

Title of meeting: Governance and Audit and Standards Committee
Cabinet
City Council

Date of meeting: 9 March 2018 (Governance and Audit and Standards Committee)
16 March 2018 (Cabinet)
20 March 2018 (City Council)

Subject: Treasury Management Policy 2018/19

Report by: Chris Ward, Director of Finance and Information Technology (Section 151 Officer)

Wards affected: All

Key decision: Yes

Full Council decision: Yes

1. Executive Summary of the Treasury Management Policy Statement

Treasury Management Policy

The attached Treasury Management Policy sets out the Council's policies on borrowing, providing for the repayment of debt and investing for 2018/19. The Treasury Management Policy also sets a number of treasury management indicators that will establish the boundaries within which treasury management activities will be undertaken. These are contained in Appendix D.

Appendix D also includes revised outturn prudential and treasury management indicators for 2016/17. The premium arising from the granting of a new head lease for land in White Hart Road occupied by Wightlink Ltd in 2016/17 was originally accounted for as a capital receipt and the treasury management outturn position was reported on this basis prior to the audit of the Council's accounts being completed. Following discussion with the auditors it was agreed that these transactions would be accounted for as borrowing rather than a capital receipt. As a consequence of this decision some of the outturn prudential and treasury management indicators for 2016/17 have been revised.

The Treasury Management Policy Statement contains a risk appetite statement similar to that adopted in 2017/18 that permits investments to be made in instruments that do not guarantee that the capital sum will not be diminished through movements in prices. In approving the Treasury Management Policy Statement members will be approving the risk appetite statement contained in paragraph 4.2 of the Treasury Management Policy Statement.

Policy For Providing For the Repayment of Debt

The Local Authorities (Capital Finance and Accounting) (Amendment) Regulations 2012 require the Council to adopt an Annual Minimum Revenue Provision (MRP) for Debt Repayment Statement. The recommended methodologies for calculating MRP are summarised in paragraph 8.3 of the Treasury Management Policy.

Annual Investment Strategy

The Treasury Management Policy includes the Annual Investment Strategy which establishes the types of investment, investment counter parties and investment durations that the Council will operate within. The 2018/19 Annual Investment Strategy is similar to the 2017/18 Annual Investment Strategy in most respects although there are some changes proposed for 2018/19.

Banks and building societies currently meeting the Council's credit criteria are listed in Appendix F. There are too many corporate bond, RSLs and universities to include in the appendix.

Summary of Proposed Changes to the Treasury Management Policy Statement

The following changes to the Treasury Management Policy Statement are proposed:

- That provision is not made for the repayment of borrowing to fund the HRA self-financing payment or any other HRA debt from 2017/18 to 2019/20;
- To change the maximum definition of specified and short term investments from 364 days to 365 days in line with the latest guidance from the Government intended to bring the treasury management definition of short term and long term investments into line with the financial accounting definition;
- To increase the maximum term of bonds that can purchased from Hampshire Community Bnk from 6 years to 10 years in line with the draft funding agreement with Hampshire Community Bnk

2. Purpose of report

The purpose of this report is to obtain the Council's approval of the updated Treasury Management Policy Statement (attached) which includes:

- Annual Minimum Revenue Provision for Debt Repayment Statement
- Annual Investment Strategy

3. Recommendations

3.1a that the following changes to the Treasury Management Policy Statement be approved:

- (i) that provision is not made for the repayment of borrowing to fund the Housing Revenue Account (HRA) Self Financing payment or any other HRA debt from 2017/18 to 2019/20 (paragraph 8.4 of the Treasury Management Policy);
- (ii) that the maximum duration of specified investments be increased from 364 days to 365 days (paragraph 11.1 of the Treasury Management Policy);
- (iii) that the maximum duration of investment categories 11 (corporate bonds with a BBB+ credit rating) and 14 (unrated building societies that are in a strong financial condition) be increased from 364 days to 365 days (paragraph 12.2 of the Treasury Management Policy);
- (iv) that the maximum term of bonds purchased from Hampshire Community Bnk be increased from 6 years to 10 years (paragraph 12.2 of the Treasury Management Policy);

3.1b that the following risk appetite statement be approved:

To assist the achievement of the Council's service objectives by obtaining funding and managing the debt and treasury investments at a net cost which is as low as possible, consistent with a high degree of long term interest cost stability. Sums are invested with a diversified range of counter parties using the maximum range of instruments consistent with a low risk of the capital sum being diminished through movements in prices.

