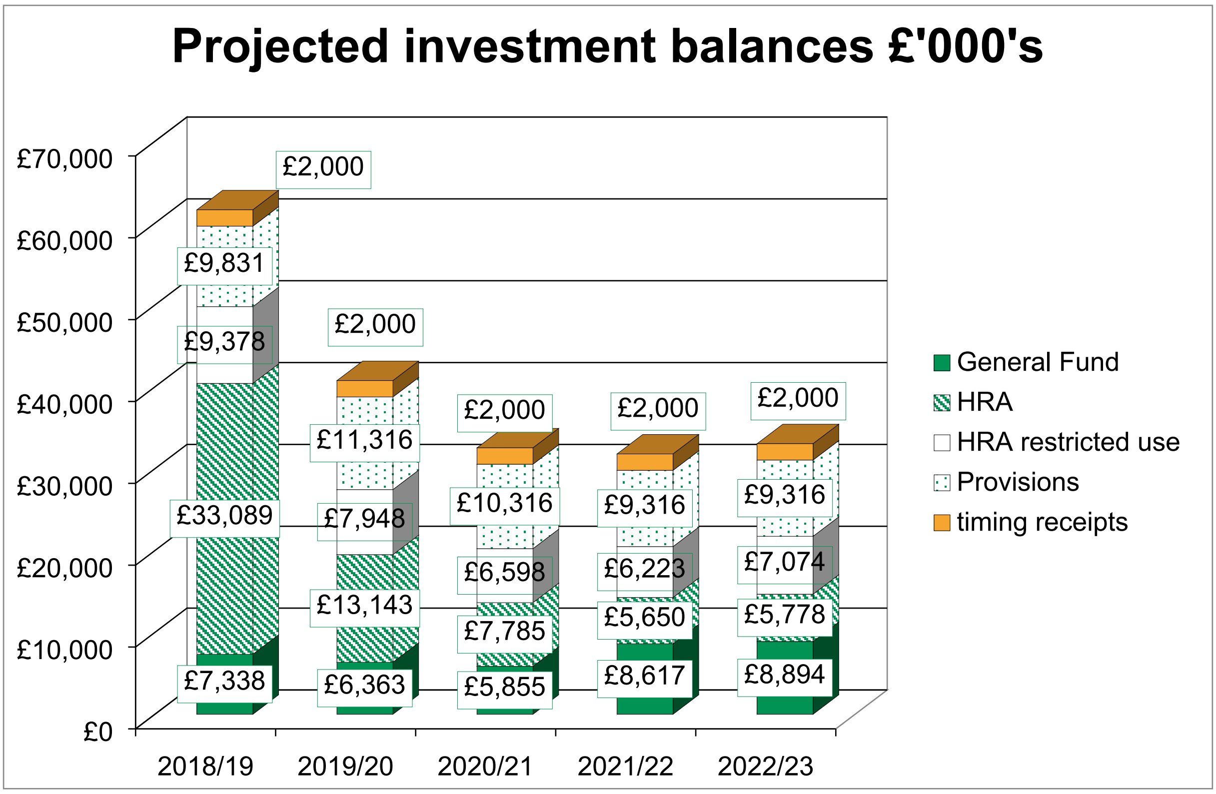
4.3.3 Executive recommend to Council to approve the Treasury Management Strategy 2019/20, and prudential indicators.

4.4 **Performance of Current Treasury Strategy**

4.4.1 For the 2018/19 financial year to 31 December 2018 returns on investments have averaged 0.82% and total interest earned was £421,000 contributing to General Fund and Housing Revenue Account revenue income.

4.4.2 Cash balances as at 31 December 2018 were £63.18Million and are forecast to be £56.9Million as at 31 March 2019. The Council's balances are made up of cash reserves e.g. HRA and General Fund balances, restricted use receipts e.g. right to buy one for one receipts and balances held for provisions such as business rate appeals.

