Part I – Release to Press

STEVENAGE BOROUGH COUNCIL

Meeting EXECUTIVE

Portfolio Area Resources

Date 14 FEBRUARY 2018

ANNUAL TREASURY MANAGEMENT STRATEGY INCLUDING PRUDENTIAL CODE INDICATORS 2018/19

NON KEY DECISION

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1 PURPOSE

1.1 To recommend to Council the approval of the Treasury Management[1] Strategy 2018/19 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 Council for approval.

2.2 That Members approve draft prudential indicators for 2018/19 subject to any changes proposed by CIPFA to the Treasury Management Code and Prudential Code.

2.3 That Members approve the minimum revenue provision policy and note the proposed changes currently under consultation.

[1] CIPFA defines treasury management 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"

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

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 2017/18 Prudential Code Indicators and TMS Report were approved by Council on the 28 February 2017. Within this report the Chief Finance Officer recognised the need for a fundamental review of the investment portfolio, including alternative investment options and TMS practices. A further update on these changes, approved as part of the 2017/18 TM Strategy, is given in paragraph 4.6.8.

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. Since March 2009, when the Official Bank Rate (Bank Rate) was reduced to 0.5% and then again in March 2009 to 0.25% the bank rate has been at a historically low level. 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%). In 2017/18 investment returns of 0.55% are forecast with a target of 0.70% for 2018/19.

3.2.4 The impact of the European Union (EU) Referendum decision to leave the EU and the implications of this for the UK economy are uncertain and further updates of the Strategy may/will be required once these are known.

REASONS FOR RECOMMENDED COURSE OF ACTION AND OTHER OPTIONS

LEGISLATIVE AND OTHER CHANGES IMPACTING ON THE TREASURY MANAGEMENT STRATEGY

3.1 Revised CIPFA Prudential Code and CIPFA Treasury Management Code

4.1.1 Development of the localism agenda and new powers granted to local authorities for alternative investment and income generating schemes has prompted a review of the Code of Practice on Treasury Management and the Prudential Code by CIPFA. During the year CIPFA consulted on proposed changes to these codes and the Assistant Director (Finance and Estates) has submitted a response.

4.1.2 CIPFA has now revised the TM and Prudential codes these are now inforce and need to be considered for the 2018/19 Strategy. However guidance notes for inclusion of specific indicators are yet to be released. To enable Members to consider and approve the TMS and Prudential Indicators within the statutory deadline all existing indicators have been included in this report.

4.1.3 The main changes introduced by CIPFA are:

- Removal of prudential indicators for:

  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

  (However this is subject to release of CIPFA TM Code guidance (see para 4.1.2) and to ensure compliance all existing indicators have been included in this report.)

- Requirement to produce a Capital Strategy which includes capital expenditure including 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 that also includes the publication of a Member approved list of non-treasury Investments.

4.2 **Department for Communities and Local Government**

4.2.1 In addition the Department for Communities and Local Government (CLG) also ran a consultation on overlapping issues that include revisions to investment guidance and Minimum Revenue Provision (MRP). The outcome from this consultation is still awaited and it may be necessary to take a revised strategy and/or MRP policy to Council at a later date as it is still a requirement for the 2018/19 TM Strategy to be approved by Council before 31st March 2018.

4.3 MiFIDII

4.3.1 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 becomes a counterparty.

4.3.2 The default position under this legislation was for the Council to be classed as a retail counterparty – limiting investment opportunities and reducing investment yields. The Council has therefore elected to professional client status to allow uninterrupted advice and opportunities for investment/debt products. There are quantitative and qualitative tests to be satisfied which the Council has passed before a local authority can be classified as such. In addition the Council must have a total investment portfolio of £10million.

4.3.3 While professional status enables the Council to maintain its existing relationships with financial institutions and ability to use alternative financial instruments, (subject to compliance with the TM strategy), there are some protections that would have been gained if the status had been downgraded to retail client. These are detailed in the following table.

