Uttlesford District Council

Treasury Management Strategy

2016/17

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1.0 - Introduction

1.1 The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management requires the preparation of an annual Treasury Management Strategy Statement (TMSS).

1.2 Treasury Management activities are defined by CIPFA as:

"The management of the Council's investments, borrowing 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 optimal performance consistent with those risks."

1.3 The Council regards the successful identification, monitoring and control of risk to be prime criteria by which the effectiveness of its treasury management activities will be measured. Therefore, any reporting of treasury management activities will focus on the risk to the Council and the management of such risks.

1.4 The main risks to the Council's treasury activities are:

- Liquidity risk (inadequate cash resources)
- Market or interest rate risk (fluctuations in interest rates)
- Inflation risk (exposure to change in prices)
- Credit and counterparty risk (security of investments)
- Refinancing risks (impact of debt maturing in future years)
- Legal and regulatory risk (i.e. non-compliance with requirements)

1.5 The main changes from the strategy adopted in 2015/16 are:

The counterparty list has been closely aligned to the recommendation and list provided by the council's Treasury Management consultants.

The strategy overall has expanded the number of counterparties, without compromising the risk. It will continue to diversify the surplus of cash in order to reduce the risk the Council is exposed to within the financial markets and increase interest earned.

In terms of money market funds the previous strategy only approved UK domiciled funds which in effect restricted UDC to invest with only 2 money market funds. The new strategy will now include non-UK domiciled funds as recommended by the Council's Treasury Management consultants.

Finally the new strategy will allow the Council to increase its investment in current accounts with other banks. These are also callable the next day and highly liquid investment options.

2.0 - Policies and Objectives

2.1 The Council acknowledges that effective Treasury Management will provide support towards the achievement of its business and services objectives. Therefore, it is committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques within the context of effective risk management.

2.2 The Council's borrowing will be affordable, ensuring appropriate provision is made within the revenue budget to repay debt. It should also be sustainable and prudent, consideration being given to the management of interest rate risk and risks associated with refinancing. Also, the Council's borrowing activities will be transparent as will its control of its debt.

2.3 With regards to the Council's Investment Strategy the key focus and order of priority will be as follows:

1) Security
2) Liquidity
3) Return

3.0 - Reporting Requirements

3.1 In line with best practice, Members are required to receive and approve, as a minimum, three main reports each year. The report which should accompany the Council's budget strategy and Medium Term Financial Strategy (MTFS) is to be reviewed by Scrutiny Committee prior to approval by Cabinet and referral to Full Council. The main reports to be reviewed during the year are:

a) Mid-Year Treasury Management Report:

updating Cabinet with progress on the capital position, amending the prudential indicators or Investment Counterparty list as necessary and in general revising the TM strategy if need be.

b) An Annual Treasury Management Outturn Report:

Providing details of actual prudential and treasury indicators and actual treasury operations compared to the estimates included in the strategy. The report will be presented to Cabinet in September 2016 after the financial year end.

c) Treasury Management Regular Reports:

included within the General Fund, Housing Revenue Account and Capital Programme budget monitoring reports received by the Cabinet as scheduled in the Committee reporting timetable.

4.0 - External Context

4.1 There is momentum in the UK economy, with a continued period of growth through domestically-driven activity and strong household consumption. There are signs that growth is becoming more balanced. The greater contribution from business investment should support continued, albeit slower, expansion of GDP. However, inflationary pressure is benign and is likely to remain low in the short-term. There have been large falls in unemployment but levels of part-time working, self-employment and underemployment are significant and nominal earnings growth remains weak and below inflation.

4.2 The MPC's focus is on both the degree of spare capacity in the economy and the rate at which this will be used up, factors prompting some debate on the Committee.

4.3 Credit outlook: The continued global economic recovery has led to a general improvement in credit conditions since last year. This is evidenced by a fall in the credit default swap spreads of banks and companies around the world. However, due to the above legislative changes, the credit risk associated with making unsecured bank deposits will increase relative to the risk of other investment options available to the Authority.