4.4.3 In considering the Council's level of cash balances, Members should note that the HRA Business Plan, General Fund MTFS and the Capital Strategy have a planned use of resources over a minimum of five and up to 30 year period, which means, while not committed in the current year, they are required in future years. This means that the Council's cash for investment purposes is projected to reduce from £59.6Million at 31 March 2019 to £30.3Million by 31 March 2023. In essence £29.3Million of investment balances are going to be used in the next four years for revenue and capital plans approved by Members. This impact on cash available to invest is shown in the chart below.

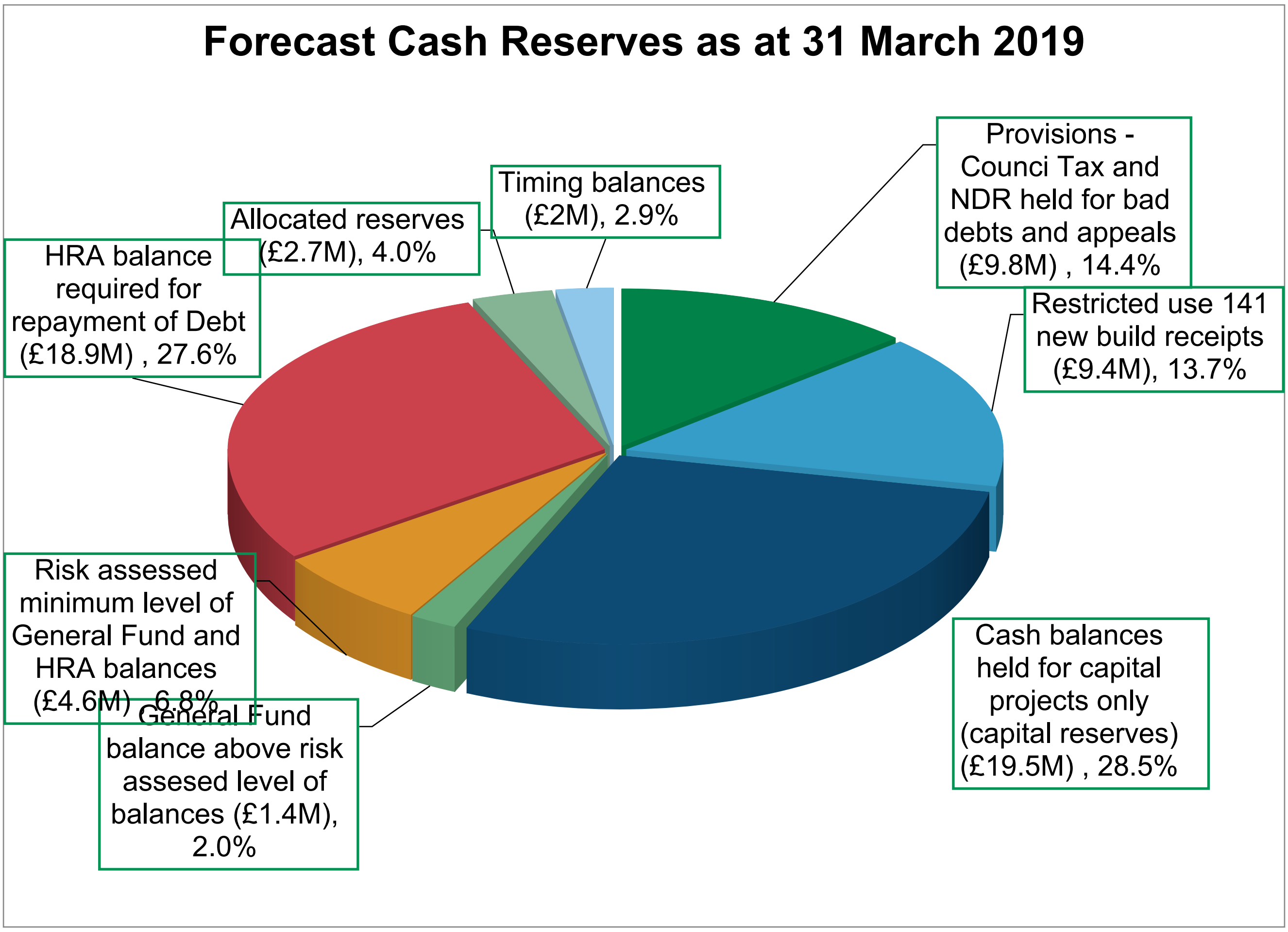


Note: General Fund and HRA balances are net of internal borrowing at year end

4.4.4 In addition to the balances projected to be held as at 31 March 2019 that will be used by 2021/22 there are other balances invested that cannot be used to run services. These may be balances related to restricted RTB receipts which in 2018/19 total £9.4Million. There are also balances relating to timing differences (from creditors and debtors) estimated at £2Million and balances held for future events such as business rate appeals yet to be realised and again these balances cannot be used to fund services.

4.4.5 Reserves and provisions forecast at 31 March 2019 to total £68.3Million, however the actual cash held is forecast to be £59.6Million, a difference of £8.7Million. This is because both the HRA and the General Fund have used investment balances totalling £6.7Million rather than take external borrowing as interest rates are so low, (see also para 4.7.4) plus timing differences of £2Million for creditor and debtors (para 4.4.4).

4.4.6 The majority of cash balances are held for the repayment of HRA debt (27.6%) and to fund the Council's capital programme (28.5%). Despite these sums held for the capital programme, external borrowing is still required as detailed in the 2019/20 capital strategy report. The forecast balances are summarised in the chart below.



Note: balances gross of internal borrowing of £6.7Million plus £2M timing differences.

4.4.7 The Council's current investment portfolio consists of "conventional" cash investments: deposits with banks and building societies, Money Market Funds and loans to other Local Authorities. Following the treasury management review in 2017/18 the use of Ultra Short Dated Bonds (USDB) was approved (formerly known as enhanced cash funds) up to £3MIllion. Currently no investments have been made with USDB funds, partly due to above base rate investment returns are being offered for standard cash deposits and these are being achieved by the TM team.

