

ASSEMBLY

28 February 2018

Title: Treasury Management Strategy Statement 2018/19	
Report of the Cabinet Member for Finance, Growth & Investment	
Open Report	For Decision
Wards Affected: None	Key Decision: Yes
Report Author: David Dickinson, Group Manager, Pensions and Treasury	Contact Details: Tel: 020 8227 2722 E-mail: david.dickinson@lbbd.gov.uk
Accountable Director: Kathy Freeman, Finance Director	
Accountable Strategic Director: Claire Symonds, Chief Operating Officer	
Summary <p>This report deals with the Treasury Management Annual Strategy Statement, Treasury and Prudential Indicators, Annual Investment Strategy and borrowing limits, in compliance with Section 15(1)(a) of the Local Government Act 2003.</p> <p>The production and approval each year of a Treasury Management Strategy Statement and Annual Investment Strategy are requirements of the Council under Section 15(1) of the Local Government Act 2003. It is also a requirement of the Act to set an authorised borrowing limit for the forthcoming financial year.</p> <p>The Local Government Act 2003 also requires the Council to have regard to the Prudential Code, and to set prudential indicators which consider the Council's capital investment plans for the next three years.</p> <p>The Treasury Management Code and the Prudential Code were revised in late 2017 with the main changes being the inclusion of the Capital Strategy requirements and the removal of some indicators. Some of these changes are reflected in the Prudential Indicators (Appendix 3) and in the Borrowing Strategy (Appendix 2). A Department for Communities and Local Government consultation on Investment Guidance closed 22 December 2017 but the final proposals were not available by the time this report was produced.</p> <p>The Cabinet considered and endorsed this report at its meeting on 19 February 2018.</p>	

Recommendation(s)

The Assembly is recommended to approve the Treasury Management Strategy Statement for 2018/19 and, in doing so, to:

- (i) Note the current treasury position for 2018/19 and prospects for interest rates, as referred to in paragraph 7.2 of the report;
- (ii) Approve the Council's Borrowing Strategy for 2018/19, incorporating the Debt Repayment Strategy and Policy on Borrowing in Advance of Need, as set out in Appendix 2 to the report;
- (iii) Approve the Annual Investment Strategy for 2018/19, incorporating the Creditworthiness Policy and outlining the investments that the Council may use for the prudent management of its investment balances, as set out in Appendix 1 to the report;
- (iv) Approve the Treasury Management and Prudential Indicators for 2018/19 – 2020/21, as set out in Appendix 3 to the report;
- (v) Approve the Minimum Revenue Provision Policy Statement for 2018/19, representing the Council's policy on repayment of debt, as set out in Appendix 4 to the report;
- (vi) Approve the Operational Boundary Limit of £1.002bn and the Authorised Borrowing Limit of £1.102bn for 2018/19, representing the statutory limit determined by the Council pursuant to section 3(1) of the Local Government Act 2003, as referred to in Appendix 3 to the report; and
- (vii) Delegate authority to the Chief Operating Officer, in consultation with the Cabinet Member for Finance, Growth and Investment, to proportionally amend the counterparty lending limits agreed within the 2018/19 Treasury Management Strategy Statement.

Reason(s)

To enable the Council to accord with the requirements of the Local Government Act 2003.

1. Introduction and Background

- 1.1 The Council is required to operate a balanced budget, with cash raised during the year sufficient to meet the Council's cash expenditure. Treasury management supports the Council by seeking to ensure its cash flow is adequately planned, with cash being available when it is needed. Surplus cash is invested in counterparties or instruments commensurate with the Council's risk appetite, providing adequate security and liquidity while also considering the investment return.
- 1.2 A second function of treasury management is funding the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council,

essentially the longer-term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short-term loans or using longer term cash flow surpluses.

- 1.3 The Council is responsible for its treasury decisions, activity and risk appetite. The successful identification, monitoring and control of risk are integral elements of treasury management, including credit and counterparty risk, liquidity risk, market risk, interest risk, refinancing risk and legal and regulatory risk. The Council is statutorily required to approve the Treasury Management Strategy Statement (TMSS) prior to the new financial year.