Area of Protection	Impact on Elective Professional Client	Impact/Mitigation for SBC
Suitability of investment and Appropriateness	As a Professional client a level of experience and knowledge of associated risks will be assumed. The advisor is not required to asses if the transaction is appropriate for the Council as there are entitled to assume as a Professional client the Council has the required level of experience and knowledge.	Low- No change from pre MiFIDII arrangements. TMS stipulates investment criteria and risk appetite to Council investments. Officers are required to attend CiPFA treasury management qualification (or equivalent) and attend training courses to ensure level of knowledge is maintained.
Arranging investment deals	A range of factors are considered for Professional clients to achieve best execution of deal (for retail clients the cost of the transaction is also considered and must be the overriding factor in placing the investment)	Low- No change from pre MiFIDII arrangements. Low transaction costs. Treasury Advice is provided through procurement process to ensure best

Area of Protection	Impact on Elective Professional Client	Impact/Mitigation for SBC
		value provider is used.
Reporting Information back to clients	Timeframe for confirming orders to retail clients is more rigorous than for professional clients	Nil- No change from pre MiFIDII arrangements. Investment confirmations are taken from online systems
Financial Ombudsman Services and FCA	Services of the Ombudsman may not be available to the Council and FCA restrictions on what can be excluded or restricted on any duty of care are tighter for retail clients	Low- No change from pre MiFIDII arrangements.
Investor compensation	Eligibility for compensation under the Financial Services Compensation scheme is dependent on the constitution (not whether professional or retail status is held)	Low- No change from pre MiFIDII arrangements.
Communication	Simplicity and frequency in the way advisors contact the Council will differ to the way information is communicated to Retail Clients	Nil- No change from pre MiFIDII arrangements. Daily access to Treasury Management advisors to ensure SBC are advised on investment and borrowing opportunities.
Information about the advisor/counterparty	Information on services, products and remuneration must be given to all clients however the detail of this information is greater for retail clients	Nil- No change from pre MiFIDII arrangements. Treasury Advice is provided through procurement process to ensure best value provider is used.

4.3.4 However under the old scheme the Council was already classified as a “professional” counterparty and as such the protections in the table above did not apply. Therefore no pre-existing protections have been lost. Officers do not consider the protections available to retail client outweigh the benefits available to professional client status.

3.4 Prudential indicators

4.4.1 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. Until the guidance that supports these changes is published, officers have retained the existing indicators.

4.4.2 This Strategy’s Prudential Indicators are included in Appendix C and are based on the Final Capital Strategy reported to the Executive in February 2018.

4.5 Comments from the Audit Committee

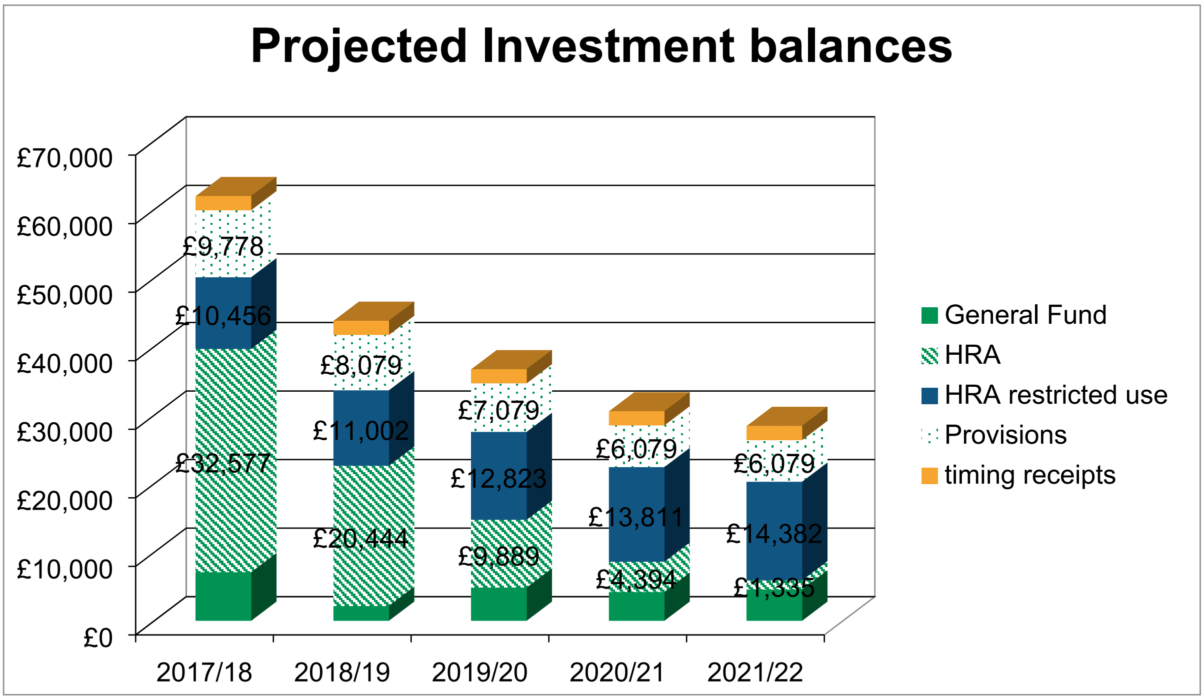
4.5.1 *To be incorporated into report to Executive and Council.*