4.4.8 During 2018/19 no investments have been made with the Debt Management office (DMO) and there has been one breach (overdraft limit 21 May 2018 - as reported to Members on 17th October 2018) in the TMS in 2018/19 as at the time of writing this report.

4.5 **Review of the Treasury Management Strategy and Proposed changes**

4.5.1 The 2018/19 TMS was revised to maintain the key principles of security and liquidity to accommodate the cash balances forecast to be held by the Council. In accordance with the prudential code the Council will continue to apply credit criteria in order to generate a list of highly credit worthy counterparties whilst maintaining diversification.

4.5.2 To comply with the new Code requirement a list of non treasury investments is included in Treasury Management Practices. The non- treasury investments have been defined as properties soley held for rental income either directly by Stevenage BC or held via a wholly owned company. Stevenage BC holds no other types of “non-treasury” investments.

4.6 Prudential Indicators

4.6.1 It is a requirement of the Local Government Act 2003 that Councils must ‘have regard to the Prudential Code and set prudential indicators to ensure capital investment plans are affordable, prudent and sustainable’. As mentioned in para 4.1.1 the Prudential Code has been revised and changes made to Prudential Indicators.

4.6.2 This Strategy’s Prudential Indicators are included in Appendix C and are based on the Draft Capital Strategy reported to the Executive in February 2019 and will be updated for the final Capital Strategy approved by Council on 27th February 2019.

4.6.3 **The Operational boundary** is the limit beyond which external debt is not normally expected to exceed and is most cases will be similar to the Council’s Capital Financing Requirement (CFR). Officers recommend that the operational borrowing limit is increased to:

- to accommodate uncertainty regarding the release of GD3 LEP monies and the cost of relocating the Bus Station, an essential requirement to progress the SG1 regeneration phase of the town centre
- recognise the finance lease (treated as borrowing -£8Million) that was entered into with Aviva for mixed use redevelopment at Queensway in the town centre. The annual finance lease payments will be used as a proxy for Minimum Revenue Provision (MRP) that would be made for this additional borrowing (see also Appendix B Minimum Revenue Provision Policy).
- To reflect the borrowing requirement in the capital strategy.

