South Derbyshire District Council

Treasury Management Strategy Statement 2018/19

February 2018

Introduction

The Authority has 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 (DCLG) 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 DCLG Guidance.

The Authority has borrowed and invested 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.

Updates on treasury activity are reported to the Finance and Management Committee on a quarterly basis. A further annual report is produced alongside the final accounts each June to detail all activity for the year.

Responsibility for Treasury Management

The Finance and Management Committee is responsible for setting and monitoring treasury activity at the Council. Under its terms of reference, this includes ensuring that the Council does not breach its borrowing limit.

The Committee is advised by its Section 151 (Chief Finance) Officer who is the Strategic Director (Corporate Resources). This Officer is responsible for the oversight of activity and to ensure that treasury strategy and associated policies are met.

The day-to-day operational activity is undertaken within the Financial Services Unit at the Council. The main officers who have responsibility for daily transactions are the Senior Accountant and the Service Accountants.

The Authorising Officers for transactions are the Strategic Director (Corporate Resources), Financial Services Manager and the Revenues and Customer Services Manager. Any new borrowing or investment has to have the prior approval of the Strategic Director (Corporate Resources).

External Support for Treasury Activity

All designated officers involved in treasury activity are covered under the Council's Fidelity Guarantee insurance. Officers are also supported by external treasury advisors who provide research material, news bulletins, together with general advice and guidance.

Audit Arrangements

The Council's Internal Audit function audits treasury policies and procedures, together with treasury activity and transactions at least once per year. This is a requirement of External Audit. Any matters raised concerning any governance or control matters, are considered and monitored by the Council's Audit Sub-Committee.

Scrutiny and Training

Scrutiny is undertaken by the Finance and Management Committee as part of their role of agreeing policy and monitoring performance. The Audit Sub-Committee review internal audit reports regarding any procedural or wider control matters.

The Elected Members involved in reviewing Treasury Management have previously received training outside of formal reports and briefing papers. To strengthen the role of Members and to supplement their understanding, it is planned to deliver a further briefing/training session during the year for Members.

The Strategy

This strategy covers:

- The management of debt
- The Council's debt and investment projections
- The expected movement in interest rates
- The Council's borrowing and investment strategies
- Treasury performance indicators
- Specific limits on treasury activities
- Any local treasury issues

The Current Economic Situation and Outlook

The MPC increased the Base Rate in November 2017 to 0.5%. Further potential movements are reliant on economic data and the likely outcome of the Brexit negotiations. Policymakers have revised lower the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the EU. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2. Forecasts for future GDP growth have generally been revised downwards.

Labour market data suggests that employment has plateaued, although house prices (outside London) appear to be relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post 2008 financial crisis.

The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger global and Eurozone economic expansions.

Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

Effect on the Council

Interest rates currently pose a low risk for the Council. Clearly, given a positive cash and reserves situation, with interest rates so low, returns on deposits are limited. However, the Council's MTFP is not based on interest rates rising to generate income to help ensure a balanced budget. Therefore, if rates do rise, this should generate extra revenue in addition to that budgeted.

The Council's current long-term borrowing is fixed at relatively low rates, with the variable element of the debt currently costing 0.45% per year. The HRA's Financial Plan allows for this to rise to 3% to its repayment date in 2021/22.

Debt and Investment Projections

The table below shows the expected debt position of the Council over the Medium Term Financial Planning (MTFP) period.

External Debt	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000
Debt 1st April	57,423	57,423	57,423	57,423	57,423	47,423
New Debt	0	0	0	0	0	0
Maturing Debt	0	0	0	0	-10,000	0
Debt 31st March	**57,423**	**57,423**	**57,423**	**57,423**	**47,423**	**47,423**
Annual Change in Debt	0	0	0	0	-10,000	0
Long-term Investments	1,000	1,000	1,000	1,000	1,000	1,000
Short-term Investments	8,000	5,000	4,000	4,000	2,000	2,000

A comparison of this estimated debt position with the various borrowing limits is shown below:

