

Audit Committee

Agenda
Item:

A.6

Meeting Date: 12 January 2018
Portfolio: Finance, Governance and Resources
Key Decision: Yes: Recorded in the Notice Ref: KD23/17
Within Policy and Budget Framework YES
Public / Private Public

Title: DRAFT TREASURY MANAGEMENT STRATEGY STATEMENT,
INVESTMENT STRATEGY AND MINIMUM REVENUE
PROVISION STRATEGY 2018/19
Report of: CHIEF FINANCE OFFICER
Report Number: RD37/17

Purpose / Summary:

This report sets out the Council's Treasury Management Strategy Statement for 2018/19, in accordance with the CIPFA Code of Practice on Treasury Management. The Investment Strategy and the Minimum Revenue Provision (MRP) Strategy for 2018/19 are also incorporated as part of the Statement. So too are the Prudential Indicators as required within the Prudential Code for Capital Finance in Local Authorities.

Recommendations:

Members of the Audit Committee are asked to note and make comments on the proposed Treasury Management Strategy for 2018/19

Tracking

Executive:	18 December 2017, 17 January 2018
Audit Committee:	12 January 2018

Report to Executive

Agenda
Item:

Meeting Date: 18 December 2017
Portfolio: Finance, Governance and Resources
Key Decision: Yes: Recorded in the Notice Ref: KD23/17
Within Policy and Budget Framework YES
Public / Private Public

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PROVISION STRATEGY 2018/19
Report of: CHIEF FINANCE OFFICER
Report Number: RD37/17

Purpose / Summary:

This report sets out the Council's Draft Treasury Management Strategy Statement for 2018/19, in accordance with the CIPFA Code of Practice on Treasury Management. The Draft Investment Strategy and the Draft Minimum Revenue Provision (MRP) Strategy for 2018/19 are also incorporated as part of the Statement. So too are the Prudential Indicators as required within the Prudential Code for Capital Finance in Local Authorities.

Recommendations:

The Executive is asked to note the Draft Treasury Management Strategy Statement for 2018/19, which incorporates the Draft Investment Strategy and the Draft MRP Strategy, together with the Prudential Indicators for 2018/19 for draft budget consultation purposes as set out in Appendix A and the Treasury Management Policy Statement as set out at Appendix D.

Tracking

Executive:	18 December 2017, 17 January 2018
Scrutiny:	BTSP 4 January 2018
Audit Committee:	12 January 2018
Council:	6 February 2018

1. BACKGROUND

- 1.1 The CIPFA Code of Practice on Treasury Management in Local Authorities was first issued in 1992 and updated in 1996, 2001 and 2011. The City Council formally adopted this Code in March 2002 and adopted the 2011 revision in February 2012. The updates made are minor, and centre around the changes in housing finance, Localism Act and the introduction of General Powers of Competence.
- 1.2 Under the requirements of the revised Code, the Council will receive each year the following reports:-
- Annual strategy and plan in advance of the year
 - A mid year review
 - Annual report after its close.

2. TREASURY MANAGEMENT STRATEGY STATEMENT

- 2.1 As required under the Code, the Treasury Management Strategy Statement (TMSS) for 2018/19, which also incorporates both the Investment Strategy for that year and the Minimum Revenue Strategy, is set out in **Appendix A**. The schedule of approved investment vehicles is contained in **Appendix B** and **Appendix C** includes a summary of current economic forecasts on interest rates that have been utilised in preparing the Strategy.
- 2.2 Also included within Appendix A are the **Prudential Indicators** that must be determined under the requirements of the CIPFA Prudential Code for Capital Finance in Local Authorities. These requirements came into operation on 1 April 2004 under the provisions of the Local Government Act 2003. Part 1 of the Act allows a local authority to borrow money for any purpose that is within its control or for the purposes of the prudent management of its financial affairs. The main purpose for borrowing money is to fund capital expenditure although some short-term borrowing is permitted to cover temporary cash flow needs.
- 2.3 Since 1 April 2004 there has been no statutory limit to the amount that can be borrowed. There is, however, a requirement for full compliance with CIPFA's Prudential Code; the key objectives of which are to demonstrate that the proposed capital investment plans have been assessed by the Council as affordable, prudent and sustainable. Section 3(1) of the Act puts a duty on the Council to determine before the start of the financial year and keep under review the maximum amount that it can afford to borrow. This amount is called the **Authorised Limit** and is discussed in Appendix A.
- 2.4 The Prudential Indicators will be monitored via the quarterly Treasury Management monitoring reports.

3. PROPOSALS TO AMEND THE CIPFA TREASURY MANAGEMENT AND PRUDENTIAL CODES

- 3.1 CIPFA is currently conducting a review of the Treasury Management Code of Practice and the Prudential Code. This review will particularly focus on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management. As finalised revised codes are not expected until December at the earliest, it may be necessary to review the TMSS once the final guidelines are issued and any implications on the Council's position is known.

4. CONSULTATION

- 4.1 The Council has appointed Link Asset Services (formerly Capita Asset Services) Treasury Services as its Treasury Advisers and they have been involved in the Strategy and proposals contained within this report.

