



## AUDIT COMMITTEE

**Subject Heading:**

Treasury Management Strategy Statement (TMSS) 2019/20 and Annual Investment Strategy (AIS) 2019/20, Capital Prudential and Treasury Indicators and Minimum Revenue Provision Policy Statement for 2019/20

**SLT Lead:**

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**Policy context:**

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The code of practice on treasury management 2017 recommends that the Treasury Management Strategy and Minimum Revenue Provision Statement are reported to a scrutiny committee for effective scrutiny.

**Financial summary:**

The Treasury Management Strategy forms part of the Council's overall budget strategy and financial management framework.

**Is this a Key Decision?**

No

**When should this matter be reviewed?**

Bi-Annually

**Reviewing OSC:**

Audit Committee

### The subject matter of this report deals with the following Council Objectives

Communities making Havering	[x]
Places making Havering	[x]
Opportunities making Havering	[x]
Connections making Havering	[x]

## **SUMMARY**

The TMSS and AIS are part of the Council's reporting procedures and are recommended by the Chartered Institute of Public Finance and Accountancy (CIPFA) code of practice on treasury management and its prudential code for capital finance in local authorities. The Local Government Act 2003 requires councils to comply with both codes.

This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance, and it covers:

- The Borrowing and Investment Strategies
- Treasury Management Indicators
- Prudential Indicators
- A Minimum Revenue Provision Policy (the means by which capital expenditure which is financed from borrowing is paid for by council tax payers)

## **RECOMMENDATIONS**

To note the report and make any comment on its content.

## **REPORT DETAIL**

### **1. Introduction**

- 1.1 The Authority is required to set a balanced budget each financial year, which broadly means that income received during the year will meet its operational expenditure. As part of the overall financial management arrangements, a primary objective of the Treasury Management service is to ensure that the Authority's cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Authority's appetite for risk and liquidity requirements, as priorities before considering investment return.
- 1.2 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG)

Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately on this agenda.

CIPFA define treasury management as “The management of the local authority’s borrowing, 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.”

- 1.2 Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities. This expenditure is shown throughout this report as “regeneration programme”.
- 1.3 The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.
  - a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
    - the capital plans, (including prudential indicators);
    - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
    - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
    - an investment strategy, (the parameters on how investments are to be managed).
  - b. **A 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.
  - c. **An 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.
- 1.4 The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Board

## **2. Key Considerations and Sustainability**

### **2.1 Treasury Management Strategy for 2019/20**

2.1.1 The strategy for 2019/20 covers two main areas:

#### **Capital issues**

- the capital expenditure plans and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

#### **Treasury management issues**

- the current treasury position; See table 1 below
- treasury indicators which limit the treasury risk and activities of the Council; Appendix 2
- prospects for interest rates; Appendix 3
- the borrowing strategy;
- policy on borrowing in advance of need; Appendix 4
- debt rescheduling;
- the investment strategy;
- creditworthiness policy;
- the policy on use of external service providers.

2.1.2 These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

### **2.2 Training**

2.2.1 The needs of the Authority's treasury management staff for training in investment management are assessed on a regular basis as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by the treasury management adviser and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations. The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for scrutiny. Training will be arranged as required.

**3. Service Delivery and Performance Issues**

- 3.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, shown in Appendix 1, which are designed to assist Members' overview and confirm capital expenditure plans.

**3.2 Current Portfolio Position**

- 3.2.1 The overall treasury management portfolio as at 31 March 2018 and the position as at 31 December 2018 are shown below for both borrowing and investments.