2. Reporting Requirements

- 2.1 The Council is required to receive and approve at least three main treasury reports each year. These reports are required to be adequately scrutinised by Cabinet before being recommended to the Council. The three main treasury reports are:
 - i. **The Treasury Management Strategy Statement (TMSS)** is the most important report and considers the impact of the Council's proposed Revenue Budget and Capital Programme on the Balance Sheet position, the current and projected Treasury position, the Prudential Indicators (PIs) and the outlook for interest rates. In addition, the current market conditions are factored into any decision-making process.
 - ii. **An Annual Treasury Report** which outlines the actual PIs, treasury indicators and treasury operations compared to the estimates within the strategy.
 - iii. **A Mid-Year Treasury Management Report** to update Members on the progress of the capital position, amending PIs and investment strategy as necessary.
- 2.2 As the Council is responsible for housing, PIs relating to capital expenditure, financing costs and the Capital Financing Requirement (CFR) are split between the Housing Revenue Account (HRA) and the General Fund (GF). The impact of new capital investment decisions on housing rents will also need to be considered.
- 2.3 This report provides an explanation of the key elements of the Council's Treasury Management Strategy, its Minimum Revenue Provision (MRP) Strategy, the Annual Investment Strategy (AIS) for 2018/19 and the borrowing strategy, which are set out in detail in the appendices attached to this report.

3. Treasury Management Strategy for 2018/19

- 3.1 The Local Government Act 2003 and supporting regulations require the Council to have regard to the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years and ensure the Council's capital programme is affordable, prudent and sustainable.
- 3.2 The Act requires councils to set out their treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by investment guidance issued after the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments, above yield.

- 3.3 The Council has adopted the Department of Communities and Local Government (DCLG) investment guidance that came into effect from 1 April 2010. The strategy for 2018/19 covers the following main areas:

Treasury Management Issues

- Current Portfolio Position at 31 December 2017 (section 4);
- Medium Term Capital Finance Budget (section 5);
- Treasury Position at 31 December 2017 & Forward Projections 2017 (section 6);
- Economic Update and Interest Rate Forecast (section 7);
- The Capital Expenditure Plans 2018/19 – 2020/21 (section 8);
- Treasury Management Advisors (section 9);
- The Annual Investment Strategy and Investment Policies (appendix 1);
- Borrowing Strategy 2018/19 (appendix 2);
- The capital plans and the prudential indicators (appendix 3);
- The minimum revenue provision (MRP) strategy (appendix 4);
- Scheme of Delegation (appendix 5).

4. Current Portfolio Position at 31 December 2017

- 4.1 The Council holds cash balances arising from its operational activities, including income from grants and Council Tax, which are offset by expenditure to run services. The timing of these cash flows can result in surplus cash which is then available to invest. Cash balances are also affected by “working capital”, which relates to amounts of outstanding payments to be made to suppliers offset by amounts owed to the Council.

- 4.2 The Council’s year-end (31 March) cash balances since 2014/15 are shown below:

2017/18 - £240m (estimate)
2016/17 - £236m
2015/16 - £243m
2014/15 - £218m

- 4.3 These balances are made up of the following sources of cash:

- Capital grants and Section 106 funds received in advance of expenditure;
- General Fund, HRA and School cash balances;
- Earmarked Reserves and provisions;
- Capital Receipts and Working Capital;
- European Investment Bank Loans to fund regeneration;
- Green Investment Bank to fund energy company expenditure;
- Public Works Loan Board (PWLB); and
- bank loans including Lender Option Buyer Option Loans (LOBO).

- 4.4 Table 1 below shows the Council's investments and borrowing balances as at 31 December 2017, including the Average Life and the Average Rate of Return. The loans have been split between HRA borrowing and GF borrowing to match the two-pool approach the Council has adopted for borrowing. The Council invests all cash in one investment pool, with interest distributed between the HRA, schools and GF.
- 4.5 Members should be aware that the elevated level of short-term borrowing (£128.9m as at 31 December 2017) does significantly reduce the Average Life and the Rate of Return for General Fund as well as increase the total value of the investments held.