4.6 **Performance of Current Treasury Strategy**

4.6.1 For the 2017/18 financial year to 31 December 2017 returns on investments have averaged 0.55% and total interest earned was £299,500 contributing to General Fund and Housing Revenue Account revenue income.

4.6.2 Cash balances as at 31 December 2017 were £73.03Million and are forecast to be £62.4Million as at 31 March 2018. 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.

4.6.3 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 these resources which means, while not committed in the current year, they are utilised in future years. This means that the Council's cash for investment purposes is projected to reduce from £62.4Million by 31 March 2018 to £29.8Million by 31 March 2022. In essence £32.6Million 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.



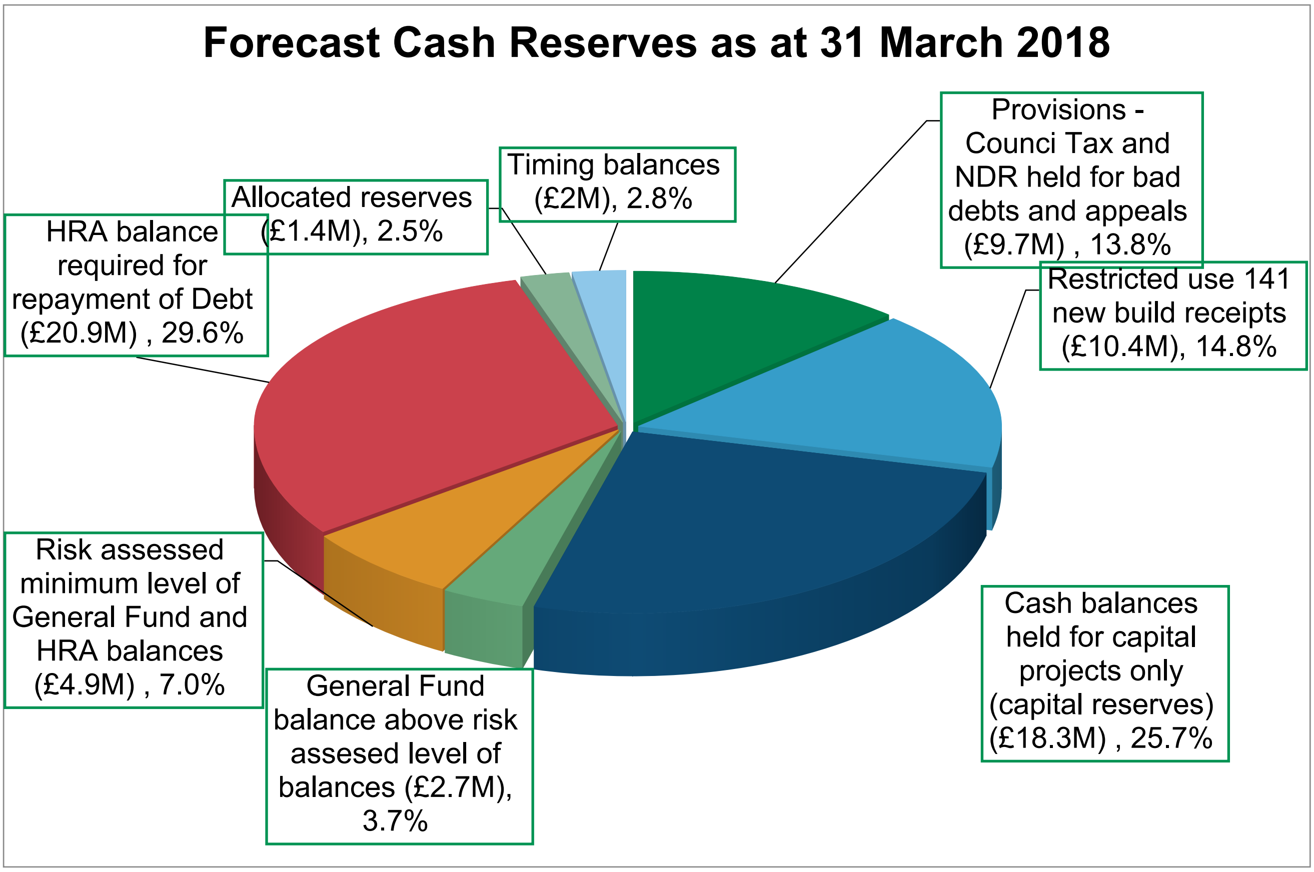
Note: General Fund and HRA balances are net of internal borrowing at year end