**Table1: Current Portfolio Position**

<b>TREASURY PORTFOLIO</b>				
	<b>Actual 31/3/18 £m</b>	<b>Actual 31/3/18 %</b>	<b>Current 31/12/18 £m</b>	<b>Current 31/12/18 %</b>
<b>Treasury Investments</b>				
Banks & Building Societies	81.002	35	75.201	35
Government (including Local Authorities)	131.850	58	120.750	55
Money Market funds	12.737	6	9.500	4
Bonds	3.000	1	3.000	1
<b>Total Treasury Investments</b>	<b>228.589</b>	<b>100</b>	<b>223.608</b>	<b>100</b>
<b>Treasury External Borrowing</b>				
Local Authorities	30.000	12	0	0
PWLB	203.235	85	203.235	97
LOBO loans from banks	7.000	3	7.000	3
Other loans	0.250	-	0.250	-
<b>Total External Borrowing</b>	<b>240.485</b>	<b>100</b>	<b>210.385</b>	<b>100</b>
<b>Net Treasury Investments/(Borrowing)</b>	<b>(11.896)</b>		<b>(13.223)</b>	

Borrowing from Local Authorities as at 31 March 2018 was taken as temporary short term debt

3.2.2 The Council's forward projections for borrowing are summarised below in Table 2. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing

**Table 2: Capital Financing Requirement (CFR)**

<b>£m</b>	<b>2017/18 Actual</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
<b>External Debt</b>					
Debt at 1 April	215	241	251	369	463
Expected change in Debt	26	10	118	94	53
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Gross debt at 31 March	<b>241</b>	<b>251</b>	<b>369</b>	<b>463</b>	<b>516</b>
The Capital Financing Requirement	<b>264</b>	<b>281</b>	<b>423</b>	<b>543</b>	<b>604</b>
Under / (over) borrowing	<b>23</b>	<b>30</b>	<b>54</b>	<b>80</b>	<b>88</b>

3.2.3 Within the above figures the level of debt relating to regeneration activities is detailed in table 3 below

**Table 3: Regeneration Programme debt**

	<b>2017/18 Actual</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>	<b>2021/22 Estimate</b>
Actual debt at 31 March £m	21	26	123	174	196
Percentage of total external debt %	9	11	33	38	38

3.2.4 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits – see Appendix 1

3.2.5 The Chief Operating Officer reports that the Council complied with the prudential indicator that the Council's gross borrowing in the current year does not exceed its CFR and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### **3.3 Prospects for Interest Rates**

3.3.1 Current Forecasts are shown in Appendix 3

3.3.2 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The forecast, and Bank of England Monetary Policy Committee (MPC) decisions, will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

### **3.4 Borrowing Strategy**

3.4.1 Caution will be adopted with the 2019/20 treasury operations. The Chief Operating Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

3.4.2 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 with loan debt as cash supporting the Council'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 still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Operating Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

If it was felt that there was a significant risk of a sharp fall in long and short term rates, (e.g. due to a 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 borrowing will be considered.

If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio

position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

3.4.3 The reasons for any rescheduling to take place will include:

- \* the generation of cash savings and / or discounted cash flow savings;
- \* helping to fulfil the treasury strategy;
- \* to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

3.4.4 All rescheduling will be reported to the Cabinet at the earliest meeting following its action.

3.4.5 In October 2018, Prime Minister Theresa May announced a policy change of abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29/10/18

3.4.6 This Council's borrowing in advance of need policy can be found at Appendix 4

### **3.5 Annual Investment Strategy**

3.5.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report) which will be considered at the same meeting.

3.5.2 The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018.

3.5.3 The Council's investment priorities will be security first, portfolio liquidity second and then yield (return).

3.5.4 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This Authority has adopted a prudent approach to managing risk, its minimum credit criteria is set out in Appendix 5.

3.5.5 The Council will consider placing longer term treasury deals while investment rates are at historically low levels and where attractive interest rates with high quality counterparties become available.