Table 1: Council's Treasury Position at 31 December 2017

	Principal Outstanding £000s	Interest Rate %	Average Life (yrs.)
General Fund Fixed Rate Borrowing			
LOBO	30,000	4.03	47.6
Local Authority (Medium-Term)	19,000	0.97	32.9
Local Authority (Short-term)	120,550	0.33	2.2
Market Loan	89,655	2.25	26.3
PWLB	130,000	2.37	41.2
Total General Fund Debt	389,205	1.77	23.6
Housing Revenue Account Fixed Rate Borrowing			
PWLB	265,912	3.50	39.3
Market Loans	10,000	3.98	61.7
Total Housing Revenue Account Debt	275,912	3.51	40.1
Total Council Borrowing	518,860	2.81	34.2
Investments			
Bank Deposit	179,744	1.13	1.1
Local Authority	81,720	1.07	1.5
Money Market Funds	19,325	0.32	-
Other Investments*	20,102	3.96	4.2
Total Investments	300,891	1.25	

* includes pension fund prepayment and loans to Barking Riverside LTD and schools.

5. Medium Term Capital Finance Budget

- 5.1 A key part of the Council's budget strategy is the medium-term capital finance budget shown as Table 2. It is a statutory requirement that the level of borrowing is kept under review and is affordable. Due to the Council's Investment and Acquisitions strategy, it is likely that the Council's cash position will significantly reduce over the next few years as a result of utilising the Council's reserves and using cash balances to fund property investments.
- 5.2 The significant increase in GF Interest Payable is due to the borrowing required to fund the Council's IAS. The medium-term capital financing budget to 2020/21 is outlined in table 2 below. The 2019/20 and 2020/21 interest payable budget will be amended when confirmation of the IAS cashflows are finalised. The interest income budget increase in 2018/19 includes interest from a prepayment to the pension fund and additional interest income expected from Reside 2:

Table 2: Medium Term Capital Finance Budget

£'000s	2017/18	2018/19	2019/20	2020/21
	Budget	Budget	Budget	Budget
MRP	6,688	8,157	8,557	9,457
GF Interest Payable	4,233	6,733	7,233	7,233
HRA Interest Payable	9,692	9,692	10,059	10,059
Interest Income	(2,099)	(4,299)	(3,099)	(3,099)
Net Cost	18,514	20,283	22,750	23,650

6. Treasury Position at 31 December 2017 and Forward Projections

- 6.1 The Council's treasury portfolio position at 31 December 2017, with forward projections are summarised in table 3. The table shows the actual external debt against the underlying Capital Financing Requirement (CFR), highlighting any over or under borrowing. The CFR and the Gross Debt includes borrowing to fund the first Barking & Dagenham Reside scheme as well as the borrowing from the EIB to fund Abbey Road Phase 2 and the Gascoigne Regeneration.

Table 3: Treasury Position at 31 December 2017, with Forward Projections

£'000s	2017/18	2018/19	2019/20	2020/21
	Estimate	Estimate	Estimate	Estimate
External Debt				
Debt at 1 April	542,302	612,302	662,302	672,302
Expected change in Debt*	70,000	50,000	10,000	10,000
Other long-term liabilities	58,078	55,245	52,308	49,407
Gross Debt at 31 March	670,380	717,547	724,610	731,709
CFR	692,315	754,583	751,668	738,181
Under / (over) borrowing	21,935	37,036	27,058	6,472

* Debt includes short-term borrowing

7. Economic Update and Rate Forecast

7.1 Economic Background

The biggest influence on the treasury strategy for 2018/19 will be the UK's progress in negotiating a smooth exit from the European Union and agreeing future trading relationships. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 2.8% in November 2017 as the devaluation of Sterling increased the price of imports. Unemployment continued to fall, and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its

inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% on 2 November 2017.

In 2017 the US economy performance continued to perform well, and the Federal Reserve raised interest rates in regular steps to remove some of the emergency monetary stimulus it provided over the past decade. The European Central Bank did not raise rates, although it has started to taper its quantitative easing programme.