4.6.4 Members are asked to note that the finance lease valuation for Queensway is subject to external audit approval and as such may change, changing the operational boundary and authorised debt limits.

4.6.5 The **Authorised limit** for external debt has in turn been increased and represents a control on the maximum level of borrowing. This represents the legal limit to which the Council's external debt cannot exceed.

4.6.6 Subject to confirmation of the valuation of the finance lease with external auditors, the Council is asked to approve the following authorised limit.

Authorised Limit for external debt	**2018/19**	**2019/20**	**2020/21**
	£000	**£000**	**£000**
Borrowing - General Fund	25,016	43,341	44,899
Borrowing - HRA	210,973	235,729	239,532
Total	**235,988**	**279,070**	**284,431**

4.7 The Council's Borrowing Position

4.7.1 The Council had external debt of £205.614Million as at 31 December 2018 is broken down as follows:

Purpose of Loan	PWLB Loan £'000
General Fund Regeneration Assets	**2,940**
HRA	
Decent Homes	7,763
Self Financing	194,911
Total HRA Loans	**202,674**
Total Debt at 31st December 2018	**205,614**

4.7.2 In 2018/19 a scheduled loan repayment of £1.241 million for the HRA was made. The HRA Business plan identified new borrowing of £3.5million due to be taken in 2017/18 but deferred to 2018/19. To date this borrowing has not been taken, the timing being dependent on cash balances held and forecast borrowing rates.

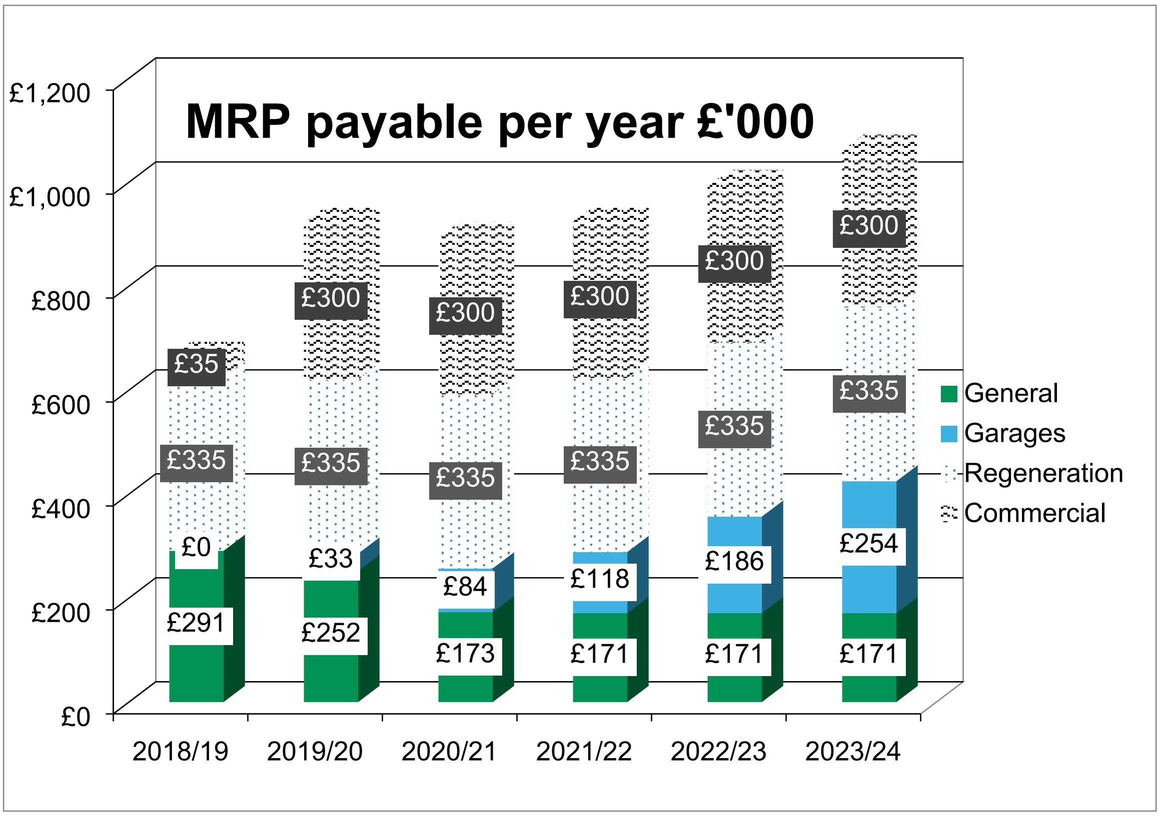
4.7.3 In 2018/19 there were General Fund loan repayments of £131,579 in August 2018 and February 2019. In addition approved prudential borrowing for the investment property portfolio and garage strategy is due to be taken, the timing of which is dependent on actual spend.

