Tunbridge Wells Borough Council

Treasury Management Policy and Strategy

2018/19

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1. INTRODUCTION

The Treasury Management Policy and Strategy is one of the Council's key financial strategy documents and sets out the Council's approach to the management of its treasury management activities.

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of treasury management is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments, commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

Another main part of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to longer cash flow planning to ensure that the Council can meet its capital spending requirement.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

> 'the management of the 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'.

The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments.

This strategy is updated annually to reflect changes in circumstances that may affect the strategy.

2. CIPFA REQUIREMENTS

The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management Code.

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement stating the policies, objectives and approach to risk management of the Council's treasury management activities (Section 3).

- Creation and maintenance of suitable Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (Section 4).

- Receipt by Full Council of an annual Treasury Management Strategy Statement (Section 5) including the Annual Investment Strategy (Section 6) and the Minimum Revenue Provision Policy (Section 7) for the year ahead.

- Production of a mid year review report and an annual report covering activities during the previous year (this Council presents a quarterly monitoring report to Cabinet with the fourth quarter taking the form of an annual review).

- Delegation by the Council of responsibilities for implementing and regular monitoring of its treasury management polices and practices and for the execution and administration of treasury management decisions (this Council delegates responsibility for implementation and monitoring treasury management to Cabinet and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. The role of the Section 151 Officer in treasury management is described in Section 8).

- Delegation by the Council of the role of scrutiny for treasury management strategy and policies to a specific named body (this Council delegates this responsibility to the Audit and Governance Committee).

3. TREASURY MANAGEMENT POLICY STATEMENT

The policies and objectives of the Council's treasury management activities are as follows:

1. This Council defines its treasury management activities as

   'The management of the 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. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council, and any financial instruments entered into to manage these risks.

3. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

4. TREASURY MANAGEMENT PRACTICES

The Council has created and maintains the following Treasury Management Practices (TMPs). These TMPs set out the manner in which the Council will seek to achieve its policies and objectives and how it will manage and control these activities.

TMP 1: Risk Management

TMP 2: Performance Management

TMP 3: Decision making and analysis

TMP 4: Approved instruments, methods and techniques

TMP 5: Organisation, clarity and segregation of responsibilities, and dealing arrangements

TMP 6: Reporting requirements and management information arrangements

TMP 7: Budgeting, accounting and audit arrangements

TMP 8: Cash and cash flow management

TMP 9: Money laundering

TMP 10: Training and qualifications

TMP 11: Use of external service providers

TMP 12: Corporate governance

The Treasury Management Practices are regularly updated and further details of these can be found within the Finance Section.

5. TREASURY MANAGEMENT STRATEGY STATEMENT

5.1 Current Investment Position

As at the 31st December 2017 the Council had £34 million of investments and the forecast equated principal for 2017/18 was estimated to be £38.50 million. The forecast average interest rate to be earned in 2017/18 is estimated at 1.71%. This compares to a current base rate of 0.50% and will earn the Council approximately £660,000 in interest.

The Council borrowed £20 million in July 2010 for potential property investment. As at the 31st December 2017 £6 million of this loan was outstanding, under the repayment terms of the loan, of which £4 million had been used to fund property purchases. The remaining £2 million has been invested as part of the Council's investment portfolio.

All the Council's investments are held within the United Kingdom.

5.2 Prospects for Interest Rates

The Bank of England raised the base interest rate from 0.25% to 0.50% in November 2017, the first rate rise in over a decade. The Council has appointed Link Asset Services (formerly Capita Asset Services) as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates. Their view is shown below along with the view of Capital Economics.

	Link Asset Services	**Capital Economics**
Current	0.50%	0.50%
Mar 2018	0.50%	0.50%
Jun 2018	0.50%	0.75%
Sep 2018	0.50%	1.00%
Dec 2018	0.75%	1.25%
Mar 2019	0.75%	1.25%
Jun 2019	0.75%	1.50%
Sep 2019	0.75%	1.50%
Dec 2019	1.00%	1.75%
Mar 2020	1.00%	2.00%

These forecasts have been reflected in the Council's interest budget calculations.

5.3 Borrowing Strategy

The Council borrowed £20 million in July 2010 for potential property investment. As at the 1st April 2018 there will be a balance of £5 million outstanding, of which £2 million will be repaid during the financial year 2018/19.

Link Asset Services forecast the PWLB borrowing rates as follows:

	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Sep 2019	Dec 2019	Mar 2020
5 year	1.55%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%
10 year	2.05%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%
25 year	2.64%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
50 year	2.38%	2.50%	2.70%	2.90%	2.90%	2.90%	3.03%	3.03%	3.15%	3.20%

Capital Economics forecast the PWLB borrowing rates as follows:

	Dec 2017	Mar 2018	Jun 2018	Sep 2018	Dec 2018	Mar 2019	Jun 2019	Sep 2019	Dec 2019	Mar 2020
5 year	1.55%	1.70%	1.90%	2.10%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%
10 year	2.05%	2.20%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%
25 year	2.64%	2.60%	2.90%	3.10%	3.30%	3.30%	3.30%	3.35%	3.35%	3.35%
50 year	2.38%	2.50%	2.70%	2.90%	2.90%	2.90%	3.05%	3.05%	3.15%	3.15%

These rates include a Government reduction of 0.20% which is given to authorities who provide information on their plans for long term borrowing and associated capital spend.