4.6.4 In addition to the balances projected to be held as at 31 March 2018 that will be used by 2021/22 there are other balances invested that cannot be used for general use to run services. These may be balances related to restricted RTB receipts which in 2017/18 total £10.45Million. 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 and again these balances cannot be used to fund services.

4.6.5 Reserves and provisions forecast at 31 March 2018 as detailed in the chart below total £70.3Million. However the actual cash held is forecast to be £62.4Million, a difference of £7.9Million. This is because both the HRA and the General Fund have used investment balances totalling £7.9Million rather than take external borrowing as interest rates are so low, (see also para 4.9.4).

4.6.6 The commentary in paragraphs 4.6.2 -4.6.5 on investment balances shows that only a small proportion of overall balances are available to fund the HRA and General Fund and some of these balances are held for specific purposes or planned to be spent over the next few years and both the General Fund and the HRA have, as yet, unidentified Financial Security targets for future years.

4.6.7 The majority of cash balances are held for the repayment of HRA debt (29.6%) and to fund the Council's capital programme (40.5%). Despite these sums held for the capital programme external borrowing is still required as detailed in the 2018/19 Capital strategy report.



Note: balances gross of internal borrowing of £7.9Million

4.6.8 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. Following the 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 additional research and advisory fees required prior to an investment being placed impacting on potential returns. In addition, above base rate investment returns are being offered for standard cash deposits and these are being achieved by the TM team.

4.6.9 During 2017/18 no investments have been made with the Debt Management office (DMO) and there have been no breaches in the TMS in 2017/18 as at the time of writing this report.

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

4.7.1 The 2017/18 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 guidance from CLG and CIPFA the Council will continue to apply credit criteria in order to generate a list of highly credit worthy counterparties whilst maintaining diversification.

4.7.2 To comply with the new Code requirement a list of non- treasury investments will be included in Treasury Management Practices. The definition of non-treasury investments has yet to be confirmed but is likely to be limited to investment properties as Stevenage BC holds no other types of "non-treasury" investments.

4.8 Prudential Indicators

4.8.1 As mentioned in para 4.1.3 CIPFA has removed a number Prudential Indicators (PI) but have yet to publish the guidance and adoption date. As such all existing PI have been retained and will be reviewed in subsequent reports when confirmation has been given.

4.8.2 The prudential indicators as shown in Appendix C have been updated based on the 2018/19 final capital strategy.

4.9 The Councils Borrowing Position

4.9.1 The Council had external debt of £209.362Million as at 31 December 2017 as is broken down as follows:

Purpose of Loan	PWLB Loan £'000	Market Loan £'000	Total £'000
General Fund: Regeneration Assets	**1,447**	**1,500**	**2,947**
HRA:			
Decent Homes	11,504	0	11,504
Self-Financing	194,911	0	194,911

Total HRA Loans	**206,415**	**0**	**206,415**
Total Debt at 31st December 2017	**207,862**	**1,500**	**209,362**

4.9.2 In 2017/18 there is a scheduled loan repayment of £3.75million for the HRA. The HRA Business plan identified new borrowing of £3.5million due to be taken in 2017/18. The timing of this borrowing is dependent on cash balances held and forecast borrowing rates.