4.4 Interest rate forecast:
The Council's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time.

4.5 A more detailed economic and interest rate forecast provided by the Arlingclose is attached at ***Appendix A3***.

5.0 - Borrowing Strategy

5.1 The Council maintained an 'under-borrowed' position up until 28th March 2012. This means that the Capital Financing Requirement was not funded with new external debt as cash supporting the Council's reserves balances and cash flow have been used. This position changed with the need to borrow to finance the HRA 'Self Financing' payment.

5.2 The Medium Term Financial Strategy (MTFS) is based on the following borrowing assumptions for the next five years:

- *To finance capital expenditure by continuing to run down cash balances and forego interest income at historically low interest rates.*
- *The Council has signed up for the Government's new 'certainty rate' for local authorities of 0.2% below the standard PWLB rates but the arrangement will not be required for 2016/17 as the intention is to use internal borrowing which is currently more cost effective.*
- *If there is a significant risk of a sharper rise in long and short term rates than forecast then the debt portfolio position will be reappraised; with consideration given to fixed rate funding whilst rates are still relatively cheap.*

5.3 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

5.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as official interest rates remain low, it is unlikely to be sustainable in the medium-term.

5.5 In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

5.6 The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board and its successor body
- UK local authorities
- any institution approved for investments
- any other bank or building society authorised by the Prudential Regulation Council to operate in the UK

5.7 The Council has previously raised £88.407m of long-term borrowing from the Public Works Loan Board.

6.0 - Debt Rescheduling

6.1 The Council's debt portfolio can be restructured through the premature repayment of loans and refinancing to reduce interest rate risk and make savings in the revenue budgets.

6.2 The Council currently pays approximately £2.6m each year towards interest cost for the £88.407m loan borrowed from PWLB.

6.3 The Council has the option of paying off some of the loans prior to maturity in order to benefit from discount rates and save on future interest rate payments if cash flow forecast permits. Following discussions with the Council's Treasury Management consultants it is agreed that the Council could benefit from future discount rates offered by Public Works Loan Board (PWLB) and overall reduce cost to the Council. With the assistance of the Council's treasury advisors, the debt portfolio will be kept under review to take advantage of any rescheduling opportunities.

January 2016 – Fixed Rate Loans Only

Final Payment	Balance Outstanding	Loan Rate	Discount Rate
28/03/2018	2,000,000	0.65	0.66
28/03/2019	2,000,000	0.65	0.66
28/03/2020	2,000,000	0.65	0.66
28/03/2021	2,000,000	0.65	0.66
28/03/2022	2,000,000	0.65	0.66
28/03/2023	2,000,000	2.56	1.30
28/03/2024	3,000,000	2.70	1.40
28/03/2025	3,000,000	2.82	1.49
28/03/2026	3,000,000	2.92	1.57
28/03/2027	3,000,000	3.01	1.64
28/03/2028	3,000,000	3.08	1.70
28/03/2029	3,000,000	3.15	1.76
28/03/2030	4,000,000	3.21	1.82
28/03/2031	4,000,000	3.26	1.88
28/03/2032	4,000,000	3.30	1.93
28/03/2033	4,000,000	3.34	1.98
28/03/2034	4,000,000	3.37	2.02
28/03/2035	4,000,000	3.40	2.06
28/03/2036	4,000,000	3.42	2.09
28/03/2037	5,000,000	3.44	2.12
28/03/2038	5,000,000	3.46	2.15
28/03/2039	5,000,000	3.47	2.17
28/03/2040	5,000,000	3.48	2.18
28/03/2041	5,000,000	3.49	2.20
28/03/2042	5,407,000	3.50	2.20
	88,407,000		

7.0 - Investment Strategy

7.01 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's outstanding investment balance has ranged between £26m and £52 million, and similar levels are expected to be maintained in the forthcoming year.