The Council will consider borrowing from the following:

- Temporary Borrowing from the money markets or other local authorities
- Public Works Loans Board (PWLB)
- Long term fixed rate market loans at rates significantly below PWLB rates

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of funds.

The Council will continue to take a flexible approach with regards to the funding of capital acquisitions. These schemes may involve the use of borrowing where it is considered to be advantageous and such decisions will be taken by the Director of Finance, Policy and Development in accordance with market conditions at that time.

5.4 Prudential Indicators 2018/19 to 2020/21

The Council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans is reflected in the prudential indicators. Local Authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2018/19 to 2020/21 are set out below:

		2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
1	**Capital Expenditure** Council's capital expenditure plans £'000	£8,307	£31,957	£32,626
2	**Capital Financing Requirement** Measures the underlying need to borrow for capital purposes as at 31st March £'000	£4,776	£29,616	£54,456
3	**Expected Investment Balances** As at 31st March £'000	£17,000	£15,000	£13,000
4	**Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	1.50%	6.00%	12.00%

5.5 Treasury Indicators 2018/19 to 2020/21

The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code.

The Treasury Indicators for 2018/19 to 2020/21 are set out below.

		2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
1	**Authorised Limit for External Debt** The Council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council.	£97 million	£97 million	£97 million
2	**Operational boundary for external debt** The Council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons.	£97 million	£97 million	£97 million
3	**Upper limit for fixed interest rate exposure** Identifies a maximum limit for fixed interest rates for borrowing and investments.	100%	100%	100%
4	**Upper limit for variable interest rate exposure** Identifies a maximum limit for variable interest rates for borrowing and investments.	70%	70%	70%
5	**Maturity Structure of Borrowings** The Council needs to set upper and lower limits with respect to the maturity structure of its borrowing. As the Council has now entered into long term borrowing, as approved by Full Council, the upper limit for borrowings with a maturity over 12 months is 100%.			

	Upper limit for under 12 months Lower limit for under 12 months Upper limit for over 12 months Lower limit for over 12 months	100% 0% 100% 0%	100% 0% 100% 0%	100% 0% 100% 0%

6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

The Council's investment policy has regard to the Local Government Act 2003, the CIPFA Prudential Code, DCLG MRP Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance. The Council's investment priorities are:

(a) the security of capital and
(b) the liquidity of its investments
(c) return

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

In accordance with guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Council stipulates the minimum acceptable credit quality of counterparties for inclusion on the lending list. Furthermore, the Council recognises that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector in relation to the economic and political environments in which institutes operate.

The Council will invest in property within the borough that is strategically important for the economic vitality of the borough and in doing so improves the longer term revenue and capital position of the Council.

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Council will ensure that all the organisation's investments are covered in the capital programme and investment strategy and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

The organisation will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

6.2 Creditworthiness Policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:

- It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Director of Finance, Policy and Development will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Cabinet for approval as necessary.

This Council uses Fitch as its main agency but also monitors ratings from the other agencies, Moodys and Standard and Poors. In line with Link Asset Services the Council focuses on the short and long term ratings of an institution. These are defined as follows:

Long Term	Long-term ratings consider periods of longer than 13 months and are a benchmark measure of the probability of default.
Short Term	Short-term ratings place greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

Link Asset Services provides the Council with information on Credit Default Swap spreads, which give an early warning of likely changes in credit ratings, which the Council also takes into account.

All credit ratings are monitored weekly and the Council is alerted to changes in ratings through its use of the Link Asset Services creditworthiness service. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

6.3 Proposed Limits 2018/19

The proposed investment criteria and limits for 2018/19 are:

- Banks – the Council will only use banks which are UK banks or are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA and have the following Fitch credit rating:

Long Term	Short Term	Maximum Investment	Maximum Duration
AA+ AA AA-	F1+	£20 million	5 years
A+ A A-	F1	£10 million	3 years

- Part Nationalised UK Banks – Royal Bank of Scotland.
  This can be included provided it continues to be part nationalised or it meets the criteria in the Banks category above.

- The Council's own banker – Lloyds Banking Group
  The Council has its bank account with Lloyds who as well as providing banking services accept Treasury Management Deposits. Having accepted that Lloyds is sufficiently secure to undertake our banking arrangements it is proposed to include them within the same top rating as banks. This will ensure that deposits and overnight current balances do not breach the current Treasury Management Policy.

Maximum Investment	Maximum Duration
£20 million	5 years

  It is proposed that the limit applies to investment deposits and is in addition to the amount held in the Lloyds current account. This is because the Council has negotiated an advantageous rate of interest paid by Lloyds for its current account balances which is often more favourable than placing a longer term investment.

- Bank subsidiary and treasury operation - the Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building Societies – the Council will use all societies which meet the ratings for banks outlined above.