5. CONCLUSION AND REASONS FOR RECOMMENDATIONS

- 5.1 The Executive is asked to note the Draft Treasury Management Strategy Statement for 2018/19, which incorporates the Draft Investment Strategy and the Draft MRP Strategy, together with the Prudential Indicators for 2018/19 for draft budget consultation purposes as set out in Appendix A and the Treasury Management Policy Statement as set out at Appendix D.

6. CONTRIBUTION TO THE CARLISLE PLAN PRIORITIES

- 6.1 To ensure the Council's investments are in line with the appropriate policies including the Treasury Management Strategy Statement.

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Appendices attached to report:

- Appendix A – Treasury Management Strategy Statement**
- Appendix B – Approved Investment Instruments**
- Appendix C – Interest Rate Forecasts**
- Appendix D – Treasury Management Policy Statement**

Note: in compliance with section 100d of the Local Government (Access to Information) Act 1985 the report has been prepared in part from the following papers:

- **None**

CORPORATE IMPLICATIONS/RISKS:

Community Services – not applicable

Corporate Support & Resources – contained within the report.

Economic Development – not applicable

Governance & Regulatory Services – The Council has a fiduciary duty to manage its resources effectively for the benefit of its area and the delivery of its services. Treasury Management is an important part of this function and it is appropriate that the Council has a strategy and takes account of the available specialist internal and external advice. The Treasury Management Strategy forms part of the Budget and Policy framework and, therefore, ultimately requires approval by Council.

Draft Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Statement

Carlisle City Council

2018/19

1. **INTRODUCTION**

- 1.1 The Local Government Act 2003 and supporting regulations requires 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 3 years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.
- 1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as paragraph 9 of this report); these set out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.
- 1.3 The Department of Communities and Local Government has issued revised investment guidance which came into effect from 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009 and 2011.
- 1.4 The Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management (revised November 2011) was adopted by this Council in February 2012.
- 1.5 The suggested strategy for 2018/19 in respect of the following aspects of the treasury management function is based upon officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury consultants. The strategy covers the following issues:
 - Treasury limits in force that will limit the treasury risk and activities of the Council;
 - Prudential and Treasury Indicators;
 - Current treasury position;
 - Borrowing requirement;
 - Prospects for interest rates;
 - Borrowing strategy considerations;
 - Debt rescheduling opportunities.
 - Investment Strategy
 - Minimum Revenue Provision Strategy
- 1.6 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year

to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

- increases in interest charges caused by increased borrowing to finance additional capital expenditure, and
- any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future

2. TREASURY LIMITS 2018/19 TO 2020/21

- 2.1 It is a statutory duty, under S3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount determined is termed the 'Affordable Borrowing Limit'.
- 2.2 The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit. This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future council tax levels is 'acceptable'. It is important to understand, however, that the Indicators themselves, which are set out in paragraph 5, do not have an inherently right or wrong answer. They are not intended as comparator information between different authorities but are designed to support and record local decision making.

3. USE OF TREASURY CONSULTANTS

- 3.1 The authority has, like most other authorities, employed treasury advisers for specialist advice and assistance for many years. In the case of this authority, this role has long been fulfilled by Link Asset Services (formerly Capita Asset Services) Treasury Services.
- 3.2 Link Asset Services provide specialist advice on both borrowing and investment matters. They also supply other relevant information and hold regular client seminars which help provide up to date training in what is an important and continually changing field. That said, it is important to recognise that responsibility for all treasury matters lies solely with the City Council and this responsibility is not delegated to Link Asset Services or any other third party. The Council has regard to the advice and information supplied by Link Asset Services along with advice and information from a variety of other sources. Such advice is valued and the authority is in frequent contact with Link Asset Services but this does lessen the ultimate responsibility of the City Council in dealing with treasury matters and taking relevant decisions.

4. **CURRENT PORTFOLIO POSITION**

The Council's treasury portfolio position at 30 November 2017 comprised:

Table 1		Principal £m	£m	Ave Rate %
Fixed Rate Funding	PWLB Market	0 15.0	15.0	8.76
Variable Rate Funding	PWLB Market	0 0	0	0.00
Other Long Term Liabilities			0	0.00
Gross Debt			15.0	8.76
Total Investments			17.4	1.29

5. **PRUDENTIAL AND TREASURY INDICATORS 2018/19 - 2020/21**

- 5.1 The Prudential and Treasury Indicators have been based on current projections for capital spending and resources in 2018/19 to 2020/21. The Council has ensured that future years' capital programmes have been set in accordance with the principles contained within the City Council's Capital Strategy and Asset Management Plan.

PRUDENTIAL INDICATOR AFFORDABILITY INDICATORS	2016/17 actual £000	2017/18 revised estimate £000	2018/19 estimate £000	2019/20 estimate £000	2020/21 estimate £000
Capital Expenditure	8,045	9,513	4,032	17,343	2,929
Ratio of financing costs to net revenue stream	11.88%	12.23%	14.56%	9.91%	9.38%
Net borrowing requirement in year (Internal & External)	425	3,442	(2,026)	12,080	(36)
Capital Financing Requirement as at 31 March	12,423	15,706	13,424	25,315	24,734
Annual change in Cap. Financing Requirement	(476)	3,283	(2,282)	11,891	(581)
Incremental impact of capital investment decisions					
Increase in council tax (band D) per annum (£)	(0.44)	2.99	(2.07)	10.77	(0.64)

- 5.2 The estimates of financing costs include both current capital commitments and the draft capital programme as presented elsewhere on the agenda. In the case of this authority, it is assumed that any support from central government towards the costs

of capital expenditure programmes in the next three years will be by means of a capital grant e.g. Disabled Facilities Grant.