Limits compared to Actual Debt	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000
Authorised Limit - General Fund	5,653	5,316	4,988	4,667	4,667	4,409
Authorised Limit - HRA	66,853	66,853	66,853	66,853	66,853	66,853
Financing Requirement	67,237	66,900	66,572	66,251	66,251	55,993
Operational Boundary	62,423	62,423	62,423	62,423	52,423	52,423
Gross Debt	57,423	57,423	57,423	57,423	47,423	47,423
Debt Less Investments	49,423	52,423	53,423	53,423	45,423	45,423

The above table shows that (gross) debt outstanding is expected to be comfortably below the Financing or underlying Borrowing Requirement (CFR) and well within the Authorised Limit (Debt Cap).

The Operational Boundary allows a temporary borrowing requirement of £5m.
However, it is expected that the Council will continue to be a net lender of funds on a day-to-day basis.

Management of Debt

As approved by the Council, treasury activities are accounted within two separate pools. This involves splitting borrowing between the General Fund and the HRA and then allocating new loans to each pool as required. This has been adopted for clarity and transparency and ensured there was no detriment to the General Fund on transition to HRA self-financing in 2012.

Treasury Management decisions on the structure and timing of borrowing is made separately for the General Fund and HRA.

Interest on loans is calculated in accordance with proper accounting practice and allocated to either pool accordingly. It is not anticipated that there will be a requirement to transfer loans between the two pools. Any proposals to do this will be considered and approved separately.

Internal Borrowing – Cash Management

Both the HRA and General Fund are likely to have surplus cash balances which will allow either account to have external borrowing below its Capital Financing Requirement.

The interest earned on all deposits is initially allocated to the General Fund with a proportion allocated to the HRA based on the average rate of interest earned on the average cash balances during the year.

Use of Financial Instruments

The Council does not use any type of derivative instruments, such as interest rate swaps or hedge accounting, to manage the risk of borrowing.

General Fund Debt

The General Fund does not currently have any actual debt outstanding and its underlying borrowing requirement is financed from reserves and balances as shown in the following table.

General Fund - Net Indebtedness	**2017/18 £'000**	**2018/19 £'000**	**2019/20 £'000**	**2020/21 £'000**	**2021/22 £'000**	**2022/23 £'000**
CFR / Borrowing Requirement	5,653	5,316	4,988	4,667	4,409	4,214
Estimated Reserves	9,213	8,180	6,742	5,407	3,899	2,052
Net Indebtedness	**-3,560**	**-2,864**	**-1,754**	**-740**	**510**	**2,162**

It has been assumed in the MTFP that the projected budget deficit on the General Fund will be financed from general reserves until budget savings have been identified.
During 2018/19, the Council will be addressing the projected deficit. Where reserves are not used, this will maintain balances at a higher level. However, this will be kept under review. If the net indebtedness does become positive, this may require some temporary borrowing at an additional cost, although this is not expected to occur until 2021/22.

HRA and Limit on Indebtedness

Under self-financing, the HRA pool operates within a cap over which no actual borrowing is allowed. This is prescribed by the Government and is set at £66.853m. The Cap is shown in the following table with a comparison to the CFR and expected level of actual debt on the HRA.

HRA Limit on Indebtedness	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000
HRA Debt Cap	66,853	66,853	66,853	66,853	66,853	66,853
HRA CFR	61,584	61,584	61,584	61,584	61,584	51,584
Difference	5,269	5,269	5,269	5,269	5,269	15,269
HRA Debt	57,423	57,423	57,423	57,423	47,423	47,423
Borrowing Headroom (Debt Cap minus Debt)	**9,430**	**9,430**	**9,430**	**9,430**	**19,430**	**19,430**

The next debt repayment is a variable rate loan of £10m in 2021/2022. The HRA's Financial Plan allows for sums to be set aside from its revenue account, commencing in 2016/17, as a provision to repay this and future loans, in accordance with the debt maturity profile.

Revenue Implications

The Financial implications of the Council's expected debt management transactions have been included in the MTFP and are summarised in the following table.