- 3.5.6 Investments will make reference to the core balance, cash flow requirements and the outlook for short and medium term interest rates.
- 3.5.7 Credit ratings should not be the sole determinant of the quality of an institution, this Council is not bound by the agency with the lowest rating and, importantly, officers will continually assess and monitor the financial sector and the economic/political environment in which institutions operate.
- 3.5.8 Treasury investment instruments identified for use in the financial year are listed in Appendix 6 under the 'specified' and 'non-specified' investment categories.
- 3.5.9 The Chief Operating Officer will, on advice, make operational changes to these limits in response to prevailing market conditions and regulatory changes.
- 3.5.10 All investments will be denominated in sterling.
- 3.5.11 As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.
- 3.5.12 Following the consultation undertaken by the MHCLG on IFRS 9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from this financial year, 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.
- 3.5.13 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.
- 3.5.14 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank (RFB) will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

3.5.15 Whilst the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

3.5.16 This Authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

3.5.17 The local benchmark for investment is the 3 month LIBOR rate.

### **3.6 Loans to Third Parties**

3.6.1 The Authority may borrow to make grants or loans to third parties for the purpose of capital expenditure, as allowable under paragraph 25 (1) (b) of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 (Statutory Instrument No. 3146). This facility is likely to be used to support local economic regeneration and development activity but not limited to those purposes. The additional capital expenditure may be funded by external borrowing. Loans for working capital or revenue purposes are permitted as long as these are funded from the Council's internal cash balances as external borrowing is not permitted in such circumstances.

### **3.7 Treasury Indicators**

3.7.1 The indicators cover 2018/19-2021/22. The CIPFA Prudential Code and the TM code requires authorities to set treasury indicators and these are set out in Appendix 2. No breaches in the indicators are expected in 2019/20.

### **3.8 Minimum Revenue Provision (MRP)**

3.8.1 The MRP Policy Statement 2019/20 is set out in Appendix 7 of this report.

### **3.9 Policy on the use of external service providers**

3.9.1 The Council uses Link Asset Services as its external treasury management advisors.

3.9.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

## **REASONS AND OPTIONS**

### **Reasons for the decision:**

The statutory Codes set out that the Council ought to approve a Treasury Management Strategy Statement, the MRP Strategy and the Prudential Indicators.

### **Other options considered:**

The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Operating Officer, having consulted the Cabinet Member for Finance and Property, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset

**Audit Committee, 30 January 2019**

long-term fixed rates		by rising investment income in the medium term, but long-term costs may be less certain
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## **IMPLICATIONS AND RISKS**

### **Financial implications and risks:**

The Treasury Management Strategy Statement is a key part of the overall budget strategy and financial management framework and governs the strategic and operational treasury management activities throughout each financial year in order to manage the Council's financial risks associated with cash management via borrowing and investments.

For the financial year 2019/20, the budget for investment income has been set at £1.4m, based on an average interest rate of 0.8%.

The budget for long term debt interest payable in 2019/20 has been increased from £8.4m to £11.3m. This is based on the existing average long term debt portfolio of £210m at an average interest rate of 3.6% and has been adjusted for anticipated borrowing for the 2019/20 capital programme.

Of the existing £210m of long term debt, £170m is in relation to the HRA, with a budget for debt interest payable of £5.2m. An additional £0.7m will be incurred in 2019/20 in respect of new external borrowing interest costs.

The General Fund Budget for debt interest on external debt has been increased by £0.2m from £2.4m to £2.6m to allow for external borrowing to be undertaken should it be considered necessary in 2019/20 to fund the cost of borrowing for the increased capital programme.

The budget for debt interest on external debt for regeneration activities has been set at £2.8m in 2019/20.

If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different. Variance from budget will be reported on a bi-annual basis to full Council.

### **Legal implications and risks:**

The Council must comply with its duty under section 3 Local Government Act 2003 to keep under review the amount of money the Authority can afford to borrow. Regulation 2 of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003/3146 requires the Authority to have regard to the code of practice entitled the

“Prudential Code for Capital Finance in Local Authorities” published by CIPFA when considering its duty under section 3.

The Council has fiduciary duties toward its tax payers to act in good faith in the interests of those tax payers with the considerable sums of money at their disposal. The Strategies being proposed for approval seek to discharge those duties in a reasonable and prudent fashion and therefore there is a low risk of successful challenge.

Otherwise there are no apparent legal implications arising as a result of this Report.”

**Human Resources implications and risks:**

There are no direct Human Resources implications arising as a result of this report.

**Equalities implications and risks:**

There are no equalities implications within this report.

<b>BACKGROUND PAPERS</b>
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None.