7.02 Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk receiving unsuitably low investment income.

7.03 The Council may invest its surplus funds with any of the counterparties in section page 11 subject to the cash, credit rating and time limits shown.

7.04 Given the increasing risk and continued low returns from short term unsecured bank investments the Council aims to diversify into more secure and/or higher yield during 2016/17.

7.05 Current Account:

The Council banks with Barclays plc which meets the Council's minimum credit criteria, BBB+. Even if the banks credit rating fell below the Council's minimum rating the bank would continue to be used to facilitate short term liquidity requirements (overnight and weekend investments) and to provide business continuity arrangements.

7.06 In determining the maximum investment with Barclays plc the Council will need to exclude the balance on the Deposit and General account which are all non-fixed cash balances and are callable at any time.

7.07 For liquidity reasons and to ensure optimum interest the Council should hold no more than £2m of cash overnight on the Barclay Bank General Bank, i.e. callable account, excluding the deposit account

7.08 The Council will also have the flexibility to open accounts with other banks subject to meeting Council's minimum credit criteria and the parameters listed within the Counterparty list. The Council will be able to hold cash balances of up to £2m, excluding fixed term deposits, per callable account with other Banks. Therefore cash balances in these accounts can be requested on the same day to help with Council's cash flow requirements during the year and earn interest returns at the same time.

7.09 This level of diversification will ensure security and liquidity of the investments the Council makes on a daily basis as part of its treasury management arrangements.

7.10 Banks Unsecured:

These are accounts, deposits and building societies. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investments with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's General Bank Account with Barclays plc.

7.11 Government:

These are loans, bonds and bills issued or guaranteed by national governments, regional and local authorities. These investments are not subject to bail-in and there is an insignificant risk of insolvency. Investments with the UK central Government may be made in unlimited amounts for up to 50 years.

7.12 Money Market Funds

These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts. In 2015/16 the Council only invested in the public sector deposit fund as it was one of the two UK domiciled money market fund.

7.13 Use of Financial Instruments

Although legislation has opened up the ability of Councils to operate in a similar manner to a corporate body (General Power of Competence – Localism Act 2011) and use financial derivatives to manage its treasury management risks. The Council does not at present intend to use derivative financial instruments to manage treasury management risk.

7.14 Treasury-Bills (T-Bills):

These are short term securities issued by HM Treasury on a discount basis. For example a £100 coupon will be issued below its value to the investor and on maturity the investor will receive £100. The difference will be the interest received. The security can also be cashed before maturity in the active secondary market giving the lending party more freedom to cash in the T-bill before maturity date. The Council has invested in T-Bills in 2014/15 using Barclays Plc as the Custodian account.

7.15 Government Gilts:

Conventional gilt is a liability of the Government which guarantees to pay the holder of the gilt a fixed cash payment (coupon) every six months until the maturity date, at which point the holder receives the final coupon payment and the return of the principal. The Council has not invested in Gilts in 2015/16.

7.16 Specified Investments:

The CLG Guidance defines specified investments as those denominated in pound sterling and due to be repaid within 12 months of arrangement. Also not defined as capital expenditure by legislation, and invested with the UK Government, a UK local Authority, or a body or investment scheme of “high credit quality”.

7.17 Non-specified Investments:

Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares.

7.18 Given the Council’s current risk appetite in the current economic climate the Council is not willing to consider ‘Non Specified’ investments.

7.19 Investment Limits

The Council’s revenue reserves (usable reserve) available to cover investment losses are forecast to be 8.039 million on 31st March 2016.