Interest Payable and Receivable	2017/18 £'000	2018/19 £'000	2019/20 £'000	2020/21 £'000	2021/22 £'000	2022/23 £'000
General Fund						
Interest Payable	0	0	0	0	0	0
Interest Received	-20	-45	-45	-45	-45	-45
HRA						
Interest Payable	1,757	1,793	1,793	1,793	1,793	1,793
Interest Received	-5	-5	-5	-5	-5	-5
Net Interest Payable	**1,732**	**1,788**	**1,788**	**1,788**	**1,788**	**1,788**

Borrowing Strategy

The Authority currently holds £57.423m of loans. This relates wholly to the HRA. For many years, the Council has not entered into any other long-term borrowing arrangements and has managed new prudential borrowing internally through its cash reserves and balances. This has proved to be a cheaper form of borrowing with interest earned by having those reserves on deposit.

The maturity analysis of the HRA debt portfolio is as follows:

	Current Rate	Balance as at 31.1.18 £'000
Less than one year		0
Between one and two years		0
Between two and five years	0.45% Variable	10,000
Between five and ten years	2.70% Fixed 3.01% Fixed	10,000 10,000
More than ten years	3.30% Fixed 3.44% Fixed 3.50% Fixed	10,000 10,000 7,423
TOTAL		**57,423**

The HRA's Financial Plan allows for these repayments by setting-aside resources from 2016/17 onwards.

The HRA debt will be reviewed regularly with the Council's treasury advisors to ensure that the portfolio continues to suit the Council. It is possible that the Council will be in a position to repay debt earlier or may opt to reschedule some longer-term debt depending on prevailing interest rates. Although this is not anticipated over the current MTFP it will be kept under review. Any early repayment or rescheduling decision will be based on a Net Present Value calculation taking into account the relevant premium or discount of repaying debt early.

As some of the debt is being borrowed at variable rates, this will be kept under closer scrutiny. The cost of this proportion of the portfolio (£10m) is currently contained within the resources of the HRA's Financial Plan. The Plan assumes that the rate on this debt will rise from its current level of 0.45% up to 3% in 2018/19 through to maturity in 2021/22.

<u>Additional Borrowing</u>

The Prudential System for Capital Finance provides flexibility for local authorities to borrow within their overall limit. Effectively, councils can borrow money as long as they are able to demonstrate that the associated interest and principal repayments are affordable and sustainable within their longer-term financial resources. Additional borrowing can also be undertaken on an "invest to save" basis, i.e. the cost of loan finance is met from the payback of the investment (efficiencies or additional income, etc.).

The Council has used the prudential system to finance two capital projects in 2013/14 (extending the Kerbside Recycling Scheme) and in 2015/16 for the development of the Extreme Sports Facility in the Grove Hall, Swadlincote. The costs and payback of this borrowing are included in the treasury indicators and the MTFP.

Borrowing in Advance

The Council will only borrow in advance of need if it is felt that the benefits of borrowing at interest rates now, compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required. Any accounting matters and the general legality will also be considered on a case-by-case basis.

Sources of Borrowing

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (as per Counterparty List)
- any other bank or building society authorised to operate in the UK

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

In summary, the key matters in the borrowing strategy for 2018/19 are as follows:

- Meeting the Council's cash flow requirements through the Investment Strategy
- Keeping under review the HRA debt pool and in particular the variable rate of borrowing.

Investment Strategy

The Council is expected to have a regular short-term investment requirement to enable it to manage its day-to-day financial affairs. There is no current proposal to enter into longer term and externally managed funds. Where the Council should need to borrow in advance of need, this investment strategy also applies.

The approved investment policy is based on a counterparty list that has been carefully considered to select those institutions with the best financial structure and the ability to incur losses before a depositor bail-in. This is based on economic data, together with analysis and advice from the Council's treasury advisors. The list is kept under review and updated depending on the changing circumstances of selected counterparties.

The approved lending list and policy is detailed in the Counterparty List. In accordance with regulations, it sets out where the Council will invest surplus funds and places limits upon the various institutions.
The proposed lending list has been updated based in information from the Council's treasury advisors and is relevant as at 1st February 2018. Any proposed changes are reported to the Finance and Management Committee on a quarterly basis.