4.7.4 Cash and investment balances have been used in preference to external borrowing as the costs of internal debt (investment interest foregone at 0.9%) is significantly lower than external borrowing (2.7% based on 25 year loan). It is the view of the Chief Financial Officer that this approach will continue to be considered while interest rates remain low.

4.8 Minimum Revenue Provision

4.8.1 Where capital expenditure has been funded from borrowing, whether this be actual external borrowing or internal borrowing through the use of cash balances the council is required to set aside a Minimum Revenue Provision (MRP). This amount is calculated based on the approved MRP policy (appendix B) based on the life of the asset.

4.8.2 Borrowing decisions and subsequent MRP payments impact on the affordability of capital schemes and subsequent revision to the current MRP policy may need to be approved by Council at a later date in 2019/20 to recognise the longer life of regeneration schemes. Current projections of MRP payments based on the existing policy are detailed in the following chart.



4.8.3 The internal borrowing approach recommended by the Chief Finance Officer and the subsequent MRP payments the General Fund needs to make has reduced the amount that the General Fund needs to borrow (on capital schemes 2011/12-2014/15) by £2.9Million of the total General Fund capital funded by borrowing as at 31 March 2019.

4.9 Future borrowing requirements

4.9.1 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 by taking loans out with PWLB. Instead the Council's reserves, balances and cash flow have been used. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

4.9.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Assistant Director (Finance and Estates) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

4.9.3 It is the Council's intention not to borrow in advance of need. However, should this happen as part of the optimising treasury management position of the Council and minimising borrowing risks, the transaction will be accounted for in accordance with proper practices.

4.9.4 The Council's treasury advisors now forecast the Bank of England base rate to increase to 1.0% in June 2019. Base rate and borrowing rate forecasts are shown in the table below. However there is volatility and uncertainty over Brexit and rates are monitored regularly.

Link Asset Services Interest Rate View														
	Dec-18	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%	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	0.80%	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	0.90%	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	1.10%	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	2.00%	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%	2.50%	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%	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%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Source: Link Asset Services 4 December 2018

4.9.5 The Treasury's Certainty Rate for borrowing remains available and enables the Council to take PWLB loans at 20 basis points (0.2%) below the standard PWLB rate. The rates shown in the table above do not include that adjustment. There have been no further updates to the government's proposal to abolish the PWLB.

4.10 Investments

4.10.1 The Council complies fully with CIPFA Treasury Management Code 2017. The Council also complies with guidance on self-financing and the investment guidance issued by Ministry of Housing, Communities and Local Government (MHCLG).

4.10.2 In managing the TM function other areas kept under review include:

- Training opportunities available to Members and officers

- That those charged with governance are also personally responsible for ensuring they have the necessary skills and training
- A full mid year review of the TMS will be reported in 2019/20

4.10.3 The 2019/20 Strategy uses the credit worthiness service provided by Link Asset Services (formerly known as Capita Treasury Solutions) the Council's treasury advisors. This service uses a sophisticated modelling approach which utilises credit ratings from the three main credit rating agencies and is compliant with CIPFA code of practice.

4.10.4 While Link Asset Services may advise the Council, the responsibility for treasury management decisions remains with the Council at all times and officers do not place undue reliance on the external service advice.