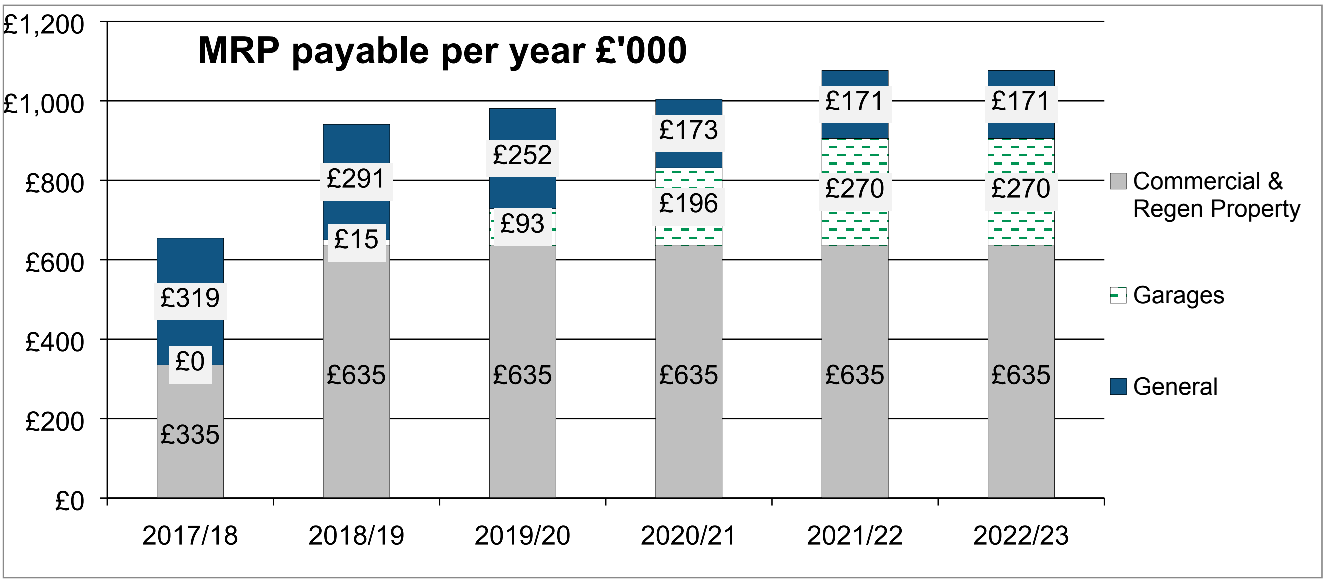
4.9.3 In 2017/18 there were General Fund loan repayments of £131,579 in August 2017 and February 2018. In addition approved prudential borrowing for the investment property portfolio and garage strategy is due to be taken in 2017/18 but will be dependent on actual spend in year.

4.9.4 Cash and investment balances have been used in preference to external borrowing as the costs of internal debt (investment interest foregone at 0.57%) is significantly lower than external borrowing (2.66% 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.

4.10 Minimum Revenue Provision

4.10.1 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.

4.10.2 Currently CLG are consulting on changes to MRP payments and any subsequent changes may require a revised MRP policy to be approved by Council at a later date in 2018/19. Current projections of MRP payments based on the existing policy are detailed in the following chart.



4.10.3 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 historic capital schemes) by £3.2Million or 24% of the total General Fund capital funded by borrowing as at 31 March 2018.

4.11 Future borrowing requirements

4.11.1 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. The Government has recently consulted on potential changes to borrowing for commercial purposes and commentary on this is in included in the 2018/19 Capital Strategy.

4.11.2 The Council's treasury advisors now forecast the Bank of England base rate to increase to 0.75% in December 2018. Base rate and borrowing rate forecasts are shown in the table below.

Link Asset Services Interest Rate View	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%

Source : Link Asset Services 7/11/17

4.11.3 The Treasury' s Certainty Rate for borrowing remains available and enables the Council to take PWLB loans at 20 basis points 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.

4.12 Investments

4.12.1 The Council complies fully with CIPFA Treasury Management Code 2011 and compliance with the updated Code will be confirmed in subsequent reports following the publication of CIPFA TM Code guidance. The Council also complies with Guidance on self-financing and the investment guidance issued by CLG. It should be noted that CLG investment guidance is currently being reviewed and an update will be given in subsequent reports.

4.12.2 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 2018/19

4.12.3The 2018/19 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.

4.12.4 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.

4.12.5 The TM limits for 2018/19 (Appendix D) have been reviewed and no changes to these limits are being proposed.

4.12.6 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 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.

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. At the time of writing updates to the prudential code indicators had not been finalised by CIPFA and as such may be amended/updated in subsequent treasury management reports to ensure the Council complies with best practice (see also section 4).

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.

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

5.2.3 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

5.4.2 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 2016/17
http://www.stevenage.gov.uk/content/committees/160923/160927/160991/20170228-Item12.pdf

BD2 2017/18 Mid Year Treasury Management Review
http://www.stevenage.gov.uk/content/committees/182083/182095/182099/Council-11-October-2017-Item11.pdf

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