General Lending Policy

Priority is given to specified investments in any investment decision. The length of investment is made in accordance with overall cash flow requirements. The policy focuses on the credit quality of investment counterparties rather than amounts invested and returns.

Where regular investments are made with named financial institutions, this is generally undertaken via instant access accounts. This allows funds to be withdrawn at short notice if the financial situation of these institutions was to change. All other deposits, such as those with the Debt Management Office and other local authorities, tend to be on a fixed and longer-term basis.

Investment Counterparty and Liquidity Framework

In accordance with Central Government guidance, the primary principle governing the Council's investment criteria is the security and liquidity of its investments. Once that principle is achieved, then yield and length of investment are considered. The Council will also ensure that:

- 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.

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below.

Specified Investments

The purpose of specified investments is to identify investments offering high security and high liquidity. These investments should be in pounds sterling and with a maturity of no more than a year. They are intended to be used with minimal procedural formalities. Any investments made with the UK Government, another local authority or parish council automatically qualify as specified investments.

In addition, short-term investments with institutions having "high credit ratings" will count as specified investments. The Guidance allows each council to determine these institutions and they must determine locally, investment limits, maximum periods and monitoring arrangements.

Non-Specified Investments

These are all other investments not meeting the criteria of specified investments. Due to the fact that these investments could carry more risk than specified ones, the Council needs to set stricter limits on these investments and determine guidelines on when they should be used.

The Guidance makes it clear that it does not wish to discourage authorities from using non-specified investments. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies that do not carry such a high credit rating.

Credit Quality

The creditworthiness of counterparties remains paramount in any investment decision and this is reflected in the approved lending policy and counterparty list.

In 2014/15, the Council approved a fundamental shift in its lending policy. This moved away from a traditional model based solely on credit ratings, to that based on an assessment of a financial institutions' ability to incur losses before a depositor bail-in.

Besides this, the Council refers to the financial press, any implied Government support for banks and other market data. This is supplemented by information and advice from the Council's retained treasury advisors.

Performance Indicators

The main indicator is for the return on short-term investments to average, over the year, the Average 7-Day Money Market Rate. This is a standard measure of performance. Performance in recent years is shown in the following table.

	2010/11	**2011/12**	**2012/13**	**2013/14**	**2014/15**	**2015/16**	**2016/17**
7-Day Rate (target)	0.51%	0.62%	0.51%	0.47%	0.50%	0.50%	0.36%
Actual Rate	0.78%	0.74%	0.31%	0.33%	0.31%	0.32%	0.25%

As at 31st January 2018, the Council's investment portfolio is as follows:

	Current Rate(s)	Balance at 31.01.18 £000
Local Authorities	0.35% - 0.55%	21,000
DMO	0.25%	9,000
Money Market Funds	0.40%	2,000
CCLA Property Funds	4.30%	1,000
Banks	0.00% - 0.15%	4,251
TOTAL		37,251

Treasury Management Prudential Indicators and Limits on Activity

The purpose of these additional indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates.

However, if these are set too restrictively, they could impede the opportunity to reduce debt costs. The indicators are detailed in the following sections.

Upper Limits on Variable Interest Rate Exposure

This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments. This is set at **5%** and is based on the affordability in the HRA Business Plan. This remains unchanged from that previously adopted.

Upper Limits on Fixed Interest Rate Exposure

This is set at **4.5%** and again is based on the affordability of the HRA Business Plan. This also remains unchanged from that previously adopted.

Maturity Structure of Fixed Rate Borrowing

The current maturity structure of the HRA debt portfolio is as follows:

Less than one year	0%
Between one and two years	0%
Between two and five years	17%
Between five and ten years	35%
More than ten years	48%

Total Principal Funds Invested for Greater Than 364 Days

In September 2017 the Council invested £1m in the CCLA Property Fund. This is for an indefinite period, subject to quarterly review and reported to Members within the Quarterly Monitoring Reports.

Other Options Considered

The DCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Strategic Director (Corporate Resources), having consulted the Finance and Management Committee, 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