Part I – Release to Press

Meeting Audit/ Executive/ Council

Portfolio Area Resources

Date 03 February/ 12 February/ 26 February 2020

ANNUAL TREASURY MANAGEMENT STRATEGY INCLUDING PRUDENTIAL CODE INDICATORS 2020/21

NON KEY DECISION

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1 PURPOSE

1.1 To recommend to Council the approval of the Treasury Management[1] Strategy 2020/21, 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 2020/21.

2.3 That Members approve the minimum revenue provision policy.

2.4 That Members approve an increase to the maximum level of long term (invested for longer than 12 months) investments from £10Million to £20Million when cash balances are higher than £30Million.

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 forward looking, it 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 The second is the mid-year treasury management report – this is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

3.1.2 The third is the annual treasury report – this is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

3.1.3 Before being recommended to Council the reports are 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 2019/20 Prudential Code Indicators and TMS Report were approved by Council on the 27 February 2019, and had been updated to reflect new guidance on considering the risk and implications for non-treasury investments (for example commercial property purchases) decisions. The previous Capital Strategy, also approved by Council on the 27 February 2019, set out the policies for Investment in Commercial Property and Other capital investments. No additional strategy updates have been required for 2020/21.

3.2.3 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. The Monetary Policy Committee (MPC) has not changed the Bank of England base rate since the increase to 0.75% on 2 August 2018. In 2019/20 investment returns of 0.93% are forecast with a target of 0.902% for 2020/21.

3.2.4 There is still ongoing uncertainty over Brexit, and the impacts after the transition period that may affect sterling. It 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.

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 There have been no revisions since the CIPFA Prudential Code and CIPFA Treasury Management Code came into force from 1st April 2018.

4.1.2 Each Authority now has a requirement to determine how best to report actual and planned non-financial / commercial activity to Members, arising from the investments described in paragraph 3.2.2. The Council has undertaken a small value of non-treasury investment to date, and the relevant statutory prudential indicators have been separated between their General Fund, HRA and Commercial components (see Appendix C).

4.2 Comments from the Audit Committee

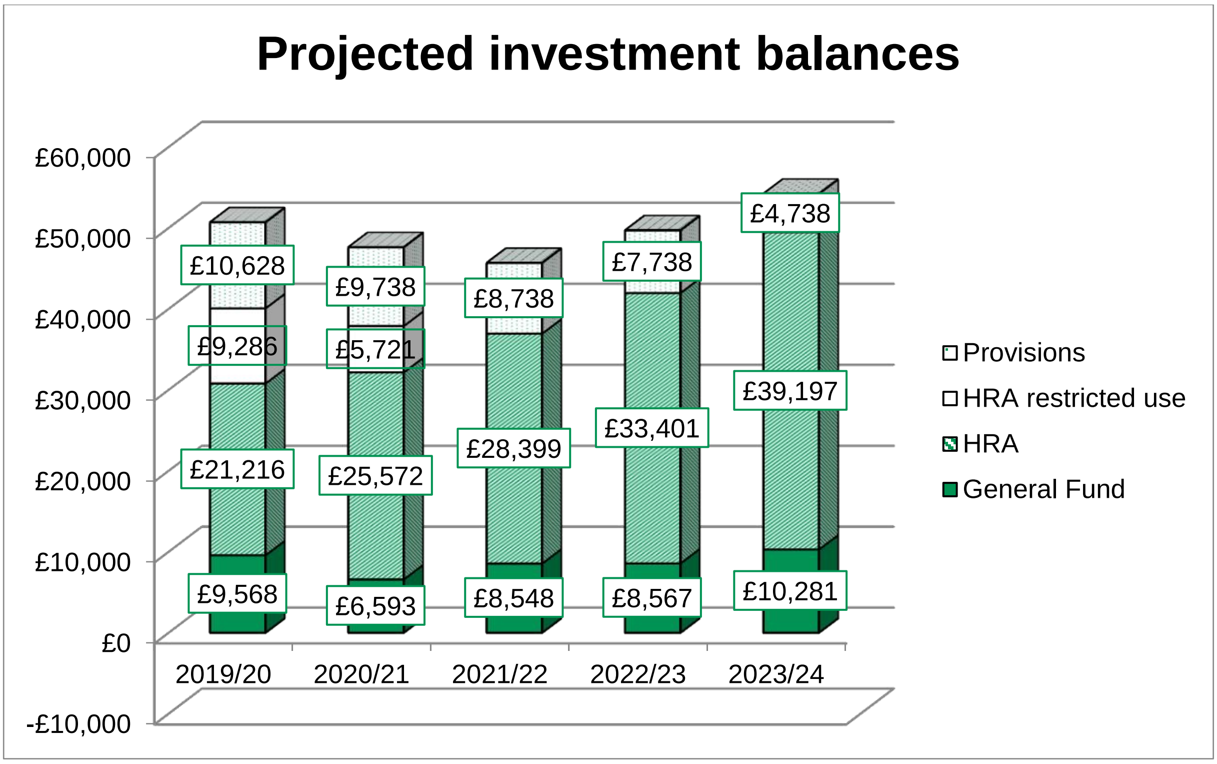
4.2.1 *To be incorporated into report to Executive and Council*.