4.10.5 The TM limits for 2019/20 (Appendix D) have been reviewed and no changes to these limits are being proposed.

4.10.6 The latest list of "Approved Countries for Investment" is detailed in Appendix E. This lists the countries that the Council may invest with providing they meet the minimum credit rating of AA- . The Council retains the discretion not to invest in countries that meet the minimum rating but where there are concerns over human rights issues.

4.11 **Non Treasury Investments**

4.11.1 The update to the Prudential Code introduced the requirement for local authorities to produce a capital strategy to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and considers prudence, sustainability and affordability. As mentioned in paragraph 3.2.3 the definition of investments has been widened to include non- treasury investments. The capital strategy 2018/19-2022/23 explains further the non-treasury investments that the Council has undertaken.

4.12 **Other Treasury issues**

4.12.1 **HRA Debt Cap**: In October 2018, Prime Minister Theresa May announced a policy change of the abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29 October 2018. The HRA's operational debt limit will be increased pending the outcome of the action plan contained in the HRA Budget report i.e. the HRA business plan review and the option between taking further borrowing in lieu of revenue contribution to finance the capital programme.

4.12.2 **Brexit - UK Sovereign rating and investment criteria:** If there were to be a disorderly Brexit, then it is possible that credit rating agencies could downgrade the sovereign rating for the UK from the current level of AA. The Council's investment only uses countries with a rating of AA- or above. The UK is exempt from the sovereign rating criteria as recommended by Link so in this event if it were to result in the UK being downgraded below AA- it would not impact on the Council's ability to invest with UK institutions.

4.12.3 **Queensway Properties LLP** -In December 2018 the Council entered into a 37 year agreement with Aviva to facilitate the regeneration of Queensway in the town centre. The regeneration scheme includes the provision of new housing, recreation facilities, and enhancement of the commercial shop units and offices. Following legal advice, a separate legal entity – Queensway Properties LLP, was incorporated to manage the rental streams and costs associated with the scheme. The Council's treasury management team has offered its services to the LLP to manage and invest its surplus cash flows through a service level agreement. These investments and cash flows will be kept separate from the Council's and will be invested in accordance with Queensway Properties LLP treasury management strategy. As the LLP does not have the expertise or treasury management experience it will be classed as a retail client under MiFIDII regulations and so will have access to a narrower band of investments.

5 IMPLICATIONS

5.1 Financial Implications

5.1.1 This report is if a financial nature and outlines the Prudential Code indicators and the principles under which the treasury management functions are managed.

5.2 Legal Implications

5.2.1 Approval of the Prudential Code Indicators and the Treasury Management Strategy is intended to ensure that the Council complies with relevant legislation.

5.3 Risk Implications

5.3.1 The current policy of not borrowing externally only remains financially beneficial while prevailing differentials between investment income rates and borrowing rates remain, and balances remain buoyant. When this changes, the Council may need to borrow at a higher rate, leading to a significant additional revenue cost in year.

5.3.2 There remains uncertainty on the impact of exiting the EU on UK economy and borrowing rates. Officers monitor interest rate forecasts to inform he timing of borrowing decisions.

5.3.3 The Council's Treasury Management Strategy is based on limits for counterparties to reduce risk of investing with only a small number of institutions.

5.3.4 The thresholds and time limits set for investments in the Strategy are based on the relative ratings of investment vehicles and counter parties. These are designED to take into account the relative risk of investments and also to preclude certain grades of investments and counterparties to prevent loss of income to the Council.

5.4 Equalities and Diversity Implications

5.4.1 This report is technical in nature and there are no implications associated with equalities and diversity within this report. In addition the council retains the discretion not to invest in countries that meet the minimum rating but where there are concerns over human rights issues (4.12.6).

Background documents

BD1 Annual Treasury management Review of 2017/18

BD2 2018/19 Mid Year Treasury Management Review

BD3 Draft Capital Strategy 2018/20 – 2022/23 (Executive 23 January 2019)

BD4 Potential Impact of the UK's withdrawal From the European Union (Executive 23 January 2019)

Appendices

A Treasury Management Strategy

B Minimum Revenue Provision Policy

C Prudential Indicators

D Specified and Non-Specified Investment Criteria

E Approved Countries for investment