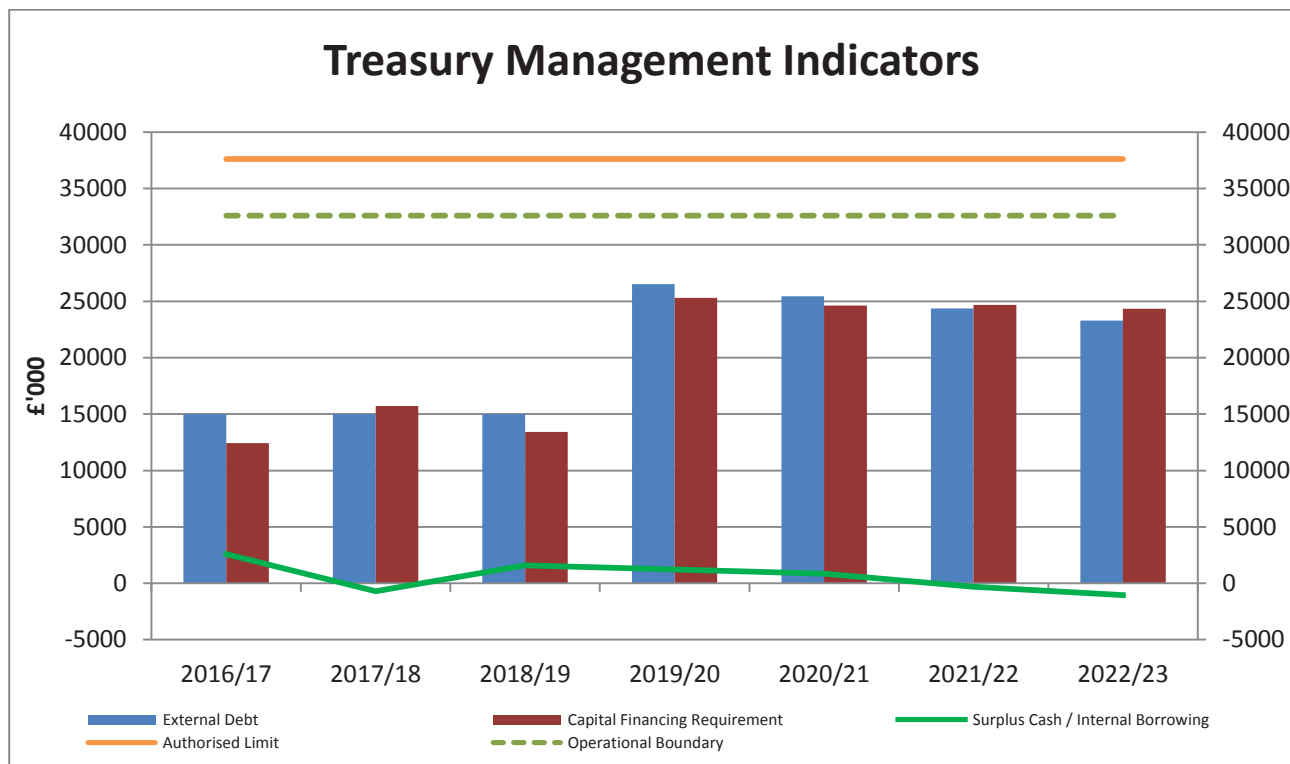
5.3 **The Council's Borrowing Need (Capital Financing Requirement)**

5.3.1 The Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for from capital grants, capital receipts or revenue contributions, will increase the CFR.