7.2 Interest rate forecast

The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. Future expectations for higher short-term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

As a result, gilt yields are forecast to remain broadly stable across the medium term, although there is likely to be some volatility during the year. Upward movement is likely to be limited but the overall trend is for market sentiment to a rate rise to increase during the year. The interest rate forecast is provided in table 3 below:

Table 3: Interest Rate Forecast for the BOE Base Rate and PWLB

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

7.3 Bail in legislation

As part of regulation changes within the banking sector the UK Government has removed the expectation that governments will support financial institutions in the event of an institution fail. This was set up to ensure there was a structure that will be followed should a financial institution fail. To do this the UK Government agreed a process to deal with a financial institution failure, which includes the option for institutional investors to lose part of their invested cash as part of a "bail in".

It could be argued that the potential for institutional investors to lose part of their investment has always been there and is the main driver behind the rates "rewarded" when an investment is made. The structure keeps the equity investor and bond holders at the top with Institutional Investors, therefore there is a significant buffer before the Council's cash holdings would be affected.

The Treasury section completes regular monitoring of the potential affect a significant market correction would have on the various banks the Council has deposited money with and will make adjustment to the strategy should any issues be identified.

7.4 Treasury Savings Targets

Historically the Council has maintained a prudent and low risk treasury investment strategy. This approach has ensured that the Council has not lost money from any of its investments, while achieving a return commensurate with the risk taken. This approach has led to treasury having a significant impact on the Council's overall funding requirements, both in terms of generating income from investments and from reducing the costs of borrowing to support the Council's capital programme.

In order for Treasury to support the reduced budgets for 2015/16 to 2018/19, Members agreed a number of savings targets for treasury as outlined in table 4 below, which shows the accumulative effect of the savings. A total of £1.6m worth of savings will have been removed from the annual treasury budget from 2018/19.

Table 4: Treasury Savings Targets for 2015/16 to 2018/19

Saving Reference	Savings Proposal	2015/16 £000	2016/17 £000	2018/19 £000	Total £000
CEX/SAV/27	Increase in Average Return	500	500	250	1,250
CEX/SAV/29	Increase Counterparty Risk	250	0	0	250
CEX/SAV/54e	Increase Duration Risk	100	0	0	100
	Total Savings	850	500	250	1,600

7.5 Return Target 2018/19 to 2020/21

To achieve the interest, target the treasury section needs to achieve the following average returns on an average cash balance of £160m (excluding EIB cash):

2018/19	1.40%
2019/20	1.70%
2020/21	2.00%

The increased return is heavily reliant on interest rates increasing from their current near historic lows. The increase does not need to occur in the first half of 2018 as treasury section has secured a return through longer dated investments, which is currently expected to achieve the 1.60% return for 2018/19. However, if rates do not increase by early 2018 then the return target for 2018/19 will be very challenging to meet without significantly increasing the duration risk and / or the counterparty risk.

7.6 HRA Investments

Cash balances held by the HRA will be invested as part of the Council's overall treasury strategy. Cash balances will generally earn the average short-term rate of the Council's investments, which will be calculated at the financial year end.

Where there is agreement by the Chief Operating Officer (COO), individual investments can be ring-fenced for the HRA, with the allocations made within the

Council's overall treasury strategy requirements. For further details please refer to the HRA Business Plan.

8. The Capital Expenditure Plans 2018/19 – 2020/21

8.1 The Council's Housing (HRA) and General Fund (GF) capital expenditure plans, together with Balances and Reserves, are the key drivers of treasury management activity. The estimates for Capital expenditure, and its funding based on current proposed Revenue Budget and Capital Programmes, are reflected in prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans. The Prudential Indicators are included in Appendix 3 of this report.

8.2 Table 5 below shows the proposed capital expenditure over the coming three financial years. It is a requirement of the Prudential Code to ensure that capital expenditure remains within sustainable limits and to consider the impact on Council Tax and, in the case of the HRA, housing rent levels.