4.3 Performance of Current Treasury Strategy

4.3.1 For the 2019/20 financial year to 31 December 2019 returns on investments have averaged 0.975% and total interest earned was £470,984 contributing to General Fund and Housing Revenue Account revenue income.

4.3.2 Cash balances as at 31 December 2019 were £63.03Million and are forecast to be £50.70Million as at 31 March 2020. 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.

4.3.3 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 of £50.70Million as at 31 March 2020 is going to be used for revenue and capital plans approved by Members. This impact on cash available to invest is shown in the chart below.

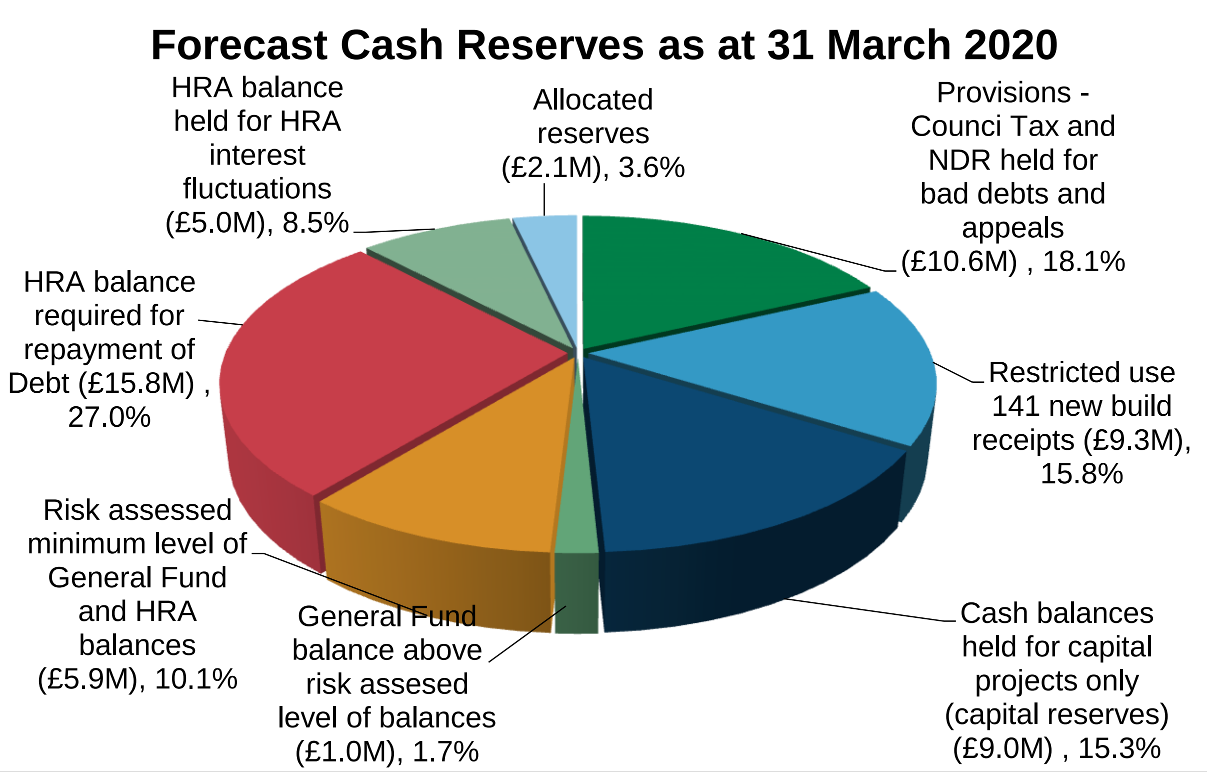


Note 1: General Fund and HRA balances are net of internal borrowing at year end