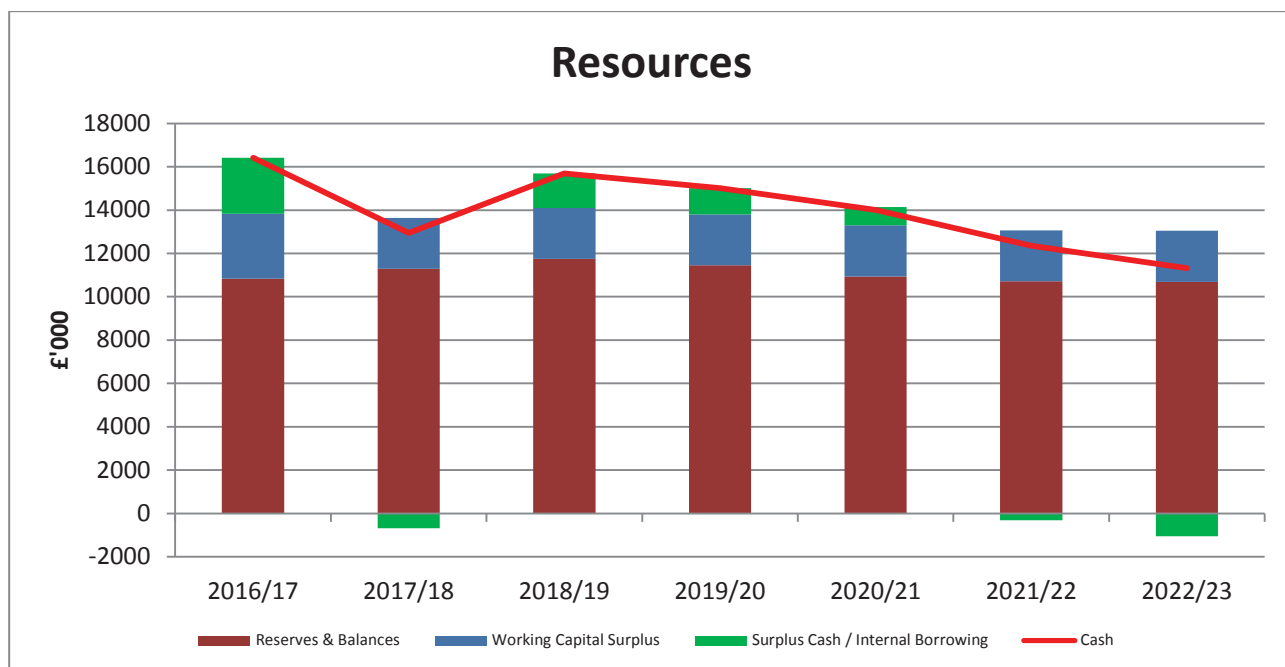
5.3.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

PRUDENTIAL INDICATOR TREASURY MANAGEMENT INDICATORS	2016/17 actual £000	2017/18 revised estimate £000	2018/19 estimate £000	2019/20 estimate £000	2020/21 estimate £000
Authorised Limit for External Debt:					
- Borrowing	37,500	37,500	37,500	37,500	37,500
- Other Long Term Liabilities	100	100	100	100	100
TOTAL	37,600	37,600	37,600	37,600	37,600
Operational Boundary for external debt:					
- Borrowing*	32,500	32,500	32,500	32,500	32,500
- Other Long Term Liabilities	100	100	100	100	100
TOTAL	32,600	32,600	32,600	32,600	32,600
Upper Limit for fixed interest rate exposure:					
- Net principal re. Fixed rate borrowing/investments	100%	100%	100%	100%	100%
Upper Limit for variable rate exposure					
- Net principal re. Variable rate borrowing/investments	100%	100%	100%	100%	100%
Upper Limit for total principal sums invested for over 1 year	50%	50%	50%	50%	50%

5.3 The graph below shows the level of external debt currently forecast against the Capital Financing Requirement.



5.4 The chart below shows the level of cash resources the Council is anticipated to hold over the same period. This shows that the level of cash held as investments is as a result of the level of cash-backed reserves, working capital surpluses and the amount of surplus cash and where internal borrowing is occurring.



Maturity structure of any fixed rate borrowing during 2017/18	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

- 5.5 In respect of its external debt, it is recommended that the Council approves the above authorised limit for its total external debt, gross of investments, for the next three financial years. The limit separately identifies borrowing from other long term liabilities such as finance leases. The Council will be asked to approve these limits and to delegate authority to the Chief Finance Officer, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities in accordance with option appraisal and best value for money. Any such change would be reported to the next available Council meeting.
- 5.6 The authorised limit is consistent with the authority's current commitments, plans and proposals for capital expenditure and it's financing. **However the overall authorised limit is not to be exceeded without prior Council approval.**
- 5.7 The operational boundary is based upon the same estimates as the authorised limit but without the headroom included within the authorised limit to allow for unusual cash movements. As with the authorised limit, the Council is asked to delegate authority to the Chief Finance Officer to effect movement between the separately agreed limits for borrowing and other long-term liabilities. The operational boundary can be exceeded in exceptional circumstances without prior Council approval providing that it remains within the authorised limit.
- 5.8 The City Council's current limits for maximum levels of fixed and variable rate funding are both 100% and this is as recommended by the treasury advisers.
- 5.9 Prudence and Sustainability
- 5.9.1 The City Council has adopted the CIPFA Code of Practice on Treasury Management in the Public Services and adopted the 2011 version of the Code in February 2012.
- 5.9.2 The current minimum level of specified investments is set at 50%. It is recommended that this level be continued into 2018/19.

- 5.10 Monitoring of the Prudential Indicators will be incorporated into the quarterly Treasury Transaction reports presented to the Executive.

6. PROSPECTS FOR INTEREST RATES

- 6.1 The Council has appointed Link Asset Services Treasury Services as a treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Link Asset Services view although it should be noted that there are some very differing views among the various economic forecasters regarding the future pattern of these rates:

	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18	Mar'19	Jun'19	Sep'19	Dec'19	Mar'20	Jun'20
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%

- 6.2 As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other

developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures. From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

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.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial-year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

7. BORROWING STRATEGY

- 7.1 The Link Asset Services forecast for the PWLB new borrowing rate (repayment at Maturity) is as follows:

	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18	Mar'19	Jun'19	Sep'19	Dec'19	Mar'20	Jun'20
5 Yr PWLB	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%
10Yr PWLB	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%
25Yr PWLB	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%
50Yr PWLB	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%