- 3.1c that the prudential and treasury management indicators, including revisions to the 2016/17 outturn indicators contained in Appendix D be approved;**
- 3.1d that the attached Treasury Management Policy Statement including the Treasury Management Strategy, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy for 2018/19, and encompassing the amendments contained in recommendation 3.1a be approved;**
- 3.1e the Director of Finance and Information Technology (Section 151 Officer) and officers nominated by him have delegated authority to (paragraph 3.2 of Treasury Management Policy Statement):**
- (i) invest surplus funds in accordance with the approved Annual Investment Strategy;**
 - (ii) borrow to finance short term cash deficits and capital payments from any reputable source within the authorised limit for external debt of £660m approved by the City Council on 13 February 2018;**
 - (iii) reschedule debt in order to even the maturity profile or to achieve revenue savings;**
 - (iv) release the over provision of MRP back into General Fund balances over a prudent period by reducing the MRP in future years;**
 - (v) to buy and sell foreign currency, and to purchase hedging instruments including forward purchases, forward options and foreign exchange rate swaps to mitigate the foreign exchange risks associated with some contracts that are either priced in foreign currencies or where the price is indexed against foreign currency exchange rates.**
- 3.1f that the Chief Executive, the Leader of the City Council and the Chair of the Governance and Audit and Standards Committee be informed of any variances from the Treasury Management Policy when they become apparent, and that the Leader of the City Council be consulted on remedial action (paragraph 17.1 of Treasury Management Policy Statement)**

3.2 that the Director of Finance and Information Technology (Section 151 Officer) submits the following (paragraph 19.1 of Treasury Management Policy Statement):

- (i) an annual report on the Treasury Management outturn to the Cabinet and Council by 31 July of the succeeding financial year;**
- (ii) a Mid-Year Review Report to the Cabinet and Council;**
- (iii) the Annual Strategy Report to the Cabinet and Council in March 2019;**
- (iv) quarterly treasury management monitoring report to the Governance and Audit and Standards Committee.**

4. Background

The Council's treasury management operations cover the following:

- Cash flow forecasting (both daily balances and longer term forecasting)
- Investing surplus funds in approved investments
- Borrowing to finance short term cash deficits and capital payments
- Management of debt (including rescheduling and ensuring an even maturity profile)
- Interest rate exposure management
- Hedging foreign exchange rate risks

The key risks associated with the Council's treasury management operations are:

- Credit risk - ie. that the Council is not repaid, with due interest in full, on the day repayment is due
- Liquidity risk - ie. that cash will not be available when it is needed, or that the ineffective management of liquidity creates additional, unbudgeted costs
- Interest rate risk - that the Council fails to get good value for its cash dealings (both when borrowing and investing) and the risk that interest costs incurred are in excess of those for which the Council has budgeted
- Exchange rate risk - the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the organisation's finances, against which the organisation has failed to protect itself adequately.

- Inflation risk, ie. the chance that cash flows from an investment won't be worth as much in future because of changes in purchasing power due to inflation.
- Maturity (or refinancing risk) - this relates to the Council's borrowing or capital financing activities, and is the risk that the Council is unable to repay or replace its maturing funding arrangements on appropriate terms
- Procedures (or systems) risk - ie. that a treasury process, human or otherwise, will fail and planned actions are not carried out through fraud, error or corruption

The total borrowings of the Council at 1 April 2018 are estimated to be £629m. The Council's investments at 1 April 2018 are estimated to be £369m. The cost of the Council's borrowings and the income derived from the Council's investments are included within the Council's treasury management budget of £23.2m per annum. The Council's treasury management activities account for a significant proportion of the Council's overall budget. As a consequence the Council's Treasury Management Policy aims to manage risk while optimising costs and returns. The Council will monitor and measure its treasury management position against the indicators contained in the Treasury Management Policy.

The City Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services Code of Practice. The Code of Practice requires the City Council to approve a Treasury Management Strategy before the start of the financial year.

In addition the Government has issued statutory guidance that requires the Council to approve an Annual Minimum Revenue Provision for Debt Repayment Statement and an Annual Investment Strategy before the start of the financial year.

The Treasury Management Strategy, the Annual Minimum Revenue Provision for Debt Repayment Statement and the Annual Investment Strategy are all contained within the attached Treasury Management Policy Statement.

5. Reasons for recommendations

The recommendations within the attached Treasury Management Policy Statement reflect the Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management Code of Practice and have regard to statutory guidance issued by the Government. These are designed to:

- Enable the Council to borrow funds as part of managing its cash flow or to fund capital expenditure in a way that minimises risk and costs
- Provide for the repayment of borrowing
- Ensure that the Council's investments are secure
- Ensure that the Council maintains sufficient liquidity
- Maximise the yield on investments in a way that is commensurate with maintaining the security and liquidity of the investment portfolio

There is no statutory requirement to provide for the repayment of Housing Revenue Account (HRA) debt although provision has been made to repay the £87m HRA self-financing payment over 30 years. Council dwelling rents are being reduced by 1% per annum until 2019/20 in line with government policy and this is placing the Housing Revenue Account (HRA) under financial pressure. It is therefore proposed that provision is not made for the repayment of borrowing to fund the HRA self-financing payment or any other HRA debt from 2017/18 to 2019/20 (**Recommendation 3.1a(i)**). This will generate a gross saving of £3m per annum. However, this will also increase the amount of interest payable by the HRA.

