Treasury Management Strategy 2016/17

Background

In accordance with the Council's Treasury Management Practices (TMPs) and The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice the Council is required to approve the Treasury Management Strategy and Annual Investment Strategy for 2016/17. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Chief Financial Officer concerning the 2016/17 budget calculations.

Treasury management is undertaken by a small team of professionally qualified staff within financial services.

In addition the Council employs Treasury Management advisors, Arlingclose, who provide information and advice on interest rate movements which is used to inform borrowing and investment decisions. The advisors have been engaged on a fixed term basis after a tendering procedure completed in July 2013.

Relevant information is also obtained from other financial commentators, the press and seminars arranged by other organisations, for example CIPFA and the Local Government Association.
Information received from these different sources is compared in order to ensure all views are considered and there are no significant differences or omissions from information given by the Council's advisors.

All Treasury Management employees take part in the Council's Staff Review and Development scheme, where specific individual training needs are highlighted. Training in Treasury Management activities and networking opportunities provided by both professional and commercial organisations are taken up where appropriate.

During 2015/16 the County Council has invested its surplus cash with selected UK Banks, selected Money Market Funds, the UK Debt Management Office and with other local authorities.

Economic Commentary

Growth in the UK economy has continued. The majority of this growth is based on domestic consumption which has been supported by growth in real household incomes, with depressed fuel and commodity prices leading to CPI inflation falling to near or just below zero. There is also evidence of some tightening in the labour market, after a period of underemployment. In contrast, elsewhere in the world, notably China, economies have slowed.

The Bank of England (BOE) Monetary Policy Committee's (MPC) outlook appears to have become more pessimistic, with the latest inflation report indicating that interest rates may not begin to rise until late 2016 at the earliest. The BOE finds itself between the European Central Bank, which recently cut rates again fearful of continued Eurozone weakness, and the Federal Reserve in the US, which has begun raising rates as its economy continues to strengthen.

The UK bank base rate has remained at the historically low level of 0.5% throughout the year and is expected to remain so for the remainder of the current financial year. The Council's Treasury Management Advisors, Arlingclose, forecast the base rate to remain at 0.5% until September of 2016 which agrees broadly with the Bank of England's (BoE) revised thinking.

The Certainty rate, launched in 2012 and giving a 0.2% reduction in borrowing rate to councils who make their capital investment plans known to HM Treasury continues. However it continues to be uneconomic to reschedule existing debt, as the difference between rates for new loans and rates for early repayment has remained.

Treasury Management Strategy

The Prudential Code for Capital Finance requires the Council to set a number of Prudential Indicators. The Treasury Management Strategy has been developed in accordance with these indicators.

Borrowing Strategy

The outlook for borrowing rates is currently difficult to predict. Fixed interest borrowing rates are based on UK gilt yields. Gilt yields have been volatile but generally depressed in recent months, due to global uncertainty and the Chinese economic slowdown in particular. Arlingclose expect volatility in yields to remain high over the short term, but do expect a shallow upward trend over the medium and longer-term however. Rates on loans of 5 years are expected to be around 2.40%, while rates on longer term loans are expected to be around 3.45% by the end of 2016/17. As with the Base rate, the balance of risks to Gilt yields is biased to the downside, since continued international uncertainty would keep them depressed for a longer period. The Council has prudently assumed a borrowing rate for 2016/17 of 3.98% in setting the budget, with a working assumption to borrow in Quarter 3. For medium-term planning purposes the Council has assumed borrowing rates of 4.13% in 2017/18, 4.23% in 2018/19 and 4.25% in subsequent years. This is in-line with Arlingclose's most pessimistic forecasts for borrowing rates during Quarter 3 of each of those years.

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.

The strategy will be to borrow in order to replenish a proportion of the reserves and cash balances used to support capital expenditure since October 2008. This will mitigate any interest rate risk in that borrowing and will be taken before borrowing rates increase significantly. The timing of the borrowing will depend on cashflow requirements and forecast future developments and on interest rate movements and the forecast for those future movements. A mixture of shorter and longer-term loans will be taken in order to fit with the Council's debt maturity profile.

Interest rates will be monitored but as forecasts stand it is likely that borrowing will be undertaken towards the final third of the financial year.

The gross capital borrowing requirement for 2016/17 is estimated to be £50.6 million. After the use of the minimum revenue provision to repay debt of £14.0 million, the net capital borrowing requirement is estimated to be £36.6 million.

The management of the Council's debt will be exercised in the most efficient manner taking into account maturing debt. The opportunity may be taken to reschedule any outstanding debt if rates become favourable to delivering savings in the revenue budget. The cost of external interest of maintaining the council debt is estimated to be £15.1 million in 2016/17.

In addition to its usual borrowing activity, the Council continues to undertake a project with Mercia Waste, to provide finance for the construction of an Energy Plant. Further details are given below in the paragraph titled "Energy from Waste".

Annual Investments Strategy

The Council's Investment Strategy has been drawn up having regard to both the Communities and Local Government's Guidance on Local Authorities Investments and the CIPFA Treasury Management in Public Services Code of Practice and CIPFA Cross-Sectoral Guidance Notes. This strategy will be revised and presented to Council if changes occur outside those envisaged within this strategy.

The policy objective for the Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third, of achieving the optimum return on investments, be taken into account.

The Council will not borrow money purely to invest. The Council will only borrow up to 12 months in advance of cash being required to fund its capital expenditure and the amount borrowed will not exceed the annual borrowing requirement.

The investments, which the Council are able to use for the prudent management of cash balances are categorised as 'Specified Investments' and 'Non-Specified Investments'.

A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council, a AAA rated Moneymarket Fund, a bank which is part-owned by the UK Government, or with a body of high credit quality. The Council defines a body of high credit quality as counterparties who achieve ratings with all three rating agencies as described below (using the lowest rating of the three):

- For overnight investments, or money placed in instant access accounts, the council defines a body of high credit quality as having the below Short-Term ratings:

Agency:	Short-Term rating:
Fitch	F1+
Moodys	P-1
Standard and Poors	A-1+

- For **unsecured** term deposits between 2 and 364 days, the council defines a body of high credit quality as having the below Long-term ratings, in addition to the above Short-term ratings:

Agency:	Long-Term rating:
Fitch	AA
Moodys	Aa2
Standard and Poors	AA

- For **secured** term deposits, the council defines high credit quality as an **instrument** that has the above ratings with every agency that rates it.

Non Specified Investments have a range of vehicles not covered by the definition of Specified Investments, which are set out in the Treasury Management Practices (TMPs) and generally carry more risk.
The only types of non-specified investments the Council will enter into or hold during the coming financial year are as below:

- Equity shares in the municipal bonds agency (Local Capital Finance Company Ltd). The primary purpose of this investment is to support the Council's priorities, rather than to speculate on the capital sum invested. Only up to £0.075 million will be invested in this category.
- A routine term deposit with a counterparty as described above for Specified Investments, for a period of more than 1 year. This type of investment will be considered when rates are favourable and cash balances allow. The Council's prudential indicators allow no more than £10 million to be invested in this category.

The credit ratings of Fitch, Moodys and Standard and Poors are monitored at least weekly, ratings watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon, in line with the revised code issued in 2009.

The Council may hold cash within its current account overnight as a transactional control to mitigate the risk of going overdrawn and incurring penalty and interest charges. On limited occasions the Council may also leave funds in this account when it is impractical and/or not economically feasible to invest elsewhere. These balances are considered as cash or cash equivalents and not investments.

The Council will aim to have not less than 50% of its investments returnable within 28 days with at least 20% within 7 days.