Counterparty list:

General Counterparty list *	Credit Rating	Cash limit	Time limit
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£3m	365 days
	AA+	£3m	365 days
	AA	£3m	365 days
	AA	£3m	365 days
	AA-	£3m	365 days
	A+	£3m	365 days
	A	£3m	365 days
	A-	£3m	365 days
	BBB+	£1m	100 days
Council's General bank acount if it fails to meet the above criteria, excluding fixed term deposit accounts		£2m	next day
UK Central Government (irrespective of credit rating)	AA+	unlimited	50 years
UK Local Authorities including Fire and Police (irrespective of credit rating), per authority	N/A	£5m	365 days
UK Building Societies without credit ratings	N/A	£1m	365 days
Saffron Building Society	N/A	£0.5m	100 days
Money Market Funds, per fund	AAA	£3m	next day

* This list is the maximum risk appetite the Council is willing to take and is within the limit set by Arlingclose Counterparty list. For practicality UDC cash limit is set prior to start of the year. The time limit set by Arlingclose in their regularly updated counterparty report will not be exceeded even if its shorter than the limit shown above

7.20 Approved Instruments:

The Council may lend or invest money using any of the following instruments:

- interest-bearing bank accounts
- fixed term deposits and loans,
- Government Treasury Bills (T-Bills)
- Money Market Funds and other pooled funds.

7.21 Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

8.0 - Risk Assessment

8.1 Where applicable, the Council uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

8.2 Credit rating:

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

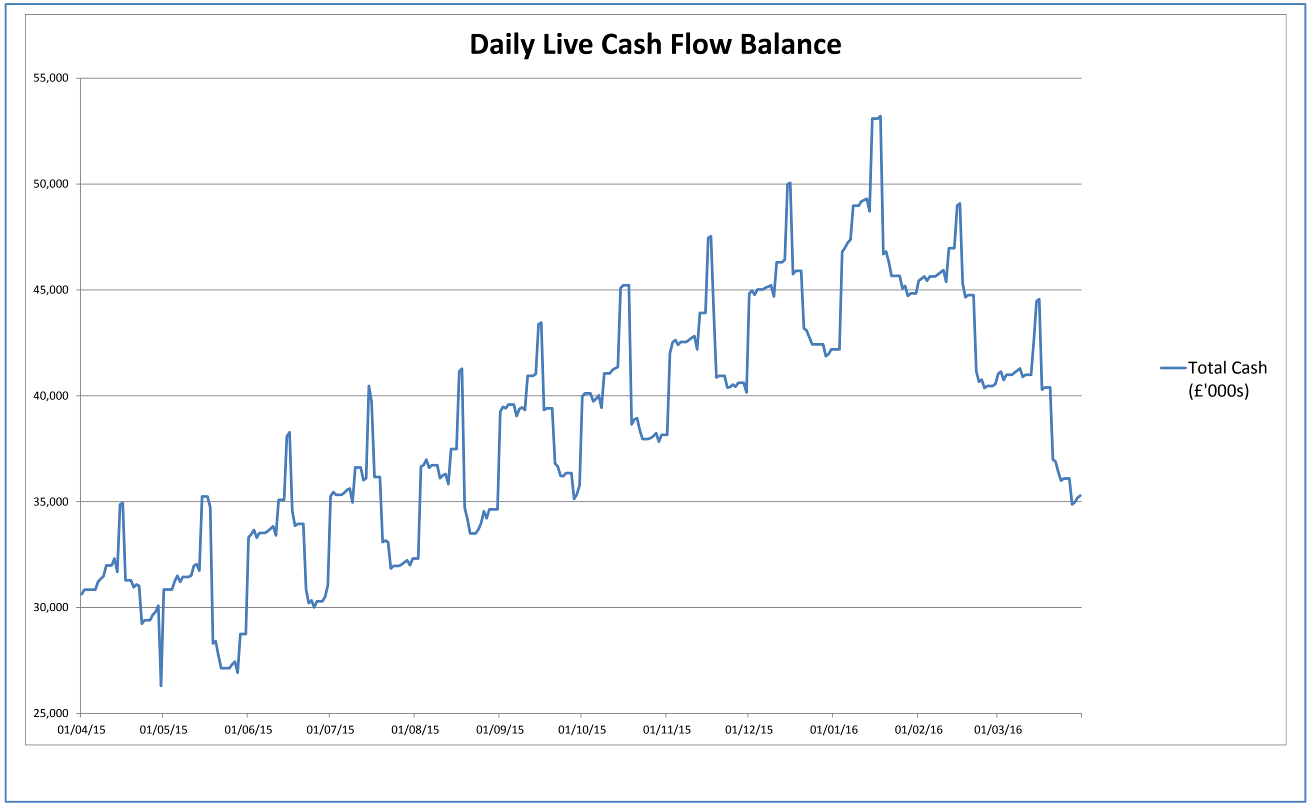
8.3 When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security.