It is proposed to increase the maximum duration of specified investments that can be made with the minimum of procedural formalities from 364 days to 365 days in line with the latest guidance from the Government to bring the treasury management definition of long and short term into line with the financial accounting definition of long and short term (**Recommendation 3.1a(ii)**). To be consistent it is also proposed to increase the maximum duration of investment categories 11 (corporate bonds with a BBB+ credit rating) and 14 (unrated building societies that are in a strong financial condition) from 364 days to 365 days (**Recommendation 3.1a(iii)**).

The previous policy permitted the Council to purchase bonds from Hampshire Community Bnk with a term of up to 6 years. It is proposed to increase the maximum term of the bonds that can be purchased to 10 years in line with the draft funding agreement with Hampshire Community Bnk (**Recommendation 3.1a(iv)**).

The Council attaches a high priority to a stable and predictable revenue cost from treasury management activities in the long term. This reflects the fact that debt servicing represents a significant cost to the Council's net revenue budget. The Council's objectives (**Recommendation 3.1b**) in relation to debt and investment can accordingly be stated as follows:

To assist the achievement of the Council's service objectives by obtaining funding and managing the debt and treasury investments at a net cost which is as low as possible, consistent with a high degree of long term interest cost stability. Sums are invested with a diversified range of counter parties using the maximum range of instruments consistent with a low risk of the capital sum being diminished through movements in prices.

This means that the Council is not totally risk averse. Treasury management staff have the capability to actively manage treasury risks within the scope of the Council's treasury management policy and strategy.

In particular when investing surplus cash, the Council will not necessarily limit itself to making deposits with the UK Government and local authorities, but may invest in other bodies including unrated building societies, RSLs, universities and corporate bonds. The Council may invest surplus funds through tradable instruments such as treasury bills, gilts, certificates of deposit, corporate bonds, covered bonds and repos / reverse repos. The duration of such investments will be limited so that they do not have to be sold (although they may be) prior to maturity thus avoiding the risk of the capital sum being diminished through movements in prices.

The Council may invest in lower risk structured investment products that follow the developed equity markets where movements in prices may diminish the capital sum invested. These investments, and indeed any other investment, could also be diminished if the counter party defaults. Although the Council only invests in counter parties offering good credit quality, the credit quality of an investment counter party can decline during the life of the investment. This is particularly the case with long term investments.

The Treasury Management Policy also sets a number of treasury management indicators that will establish the boundaries within which treasury management activities will be undertaken. These are contained in Appendix D (**Recommendation 3.1c**).

Appendix D also includes revised outturn prudential and treasury management indicators for 2016/17. The premium arising from the granting of a new head lease for land in White Hart Road occupied by Wightlink Ltd in 2016/17 was originally accounted for as a capital receipt and the treasury management outturn position was reported on this basis prior to the audit of the Council's accounts being completed. The Council granted a new head lease to Canada Life for a premium subject to a lease back to the Council for an ongoing rent. Both transactions take the legal form of leases, however when taken together they are in substance a £72m loan from Canada Life. Following discussion with the auditors it was agreed that these transactions would be accounted for as borrowing rather than a capital receipt. As a consequence of this decision some of the outturn prudential and treasury management indicators for 2016/17 have been revised.

Recommendation 3.1(d) seeks the Council's approval to adopt the revised Treasury Management Policy Statement.

Recommendation 3.1(e) seeks delegated authority for the Director of Finance and Information Technology (Section 151 Officer) and officers nominated by him to execute the Council's Treasury Management Policy.

Recommendation 3.1(f) seeks the Council's approval for the proposed actions to report any variances from the Treasury Management Policy.

Recommendation 3.2 seeks the Council's approval for the proposed reporting arrangements for the treasury management operation.

6. Equality impact assessment (EIA)

The contents of this report do not have any relevant equalities impact and therefore an equalities assessment is not required.

7. Legal Implications

The Section 151 Officer is required by the Local Government Act 1972 and by the Accounts and Audit Regulations 2011 to ensure that the Council's budgeting, financial management, and accounting practices meet the relevant statutory and professional requirements. Members must have regard to and be aware of the wider duties placed on the Council by various statutes governing the conduct of its financial affairs.

8. Director of Finance and Information Technology (Section 151 Officer)'s comments

All financial considerations are contained within the body of the report and the attached appendices

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Signed by Director of Finance and Information Technology (Section 151 Officer)

Appendix: Treasury Management Policy Statement, Annual Minimum Revenue Provision for Debt Repayment Statement and Annual Investment Strategy 2018/19

Background list of documents: Section 100D of the Local Government Act 1972

The following documents disclose facts or matters, which have been relied upon to a material extent by the author in preparing this report:

Title of document		Location
1	Information pertaining to the Treasury Management Strategy	Financial Services