7.2 The Council is, as stated above, not currently expecting to have any recourse to borrowing externally in 2018/19 and although significant capital expenditure on new leisure facilities is anticipated in 2019/20 with this to be potentially funded from borrowing, the use of internal resources, i.e. surplus investment balances may be more affordable in the short term with low investment returns forecast until 2020/21. Approval was given as part of the Capital Strategy approved in September 2016, for the Section 151 Officer to undertake external borrowing at a time it was felt to be most appropriate, taking into account forecasts for potential rises in interest rates and utilising any favourable borrowing rates. It is anticipated that a combination of capital grants and internal resources will be used to meet most, if not all, capital commitments in the new financial year. Nevertheless, the use of external borrowing is to be planned for in future years. The Chief Finance Officer will therefore continue to monitor the interest rate market as regards borrowing opportunities as well as in respect of investment policy.

7.3 Policy on borrowing in advance of need

7.3.1 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. As part of the Capital Strategy approved by Council in September, approval in principle was given to borrowing in advance of need for the re-financing of the stock issue loan if interest rates were favourable and would be cost effective over the term of any new loan.

7.4 External v. Internal Borrowing

7.4.1 This Council currently has differences between gross debt and net debt (after deducting cash balances). This is shown in the graphs at 5.3.

7.4.2 The general aim of this Treasury Management Strategy is to reduce the difference between the two debt levels over the next three years in order to reduce the credit risk incurred by holding investments. However, measures taken in the last year have already reduced substantially the level of credit risk (see paragraph 9) so

another factor which will be carefully considered is the difference between borrowing rates and investment rates to ensure the Council obtains value for money once an appropriate level of risk management has been attained to ensure the security of its investments.

- 7.4.3 The next financial year will continue to be one of historically abnormally low Bank Rate. This provides a continuation of the current window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.
- 7.4.4 Over the next three years, investment rates are therefore expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.
- 7.4.5 However, short term savings by avoiding new long term external borrowing in 2018/19 will also be weighed against the potential for incurring additional long term extra costs by delaying unavoidable new external borrowing until later years when PWLB long term rates are forecast to be significantly higher.
- 7.4.6 Against this background caution will be adopted with the 2018/19 treasury operations. The Chief Finance Officer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

8. DEBT RESCHEDULING

- 8.1 There is unlikely to be much scope for debt rescheduling in either the current financial year or in 2018/19. Only one substantial sum of long term debt remains on the authority's books. This is the £15m stock issue which dates from 1995 and is not due to mature until 2020. The current view is that a premature repayment is not recommended because of the size of the premium payment that would be incurred. The position remains under review, however, if circumstances should change and may become more favourable the closer it gets to natural maturity dates.

9. INVESTMENT STRATEGY

9.1 Principles

- 9.1.1 The City Council will have regard to CLG's Guidance on Local Government Investments and the revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

9.1.2 The Council's investment priorities are:

- The security of capital
- The liquidity of its investments

9.1.3 The Council will also endeavour to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. Security of principal will always be the primary consideration. The risk appetite of this Council is low in order to give priority to security of its investments.

9.1.4 The borrowing of monies purely to invest or to on lend and make a return is unlawful and the Council will not engage in any such activity. Any borrowing in advance of need will only be undertaken after a full financial assessment of the costs and benefits of drawing down any such funding.

9.1.5 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' Investment categories. Individual counterparty limits will be set through the Council's Treasury Management Practices – Schedules which will be authorised by the Chief Finance Officer.

9.1.6 Total investments with any one counterparty or group currently will not exceed £6m to ensure a reasonable spread of investments in terms of counterparties. Investments with Money Market Funds and investments in overseas banks with a sovereign rating of not less than the UK sovereign rating will not exceed £4m.

9.1.7 This Annual Investment Strategy states which instruments the Council may use for the prudent management of its treasury balances during the financial year under the headings of **Specified Investments** and **Non Specified Investments**. These are listed in **Appendix B**. Essentially, specified investments are those with a maturity of up to one year which have a suitable credit rating or are otherwise guaranteed e.g. by HM Government. All other investments are non-specified.

9.1.8 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long-Term ratings.

9.1.9 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with

its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

9.1.10 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

9.1.11 Credit ratings will be used as one means of assessing the credit quality of rated counterparties although it is recognised that reliance should not be placed on credit rating alone. The minimum short-term rating for a bank will be either F1 (Fitch) or P1 (Moody’s). For a rated UK building society, a similar rating would be anticipated although the proposed criteria do give authority to the Chief Finance Officer to approve, if considered appropriate, the addition of other building societies with both a F2 (Fitch) and a P2 rating (Moody’s). This is still a high quality credit rating but recognises the very strong record of the UK building society movement over many years in protecting the capital of all depositors. The Strategy already allows discretion to the Chief Finance Officer to include as counterparties non-credit rated building societies whose assets total at least £1bn. Any such investment would be subject to an assessment of such a society as a suitable counterparty. There are, for example, good reasons why many building societies do not have a credit rating but there are other means of making an appropriate financial judgment.

