Treasury Management Strategy 2018/19

Background

In accordance with the County 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 2018/19. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Interim Chief Financial Officer concerning the 2018/19 budget calculations.

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

In addition the County Council employs Treasury Management advisors, Link Asset Services (formerly Capita Asset Services), 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 August 2016.

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 County Council's advisors.

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

During 2017/18 the County Council has invested its surplus cash with selected Banks, AAA-rated Money market and cash-plus funds, the UK Debt Management Office and with other local authorities.

Economic Commentary

The Monetary Policy Committee, (MPC), increased the Bank Rate from 0.25% to 0.50% in November as it perceived the need for extra monetary support had eased. There is a push towards more normalised monetary policy, however the Bank of England has indicated that subsequent rises will be slow and gradual. In the coming financial year, Link Asset Services believe there will be one further rise of 0.25% by November 2018, with slow and gradual rises thereafter.

There are several unknowns that could influence the economy as the UK negotiates its exit from the EU, scheduled for the 29th March 2019. A positive outcome with regards to market access and movement of goods and services could lead to accelerated growth and domestically generated inflation (from wage growth etc.)

and possibly bring forward rate rises, whereas a negative outcome could defer further monetary tightening indefinitely.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

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

PWLB rates and gilt yields rose sharply in the wake of the June General Election and the September MPC meeting, otherwise rates have remained volatile, with no discernible trend. It is likely that volatility could continue to occur for the foreseeable future, with the balance of risks generally biased to the downside; with political turmoil exerting downward pressure, but inflation and debt concerns exerting upward pressure.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation. Rates on loans of 5 years are expected to be around 1.80%, while rates on longer term loans are expected to be around 3.10% by the end of 2018/19. The County Council has prudently assumed a borrowing rate for 2018/19 of 3.30% in setting the budget, with a working assumption to borrow in Quarter 3. For medium-term planning purposes the County Council has assumed borrowing rates of 3.30% in 2018/19, 3.80% in 2019/20 and 4.20% in subsequent years. This is in-line with Link Asset Services' forecasts for borrowing rates during Quarter 3 of each of those years plus a margin of 0.20% for 2018/19, 0.40% for 2019/20 and 0.60% for subsequent years, for prudence.

The County 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 County Council's debt maturity profile.

Interest rates will be monitored but as forecasts stand it is likely that borrowing will be undertaken during the second half of the financial year.

The gross capital borrowing requirement for 2018/19 is estimated to be £43.7 million. After the use of the minimum revenue provision to repay debt of £9.7 million, the net capital borrowing requirement is estimated to be £34 million.

The management of the County 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's debt is estimated to be £16.7 million in 2018/19.

In addition to its usual borrowing activity, the County Council provided finance for the construction of an Energy Plant. Further details are given below in the paragraph titled "Energy from Waste".

Annual Investments Strategy

The County 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 County 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 County Council will not borrow money purely to invest. The County 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 County Council is 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 Money Market Fund, a bank which is part-owned by the UK Government, or with a body of high credit quality. The County Council defines a body of high credit quality as counterparties who satisfy the criteria as described below:

- For overnight investments, or money placed in instant access accounts, the County Council defines a body of high credit quality as firstly 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 will initially define a body of high credit quality as having the below Long-term ratings:

Agency:	**Long-Term rating:**
Fitch	A+
Moodys	A1
Standard and Poors	A+

- Additionally, the County Council will undertake continued due diligence and will not automatically lend to Counterparties that merely satisfy the above criteria. As additional consideration, the County Council will assess for each:
    - Input from Treasury Advisors
    - Other market data from a reputable source
    - Press coverage
    - Market presence by the Counterparty
    - Availability of suitable products from the Counterparty
    - Ease of execution with the Counterparty
    - Level of Customer service from the Counterparty

- The above list is not exhaustive, the County Council may at any time exclude a Counterparty should it perceive any reasonable doubt concerning its Creditworthiness; the 2011 Code revision advises that subjective criteria may be used, in line with the Council's risk appetite.

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

- Enhanced Money Market funds or Cash Plus funds, which carry a AAA-rating from at least one rating agency.

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 County 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.

- Investments in Pooled Property Funds, these will be considered as having a 5 to 10-year term.

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 2009 code revision.

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

Pension Fund

Cash is held in the Pension Fund account at the bank. This is a transactional sum to ensure that contributions are received and benefits are paid efficiently. The vast majority of Pension Fund assets are invested elsewhere under separate Governance Arrangements to the County Council's Annual Investments Strategy above. The cash held at the bank may be either held in this account, or be invested in a manner deemed appropriate by the Pension Committee.

Non-Treasury Investments

The County Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The County Council will ensure that all the organisation's investments are covered in the capital strategy, investment strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

The County Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

MIFID II

The County Council has elected to opt-up to Professional Client status for most of its Counterparties, on the grounds of the typical size of its Investment portfolio and the volume of Transactions on the relevant market. This was primarily concerned with maintaining access to the financial instruments used. A few selected Counterparties indicated that the County Council would not need to opt-up to Professional Client status to continue service.

A schedule of the County Council's status with its Counterparties (Retail or Professional) is maintained as part of the Treasury Management Practices and will be reviewed annually and/or when a counterparty is added or removed.

West Mercia Energy

With regard to the joint ownership of West Mercia Energy, the County Council may, if deemed in the best interest of prudent management of the West Mercia business, undertake transactions pertaining to foreign currencies, such as foreign exchange deals and investments. Such dealings must have relevance to the course of business of West Mercia Energy. These dealings will be classified as Non-specified Investments as they are not sterling denominated.

Energy from Waste

In partnership with Herefordshire Council, the County Council provided finance to Mercia Waste for the building of an Energy from Waste Plant, which they are operating for a period determined by the existing PFI contract. At the end of the contract, the ownership of the plant will revert to the Councils. The construction phase commenced on the 21st May 2014, Mercia took control of the plant from the contractor at the beginning of March 2017.

Worcestershire County and Herefordshire Councils provided the finance on a 758:252 split, by granting loans on a commercial basis, in accordance with the agreed timetable. Loans granted to Mercia Waste for this purpose will be considered separately to normal Treasury Management investment activity. All costs and income related to this scheme shall be ringfenced for budget monitoring purposes and the loans granted are being considered as Capital Expenditure.

The loans to Mercia Waste, from the County Council were given as follows and reflect the Council's agreed shares in the scheme:

Year:	**Amount:**
2014/15	£22.0m (actual)
2015/16	£54.5m (actual)
2016/17	£35.8m (actual)

Herefordshire Council, under identical arrangements lent Mercia Waste amounts proportional to their share in the scheme.
During the operational period of the waste PFI contract, Mercia Waste will repay the Council Capital and Interest on the amortising senior term loan. At the expiration of the PFI contract during 2023/24, the Council shall assume ownership of the plant, which will represent repayment of the bullet loan.