4.3.4 In addition to the balances projected to be held as at 31 March 2020 there are other balances invested that cannot be used to run services. These may be balances related to restricted RTB receipts which in 2019/20 total £9.3Million. There are also balances held for future events such as business rate appeals yet to be realised and again these balances cannot be used to fund services.

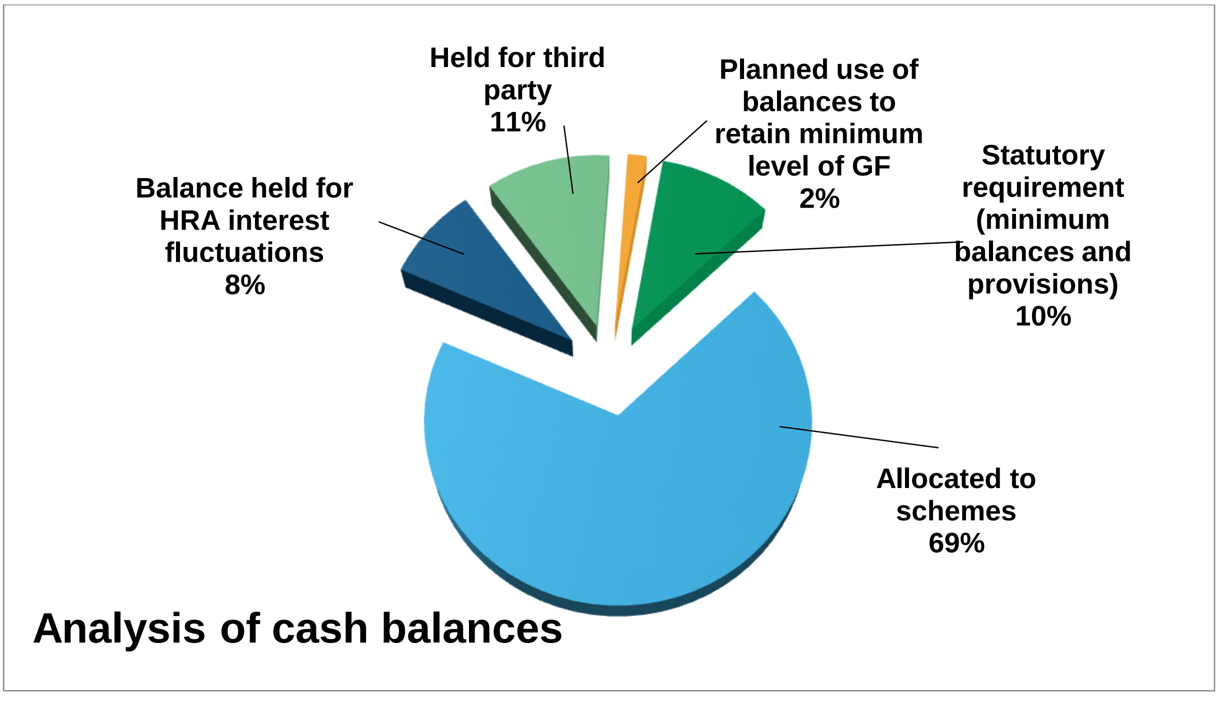
4.3.5 Reserves and provisions forecast to total £58.8Million as at 31 March 2020, however the actual cash held is forecast to be £50.7Million, a difference of £8.1Million. This is because both the HRA and the General Fund have used investment (cash) balances totalling £8.1Million rather than take external borrowing as interest rates are so low, (see also para 4.7.3).