9.1.12 Due care will be taken to consider the country, group and sector exposure of the Council’s investments. In addition:

Country limits:

- where the country of registration of an institution has an average credit rating (i.e. an average sovereign credit rating) equal to, or better than that of the UK; it will enable the Council to consider the placement of investments on the same basis applied for UK-registered institutions (i.e. subject to the overarching counterparty criteria as set out at **Appendix B**; and
- where an institution meets the approved counterparty status* but the country of registration has an average credit rating below that of the UK; limit such investments in total to such rated non-UK countries to be no more than £2m of the portfolio.
* i.e. it meets the overarching counterparty criteria as set out at **Appendix B**.
- sector limits will be monitored regularly for appropriateness.

9.1.13 Following approval in 2014/15, the Council now makes use of the CCLA Property Fund for longer term investments, and at present has invested £3m into this fund. The anticipated yield from this investment is assumed to be 4.50% in the MTFP.

9.1.14 Any investments with institutions that do not have a credit rating e.g. many smaller building societies or investments for periods over one year would be classed as non-specified investments. **However, it is important to stress that both the specified and non-specified investments in Appendix B are perfectly legal instruments in which the City Council may invest.** This includes for example many building societies as only the larger societies have an individual credit rating although there are other criteria by which a judgement can be made as to their credit quality.

9.1.16 The minimum percentage of its overall investments that the Council will hold in specified investments is 50%.

9.2 Creditworthiness Policy

9.2.1 This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

9.2.2 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore have consideration to using counterparties within the following durational bands:

- | | |
|--------------|--|
| • Yellow | 5 years * |
| • Dark pink | 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25 |
| • Light pink | 5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5 |
| • Purple | 2 years |
| • Blue | 1 year (only applies to nationalised or semi nationalised UK Banks) |
| • Orange | 1 year |
| • Red | 6 months |

- Green 100 days
- No colour not to be used

9.2.3 The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

9.2.4 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

9.2.5 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

9.3 Investment Strategy

9.3.1 With bank base rate forecast to remain at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021, investment conditions will continue to be difficult. The view of Link Asset Services is that bank rate will be at the following levels:

	Dec'17	Mar'18	Jun'18	Sep'18	Dec'18	Mar'19	Jun'19	Sep'19	Dec'19	Mar'20	Jun'20
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%

9.3.2 Clearly, these projections can only be best estimates at this stage and the risk is to the downside i.e. if the economic recovery is slower than expected, then interest rates are like to rise more slowly. At this stage, the budget for 2018/19 has assumed an average yield of 0.93% on its investments (excluding CCLA Property Fund) in the next financial year. This allows for the fact that there are some higher value, longer term investments placed. This forecast will, however, be reviewed further during the budget cycle. The anticipation of interest yielded from investing in the Property Fund is estimated at 4.50% in the MTFP.

9.3.3 In this situation, the authority will continue to try and seek value in its investments by placing them out for longer periods where possible e.g. six months to one year, to meet future cash flow needs, subject to retaining some sums for shorter periods to meet liquidity requirements and also to take advantage of any particular investment opportunities. Much of the basic framework of the authority's cash flows is already known for the next financial year and use will be made of this information in determining investment periods. The money market is monitored daily and use will be made of a plurality of sources of financial information in determining investment opportunities. All investments will be placed only with institutions that conform to the criteria set out in the Investment Strategy.

9.3.4 The investment income budget will, as ever, be carefully monitored in the coming financial year and reported to members via the regular Treasury Transactions reports.

9.4 End of Year Investment Report

In line with current practice, the Council will receive a report on its investment activity as part of the Annual Treasury Report at the end of the financial year. It should also be noted that best practice now requires a mid-year report on the treasury function. This has long been the practice within the City Council where quarterly reports are presented to the Executive. In addition, the Audit Committee has taken on the role of the 'strategic committee' that oversees treasury matters.

10. THE MINIMUM REVENUE PROVISION STRATEGY

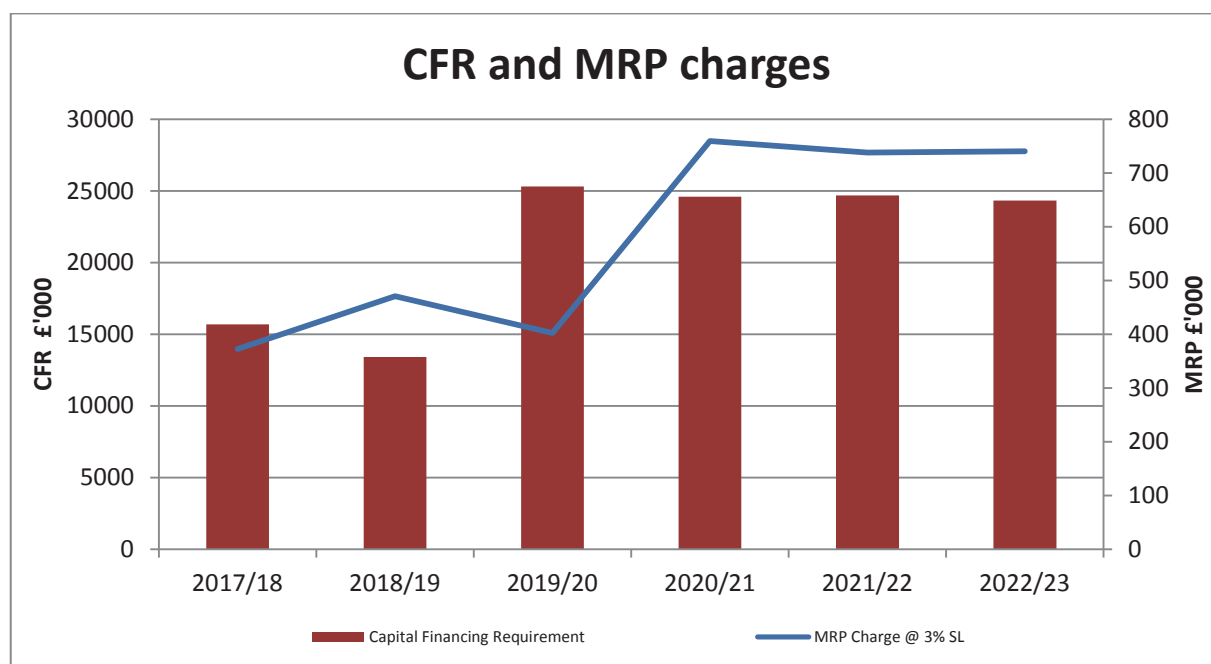
10.1 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09, and will assess their MRP for 2018/19 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. Furthermore, the Council revised its MRP Policy in 2017/18 to provide for MRP on a 3% straight Line basis going forward.

