Uttlesford District Council

Treasury Management Strategy 2017/18

1.0 – Introduction

The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.

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."*

The Authority has invested and borrowed substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

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.

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)

The changes from the strategy adopted in 2016/17 are:

The counterparty list for other Local Authorities (to include Fire and Police) was revised in December 2016 and the changes were;

- The investment limit was increased from £5m per authority to unlimited
- The percentage of portfolio invested increased from 70% to 100%
- The maximum number of days of investment increased from 365 to 730 days.

The operational boundary was increased from £101.5m to £250.0m to allow the Council flexibility in its borrowing to support future investment and the Council's wholly owned company.

2.0 – Policies and Objectives

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.

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.

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

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:

- 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.

- 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 the June Cabinet after the financial year end.

- 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

Economic Background

The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook

Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18**.** The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic

fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix C.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 2.86%.

5.0 – Borrowing Strategy

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.

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

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 2017/18 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.

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.

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.

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

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

- Public Works Loan Board and any 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
- European Banks as approved by our independent Consultants, Arlingclose, who will undertake appropriate analysis of financial statements

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Operating and Finance Leases
- Hire Purchase
- Private Finance Initiative
- Sale and Leaseback

The Council has previously raised all of its long term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

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

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.

The Council currently pays approximately £2.6m each year towards interest cost for the £88.407m loan borrowed from PWLB. 2017/18 is the first year of the principal repayment of the loan, for £2.0m. The following table details the current debt portfolio.

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

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.

6.0 – Investment Strategy

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 £54m, and similar levels are expected to be maintained in the forthcoming year.

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. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

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

Given the increasing risk and falling returns from short term unsecured bank investments the Council will investigate options to diversify into more secure and/or higher yield investments during 2017/18.

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.

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.

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.

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.

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.

Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

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.

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.

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 2017/18 the Council only invested in the public sector deposit fund, one of the two UK domiciled money market funds.

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.

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 not invested in T-Bills in 2016/17 and has no current plans to use this investment option in 2017/18.

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 2016/17 and has no current plans to use this investment option in 2017/18.

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".

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.

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

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.

Investment Limits:
The Authority's revenue reserves available to cover investment losses are forecast to be £9.921million on 31st March 2017. In order that no more than 10% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and other Local Authorities, including Fire and Police) is detailed in the counterparty list on the next page. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

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.

The counterparty list as approved by Cabinet on the 1st December 2016 is shown below;

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
	A+	£3m	365 days
	A	£3m	365 days
	A-	£3m	365 days
	BBB+	£1m	100 days
Council's General Bank Account if it fails to meet the above criteria, excluding fixed term deposits accounts		£2m	Next Day
UK Central Government (irrespective credit rating)	N/A	Unlimited	50 years
UK Local Authorities including Police and Fire (irrespective of credit rating) per authority	N/A	Unlimited	730 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 limits set by Arlingclose Counterparty list.

For practicality UDC cash limit is set prior to the start of the year. The time limit set by Arlingclose in their regularly updated counterparty report will not be exceeded even if it is shorter than the limit shown above.

7.0 - Risk Assessment

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
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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.

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.

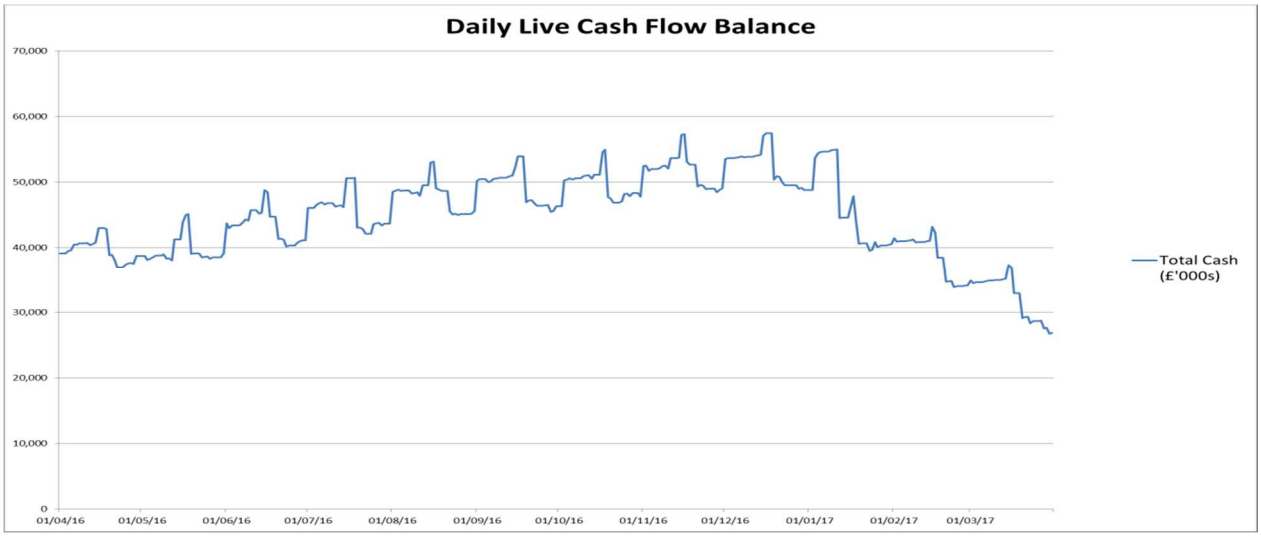
The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via 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.

8.0 - Liquidity Management

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

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 graph below shows the levels of cash held in the financial year 2016/17. 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.



Existing Investment & Debt Portfolio Position

	31 December 2016	
	Actual Portfolio £m	**Average Rate %**
External Borrowing:		
Public Works Loan Board	88.407	1.64
Total External Borrowing	**88.407**	
Other Long Term Liabilities:		
PFI	4.956	8.29
Total Gross External Debt	**93.363**	
Investments:		
Banks & building societies (unsecured)	6.500	0.47
Government (incl. local authorities)	48.500	0.33
Money Market Funds	1.000	0.68
Total Investments	**56.000**	
Net Debt	**37.363**	

Investment Training:
The needs of the Authority's treasury management staff for training in investment management are assessed regularly as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend workshops, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment Advisers:
Arlingclose Limited is the Councils appointed treasury management advisers and they provide specific advice on investment, debt and capital finance issues.

Budget Implications:
The budget for investment income in 2017/18 is £65,000 for the General Fund and £15,000 for the HRA, based on an average investment portfolio of £27 million at an average interest rate of 2.86%. The budget for debt interest paid in 2017/18 is £2.6 million, based on an average debt portfolio of £88.4 million at an average interest rate of 1.64%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

9.0 - Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance and Corporate Services (s151 Officer), having consulted the Portfolio Holder for Finance, 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 long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

10.0 - Governance Arrangements

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. Receives reports on Treasury Management activities.

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