4.3.6 The majority of cash balances are held for the repayment of HRA debt (27.0%) and to fund the Council's capital programme (31.1%, which includes 15.8% restricted RTB receipts for new build). Despite these sums held for the capital programme, external borrowing is still required as detailed in the 2020/21 capital strategy report. The forecast balances are summarised in the following chart.



Note 2: balances gross of internal borrowing of £8.1Million

4.3.7 These cash balances can be further analysed between allocated, held for statutory requirements and held for third parties. This identifies that of the £58.8Million, all cash balances have been allocated, so unless allocated reserves are no longer needed in the future, there are currently no cash resources available for new projects. In addition the capital strategy identifies the need for external borrowing and a number of capital schemes have not been approved due to the lack of funding resources.



4.3.8 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. Currently no investments have been made with any of the other approved instruments within the Specified and Non-specified Investment Criteria (see Appendix D), partly due to the "above base rate" investment returns which are being offered for standard cash deposits, and those being achieved by the TM team.

4.3.9 There have been no breaches of treasury counter party limits during 2019/20, with the investment activity during the year conforming to the approved strategy. Any breach would be notified to the Chief Finance Officer. The Council has had no liquidity difficulties and no funds have been placed with the Debt Management Office (DMO) during 2019/20, demonstrating that counterparty limits and availability for placing funds approved in the TM Strategy are working as at the time of writing this report.

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

4.4.1 The 2019/20 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.

4.4.2 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 solely 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.

4.4.3 The Chief Finance Officer proposes to increase the maximum level of long term (invested for longer than 12 months) investments from £10Million to £20Million when cash balances are higher than £30Million. This is to enable greater flexibility to use opportunities to invest longer term when forecast balances are expected to be higher due to the timing of expenditure. The Chief Finance Officer proposes no changes to the other treasury limits contained in the Treasury management Strategy (Appendix D).

4.5 Prudential Indicators

4.5.1 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'.

4.5.2 This Strategy's Prudential Indicators are included in Appendix C and are based on the Final Capital Strategy reported to the Executive in February 2020 approved by Council on 26th February 2020. Should changes be made to the capital strategy prior to Council approval these changes will be incorporated into the final treasury management strategy to be approved by Council on 26th February 2020

4.5.3 **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 continued 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.
- To accommodate uncertainty regarding the timing of significant land sales.
- To reflect the identified borrowing requirement in the capital strategy.
- To reflect the capital programme financing requirement includes capital receipts and the uncertainty of when these receipts may materialise.
- To reflect the valuation of the finance lease of Queensway properties in the town centre.

4.5.4 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.