10.2 No requirement is currently anticipated to undertake any long term borrowing in either 2017/18 or 2019/19 although the authority will need at this stage to keep its options open and there are plans for borrowing to support future capital investment in leisure facilities in 2019/20. This is particularly so if any major capital project requires an element of long term borrowing as part of the overall funding package.

10.3 Notwithstanding this possibility, the City Council is still obliged to make proper provision for the repayment of its outstanding debt. Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. land, buildings, vehicles etc. It would usually be impractical to charge the entirety of such expenditure, which is often funded by borrowing, to the revenue account in the

year it was incurred. Instead, this is spread over a longer period to try and match the years over which these assets will benefit the community. The manner of spreading these costs is through the Minimum Revenue Provision (MRP). Until recently, the MRP was calculated according to detailed and complex regulations. It is now determined under Guidance.

- 10.4 The only statutory duty that a local authority has under the new MRP regime is ‘to determine for the current financial year an amount of minimum revenue provision that it considers to be prudent’. The Guidance, which authorities must ‘have regard to’ provides four options for calculating the MRP as set out below. It is important to realise, however, that there is no obligation to follow any of these options and that it is up to each authority to decide upon the most appropriate method of making a prudent provision, having had regard to the Guidance.
- 10.5 Using the 3% Straight Line method for calculating the MRP charge more reflects an average life of Council assets of 33 years and since it has a mix of short life assets such as vehicles (typical life 5-10 years) and long-life assets such as land and buildings (typical life 40-50 years) this is still deemed to be a prudent approach to take.
- 10.6 In 2017/18, the opening CFR was £12.422million which will result in an MRP of £373,000 in this financial year. The chart below shows the anticipated CFR in future years as well as the MRP charge based on a 3% straight Line method.



APPROVED INVESTMENT INSTRUMENTS

Specified Investments

All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable.

- All UK banks and building societies with a minimum specified 'high' credit rating shall have a **maximum of £6m** as the counterparty limit.
- All overseas banks with a sovereign rating of not less than the UK sovereign rating and a minimum individual credit rating, shall have a **maximum of £4m** as the counterparty limit.
- Where an institution meets the approved counterparty status but the country of registration has an average credit rating below that of the UK; limit such investments in total to such rated non-UK countries to be no more than **£2m** as the counterparty limit.
- UK building societies that are not credit rated shall have a maximum of **£2m** as the counterparty limit.
- MMFs shall have a maximum counterparty limit of **£4m**.

Fixed Term Deposits with fixed rates and maturities:-	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	Government backed	In-house
Term deposits – local authorities	--High level of security	In-house
Term deposits – U K banks**	Short-term F1 (Fitch) or P1(Moodys)	In-house
Term Deposits – UK building societies**	Short Term F1 (Fitch) or P1 (Moodys) or as determined by the Chief Finance Officer	In-house
Term Deposits – Non UK Banks	Sovereign Rating (not less than UK) Short Term F1 (Fitch) or P1 (Moodys) or as determined by the Chief Finance Officer	In-house
Fixed term deposits with variable rate and variable maturities: -	Minimum 'High' Credit Criteria	Use
Callable deposits	Short-term F1 (Fitch) or P1 (Moodys)	In-house
Certificates of deposits issued by UK banks and building societies	Short-term F1 (Fitch) or P1 (Moodys)	In-house buy and hold
UK Government Gilts	Government backed	In-house buy and hold
Bonds issued by multilateral development banks	AAA	In-house on a 'buy-and-hold' basis.
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house on a 'buy-and-hold' basis.
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -	Minimum 'High' Credit Criteria	Use
1. Money Market Funds	Short-term AAA	In-house
2. Enhanced Cash Funds	Short-term AAA	In-house
3. Government Liquidity Funds	Short-term AAA	In-house