8.4 The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

9.0 - Liquidity Management

9.1 The Council uses cash flow forecasting spreadsheets to determine the maximum period for which funds may prudently be committed.

9.2 The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.



* *The fall in income during the last two months of the financial year is due to the fact that the Council receives most of its Council Tax and Business Rates income in the first 10 months of the year.*

10.0 - Governance Arrangements

10.1 Treasury Management Scheme of Delegation:

The following lists the main treasury management responsibilities in relation to the relevant individual/Committee:

Full Council:
Approval of the Treasury Management Strategy, Prudential Indicators and Minimum Revenue Provision.

Cabinet:
Reviews the Treasury Management Strategy and recommends the Strategy for approval by Full Council. Receive reports on Treasury Management activities.

Performance and Audit Committee:
Monitors compliance with the Council’s Financial Regulations.

Scrutiny Committee:

Assists in the development of budget and policy framework. Reviews and scrutinises policy objectives and performance targets.

S151 Officer – Director of Finance and Corporate Services:

Implements and monitors the Treasury Management Strategy. Reports to Cabinet no less than three times in each financial year on treasury management activities and the relevant delegated powers.

One activity report must comprise the annual treasury management outturn report. To be reported to Cabinet by the October following the end of the financial year.

11.0 - Treasury Management Procedures

11.1 Treasury Management Procedures (TMP's) will be reviewed on an annual basis prior to the commencement of the financial year and will be in compliance with CIPFA's guidance on Treasury Management Practices.

11.2 Role of Treasury Management Advisors:

The Council uses Arlingclose as its treasury management advisors, which provides access to specialist skills/resources in the following areas:

- Credit Advice
- Investment advice
- Technical advice
- Economic and interest rate forecasts
- Workshops and training events
- HRA support and other support

11.3 The quality of the service provided by Arlingclose reviewed by the Chief Finance officer and other relevant staff members.

11.4 In applying the Council's agreed terms of appointment and undertaking timely reviews of the service provided; the value added from the appointment can be assessed and properly documented.

11.5 The Council recognises that the responsibility for treasury management decisions remains with the Council at all times and will ensure that the appropriate training and decision making process does not place undue reliance on the advisors.

11.6 Training:

CIPFA's Code of Practice requires the S151 Officer to ensure that all officers and members tasked with treasury management responsibilities, including scrutiny of the TM function receive appropriate training and understand fully their roles and responsibilities.

12.0 – Existing Investment & Debt Portfolio Position

Forecast Investment and Debt Portfolio Position As at 31st March 2016	
Balance Sheet Extract	**Forecast £'000**
External Borrowing:	
Variable Rate PWLB	10,000
Fixed Rate PWLB	78,407
Total External Borrowing	**88,407**
Other Long Term Liabilities:	
PFI	4,967
Finance Leases	11
Pension Liability	0
Total Long Term Liabilities	**4,978**
Total Gross Debt	**93,385**
Investments	
Long Term Investments	0
Short Term Investments	21,000
Cash and Cash Equivalents	2,416
Total Investments	**35,527**
Net Borrowing	**57,858**