4.5.5 The Council is asked to approve the following authorised limit.

Authorised Limit for external debt	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	£000	**£000**	**£000**	**£000**
General Fund Finance lease (accounted for as borrowing)	11,875	26,875	26,875	26,875
General Fund – Borrowing for capital expenditure	43,442	46,669	47,448	50,665
Total Borrowing - General Fund	**55,317**	**73,544**	**74,323**	**77,540**
Borrowing - HRA	223,824	247,627	274,229	289,869
Total	**279,141**	**321,171**	**348,552**	**367,410**

4.6 The Council's Borrowing Position

4.6.1 The Council had external debt of £205.351Million as at 31 December 2020 and is broken down as follows:

Purpose of Loan	**PWLB Loan £'000**
General Fund Regeneration Assets	**2,677**
HRA	
Decent Homes	7,763
Self Financing	194,911
Total HRA Loans	**202,674**
Total Debt at 31st December 2020	**205,351**

4.6.2 The HRA borrowing of £1.81million in 2018/19 has not been taken to date, internal (cash) balances have been used and the timing of taking external borrowing is being dependent on cash balances held and forecast borrowing rates.

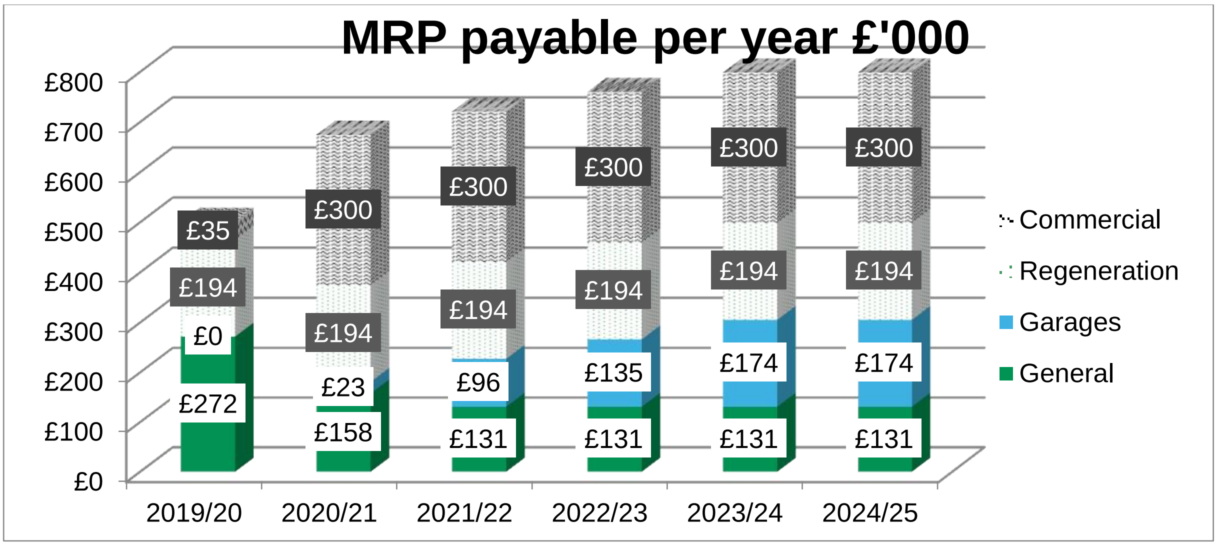
4.6.3 In 2019/20 there has been a General Fund loan repayment of £131,579 in August 2019, and a further £131,579 is due to be repaid in February 2020. In addition approved prudential borrowing for the investment property portfolio and garage strategy is due to be taken, the timing of which is dependent on actual spend.

4.6.4 Cash and investment balances have been used in preference to external borrowing as the costs of internal debt (investment interest foregone at 0.93%) is significantly lower than external borrowing (3.02% 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.

4.7 Minimum Revenue Provision

4.7.1 Where capital expenditure has been funded from borrowing, whether this be actual external borrowing or internal borrowing 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.

4.7.2 Borrowing decisions and subsequent MRP payments impact on the affordability of capital schemes. The MRP policy was updated as part of the mid-year Treasury Management review of 2019/20 to reflect the revised useful lives of assets financed through borrowing. Current projections of MRP payments based on the updated policy are detailed in the following chart.



4.8 Future borrowing requirements

4.8.1 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 (as mentioned above).

This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

4.8.2 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Assistant Director (Finance and Estates) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

4.8.3 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.