** If forward deposits are to be made, the forward period plus the deal period should not exceed one year in aggregate.

Non-Specified Investments:

A maximum of 50% will be held in aggregate in non-specified investments

1. Maturities of ANY period.

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits with non credit rated UK Building Societies	As approved by the Chief Finance Officer. Minimum asset base of £1bn	In-house	50	364 days

2. Maturities in excess of 1 year

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – local authorities	Any authority	In-house	50	3 Years
Term deposits – UK banks and building societies	Long-term A (Fitch) or A2 (Moody's)	In-house	50	3 Years
Fixed term deposits with variable rate and variable maturities	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Certificates of deposits issued by UK banks and building societies	Long-term A (Fitch) or A2 (Moody's)	In house on a 'buy and hold basis'	50	3 Years
UK Government Gilts	Government backed	In house on a 'buy and hold basis'	50	3 Years
Bonds issued by multilateral development banks	AAA	In-house on a 'buy-and-hold' basis.	50	3 Years
Bonds issued by a financial institution which is guaranteed by the UK government	AAA	In-house on a 'buy-and-hold' basis.	50	3 Years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
1. Bond Funds	Long-term AAA	In-house	50	3 Years
2. Gilt Funds	Long-term AAA	In-house	50	3 Years

3. Approved Property Funds

	Use	Max % of total investments	Max. maturity period
CCLA Property Fund	In-house as determined by the Chief Finance Officer	50	No maximum

The Council uses Fitch (primarily) or Moody's ratings to derive its counterparty criteria. All credit ratings will be monitored monthly. The Council is alerted to changes in credit ratings through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

INTEREST RATE FORECASTS

The data below shows a variety of forecasts published by Link Asset Services and Capital Economics. The forecast within this strategy statement has been drawn from these diverse sources and officers' own views. Revised forecasts will be provided when they become available.

1. INDIVIDUAL FORECASTS

Link Asset Services Interest Rate View														
	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 View	0.50%	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%
3 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.00%	1.20%	1.20%	1.20%
6 Month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%
12 Month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.60%
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 Rate	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 Rate	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%
Bank Rate														
Link Asset Services	0.50%	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%
Capital Economics	0.50%	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	-	-	-	-	-
5yr PWLB Rate														
Link Asset Services	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%
Capital Economics	1.70%	1.90%	2.30%	2.60%	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-
10yr PWLB Rate														
Link Asset Services	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%
Capital Economics	2.30%	2.60%	2.80%	3.10%	3.30%	3.30%	3.30%	3.30%	3.30%	-	-	-	-	-
25yr PWLB Rate														
Link Asset Services	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%
Capital Economics	2.95%	3.15%	3.45%	3.65%	3.90%	3.90%	3.90%	3.90%	3.90%	-	-	-	-	-
50yr PWLB Rate														
Link Asset Services	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%
Capital Economics	2.80%	3.10%	3.30%	3.60%	3.80%	3.80%	3.80%	3.80%	3.80%	-	-	-	-	-

TREASURY MANAGEMENT POLICY STATEMENT

Carlisle City Council defines treasury management as:

“The management of the organisation’s cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.”

Carlisle City Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the authority.

Carlisle City Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving best value in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.

EXCERPT FROM THE MINUTES OF THE EXECUTIVE HELD ON 18 DECEMBER 2017

**EX.135/17 DRAFT TREASURY MANAGEMENT STRATEGY STATEMENT,
INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION
STRATEGY 2018/19**

(Key Decision – KD.23/17)

Portfolio Finance, Governance and Resources

Relevant Scrutiny Panel Business and Transformation

Subject Matter

Pursuant to Minute EX.119/17, the Deputy Leader, and Finance, Governance and Resources Portfolio Holder submitted report RD.37/17 setting out the Council's draft Treasury Management Strategy Statement (TMSS) for 2018/19 in accordance with the CIPFA Code of Practice on Treasury Management.

He informed Members that the draft Investment Strategy and the draft Minimum Revenue Provision Strategy for 2018/19 were incorporated as part of the Statement, as were the Prudential Indicators as required within the Prudential Code for Capital Finance in Local Authorities.

CIPFA was currently conducting a review of the Treasury Management Code of Practice and the Prudential Code focussing, in particular, on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance those purchases, or the use of existing cash balances. Both actions would affect treasury management. As finalised revised codes were not expected until December at the earliest, it may be necessary to review the TMSS once the final guidelines were issued and any implications on the Council's position was known.

The Deputy Leader indicated that the report would be considered by the Business and Transformation Scrutiny Panel and the Audit Committee on 4 and 12 January 2018 respectively.

In conclusion, the Deputy Leader, and Finance, Governance and Resources Portfolio Holder formally moved the recommendation, which was formally seconded by the Leader.

Summary of options rejected None

DECISION

That the Executive noted the Draft Treasury Management Strategy Statement for 2018/19, which incorporated the Draft Investment Strategy and the Draft Minimum Revenue Provision (MRP) Strategy, together with the Prudential Indicators for 2018/19 for draft budget consultation purposes as set out in Appendix A and the Treasury Management Policy Statement as set out at Appendix D to Report RD.37/17.

Reasons for Decision

To enable the Executive's draft Budget proposals to be prepared for consultation purposes