- Money Market Funds (rated AAA) – a maximum investment per body of £5 million up to a maximum duration of 5 years

- Local Authorities - a maximum investment per body of £5 million up to a maximum duration of 5 years

- UK Government DMADF account – a maximum investment of £30 million up to a maximum duration of 5 years.

- UK Government Gilts and treasury bills – a maximum investment of £10 million up to a maximum duration of 5 years.

- Bonds issued by multilateral development banks (AAA rated) – a maximum investment of £5 million up to a maximum duration of 1 year.

- Collective Investment Schemes (Pooled Funds) – on advice from Link Asset Services up to a maximum of £10 million.

- Investment in organisations for the purposes of improving the Council's Assets – following a satisfactory external credit report. A maximum investment of £5 million per body up to a maximum duration of 5 years.

The Director of Finance, Policy and Development will continue to consider all investment decisions on an individual basis and investments will not be made based only on satisfying the criteria set out above.

6.4 Interest Budget 2018/19

The interest income included in the 2017/18 budget was £630,000 and it is expected this will be over achieved by an additional £30,000. The interest cost from the current PWLB loan is budgeted at £145,310.

The estimated average funds available for investment in 2018/19 are £30.1 million. The Council's existing investments in 2018/19 equate to £5.26 million of this at a rate of 2.00% resulting in interest of £105,000.

The Council currently has £9 million worth of units in The Local Authorities' Property Fund which pays a dividend to the Council on a quarterly basis. It is expected that the Council will keep the £9 million of units with the Fund during the course of 2018/19. An average rate, net of fees, of 4.75% has been applied which results in interest of £427,000.

It is estimated that, on average, a rate of 0.50% will be achieved on the remaining funds of £15.84 million resulting in interest of £79,000. The rate is low compared to the rest of the portfolio as much of this money will need to be kept short term to meet the Council's cash flow requirements. This, along with the £105k from existing investments and £427K from the Property Fund, brings the total interest budget to £611k, an overall average rate of interest of 2.03%.

The interest to be charged on the existing PWLB loan for 2018/19 is £97,710.

In summary the estimated position is as follows:

Interest/Yield Received	£611,000
Interest Cost	£97,710
Net Interest	**£513,290**

6.5 Treasury Management Targets 2018/19

The Treasury Management targets for 2018/19 are:

1. To achieve an average investment rate of 2.03% in 2018/19;

2. Longer term investment decisions (in excess of one year) to be made in the context of a minimum investment rate of 0.50% in 2018/19, 0.75% in 2019/20 and 1.00% in 2020/21; and

3. Overall cash flow will be managed to achieve a nil borrowing requirement although borrowing will be considered an option where it is prudent to do so.

The annual strategy and targets will need to take into account changing market conditions. Therefore the Director of Finance, Policy and Development will make investment decisions in accordance with market conditions prevailing at the time. Changes to the general strategy position will be reported to the next appropriate Cabinet.

7. MINIMUM REVENUE PROVISION POLICY

Where a Local Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. This amount is charged to the revenue budget for the repayment of debt and is known as Minimum Revenue Provision (MRP).

Authorities are required to calculate an MRP that they consider to be prudent. The objective is to ensure that the debt is repaid over a period that is reasonable and commensurate with that over which the capital expenditure provides benefits.

The proposed Policy Statement for 2018/19 is below:

Minimum Revenue Provision Policy Statement

There are four options for calculating MRP as set out in the Guidance for the Local Government Act 2003. They are:

- Option 1: Regulatory Method (4% borrowing requirement)
- Option 2: Capital Financing Requirement (CFR) Method (4% of non-housing borrowing requirement)
- Option 3: Asset Life Method (divide debt by asset life)
- Option 4: Depreciation Method (dependent on depreciation policy)

However, only options 3 and 4 are available to this Council as the borrowing is unsupported by the Revenue Support Grant.

For capital expenditure financed from borrowing or credit arrangements, the MRP for this Council will be calculated using Option 3, Asset Life Method, with the asset life determined from the outset and MRP charged in the year following the one in which the expenditure occurred. Where expenditure is incurred over more than one year, then the MRP shall commence in the year following the year in which the asset becomes operational. If no life can be reasonably attributed to an asset, such as freehold land, the life should be taken to be a maximum of 50 years.

It is thought that this is the most appropriate method as this provides for the Council to make revenue provision over the estimated life of the asset for which the borrowing is undertaken. In effect, the charge to the Comprehensive Income and Expenditure account will be the amount borrowed in respect of the asset, divided by the number of years of estimated life of the asset, and will result in an equal annual amount being charged as MRP.

The regulations require Full Council approval in advance of the year to which the MRP applies. The Council can change the method of calculating MRP on an annual basis but once a method has been approved for a particular year, any assets purchased through borrowing that year must continue to have MRP charged in the same way. The Council cannot change the method of calculating MRP on individual assets.

8. ROLE OF THE SECTION 151 OFFICER IN TREASURY MANAGEMENT

The Section 151 officer has the following role in treasury management:

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing management information reports
- Reviewing the performance of the treasury management function
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- Ensuring the adequacy of internal audit, and liaising with external audit
- Recommending the appointment of external service providers