Table 5: Proposed Capital Expenditure 2018/19 – 2020/21

Capital expenditure	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual £000	Estimate £000	Estimate £000	Estimate £000	Estimate £000
General Fund	120,849	135,809	142,738	10,985	1,901
HRA	57,391	90,719	82,730	57,960	56,000
Total	178,241	226,528	225,467	68,945	57,901
Financed by:					
Capital Grants	81,333	38,415	34,707	0	0
Section 106	43	0	0	0	0
Revenue Contributions	860	990	400	400	400
Capital Receipts	13,687	25,698	2,809	400	350
HRA Contributions	40,668	79,804	82,730	57,960	56,000
Sub-Total	136,591	144,908	120,646	58,760	56,750
Net financing need for the year	41,650	81,620	104,821	10,185	1,151

8.3 The estimated financing need for the year in Table 5 represents a shortfall of resources resulting in a requirement to borrow. This underlying need to borrow is the CFR. The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

8.4 A portion of the net financing need has already been borrowed as this relates to the Abbey Road Phase 2 and Gascoigne regeneration schemes which was borrowed from the European Investment Bank.

8.5 Other long-term liabilities: the above financing need excludes other long-term liabilities, such as PFI and leasing arrangements, which already include borrowing instruments.

8.6 Sufficient headroom has been provided within the Authorised Limit on external borrowing to ensure that any major capital investment projects resulting from the

IAS are not restricted by this statutory limit. The limit also covers any short term borrowing for cash flow purposes as well as long term borrowing for capital projects, finance leases PFI initiatives as well as any unforeseen incidences where expected capital receipts are not forthcoming due to unexpected economic factors.

9. Treasury Management Advisors

- 9.1 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.
- 9.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
- 9.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

10. Minimum Revenue Provision Policy Statement

- 10.1 In accordance with Statutory Instrument 2008 number 414 and guidance issued by the Government under section 21 (1A) of the Local Government Act 2003 a statement on the Council's policy for its annual Minimum Revenue Provision (MRP) needs to be approved before the start of the financial year.
- 10.2 A Department for Communities and Local Government (DCLG) consultation on Investment Guidance, which included potential changes to MRP closed on 22 December 2017, although the final proposals were not available in time to be included in this report.
- 10.3 The Cabinet is asked to approve the Minimum Revenue Provision Policy Statement set out in Appendix 4.

11. Impact of MIFID II reforms from 3 January 2018

- 11.1 Under MIFID II, all local authorities will be classified as retail counterparties and will have to consider whether to opt up to professional status and for which types of investments. The Council has now completed its opting up process with its advisors, brokers and banks.

12. Financial Implications

- 12.1 The financial implications are discussed in detail in this report.

13. Legal Implications

Implications completed by: Dr. Paul Feild, Senior Governance Solicitor

- 13.1 It is a statutory requirement under the Government Finance Act 1992 (LGFA 1992) for the Council to set out what the council has to base its budget calculations upon.

Further it's a legal requirement for the council to set a balance budget with regard to the advice of its Chief Finance Officer. However, what is meant by 'balanced' is not defined in law and this has means that the Council must rely upon the professional judgement to ensure that the local authority's budget is robust and sustainable. The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy which sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The Council also has to 'have regard to' the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code for Capital Finance in Local Authorities when carrying out its functions under the Act.

13.2 This report sets out the Councils strategies in accordance with the Act.

14. Other Implications

14.1 **Risk Management:** This report has risk management issues for the Council, primarily that a counterparty could cease trading or risk that interest rates would rise adversely. The mitigation of these is contained in this report.

Public Background Papers Used in the Preparation of the Report: None

List of appendices:

- Appendix 1 – Annual Investment Strategy 2018/19
- Appendix 2 – Borrowing Strategy 2018/19
- Appendix 3 – Treasury Management and Prudential Indicators 2018/19 – 2020/21
- Appendix 4 – Minimum Revenue Provision Policy Statement 2018/19
- Appendix 5 – Treasury Management Scheme of Delegation 2018/19