4.8.4 The Council's treasury advisors now forecast the Bank of England base rate to increase to 1.0% in March 2021. 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-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

Source: Link Asset Services 23 December 2019

4.8.5 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 rate changes since the 100bps change in October 2019, increasing the PWLB margin over gilt yields from 80bps to 180bps. This change may result in other sources of borrowing being preferential to PWLB, such as the Municipal Bond Agency.

4.8.6 The HRA Business Plan's (HRA BP) existing loans have an average interest rate of 3.38% based on £202.674Million of borrowing. The current business plan makes allowance for new loans totalling £8,556,508 in 2019/20 and £23,802,670 in 2020/21. The decision when to take the new borrowing will be reviewed, weighing up the cost of carry and the prevailing borrowing rate. The interest payable in 2019/20 and 2020/21 is estimated to be £6,866,810 and £7,837,130 respectively.

4.8.7 The HRA Business Plan presented to Executive on 16 December 2019 identified that the lifting of the HRA borrowing cap meant that the HRA was not constrained by the £217.685Million cap set as part of the self-financing settlement. The 2019 HRA Business Plan looked at a revised approach to borrowing, versus using revenue contributions to capital. This was based on the HRA need to borrow and affordability as identified in the BP action plan.

4.9 Investments

4.9.1 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).

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

- Training opportunities available to Members and officers (the most recent training for Members took place on 5th September 2019)
- 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 2020/21

4.9.3 The 2020/21 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.

4.9.4 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.

4.9.5 The TM limits for 2020/21 (Appendix D) have been reviewed and no changes to these limits are being proposed.

4.9.6 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.

4.10 **Non Treasury Investments**

4.10.1 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 2020/21 Capital Strategy (Council 26 February 2020) includes more details on the Councils non treasury investments.

4.11 **Other Treasury issues**

4.11.1 **Brexit - UK Sovereign rating and investment criteria:** If there were to be a negative reaction to Brexit, then it is possible that credit rating agencies could downgrade the sovereign rating for the UK from the current level of AA (or equivalent). The Council's investment criteria only use countries with a rating of AA- or above. The UK current Sovereign rating is AA as at 23-1-2020. There is a possibility that this may change due to reactions to Brexit. The UK rating will be exempt from the sovereign rating investment criteria 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. Other investment criteria will be considered in this event to ensure security of funds for the Council.

4.11.2 **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. 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 offered its services to the LLP to manage and invest its surplus cash flows through a service level agreement, however to date no investment activities have been undertaken on their behalf.

4.11.3 **Queensway Properties LLP 2nd phase** –the first phase of the head lease has been recognised on the Council's balance sheet and the operational borrowing limit was increased to reflect the valuation. When the second phase of residential properties becomes available to let the Council's lease payments will increase to reflect this. As such the balance sheet valuation of the finance lease will increase and the operational and authorised borrowing limits for the General Fund will need to be increased accordingly. This has been reflected in the TM indicators but may be subject to change after external audit review. Any updates regarding the valuation of the Queensway head lease will be reported in future treasury management reports.

4.11.4 **IFRS16 – Leasing** – Some currently off balance sheet leased assets may need to be brought onto the balance sheet under IFRS 16. This will be a requirement for closing of the accounts for 2020/21, and could impact the Capital Financing Requirement and external debt (Other long-term liabilities), and the authorised limit and operational boundary would need to allow for these.

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.

5.5 Climate Change Implications

5.5.1 The council's investment portfolio is sterling investments and not directly in companies. However the TM team will review the use of Money Market funds in 2020/21 to ensure, where possible, money market funds that invest in environmentally sustainable companies are used. In this way the TM team will align with the Councils ambition to attempt to be carbon neutral by 2030.

Background documents

BD1 Annual Treasury management Review of 2018/19

BD2 2019/20 Mid Year Treasury Management Review

BD3 Draft Capital Strategy 2019/20 – 2024/25 (Executive 22 January 2020)

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