APPENDIX B

EXETER CITY COUNCIL

TREASURY MANAGEMENT STRATEGY 2017/18 (Revised October 2017)

1. Introduction

1.1 The Council's strategy is based on the requirements of the DCLG's Guidance on Local Government Investments ("Guidance") and CIPFA's Treasury Management in Public Services: Code of Practice and Cross Sectoral Guidance Notes ("CIPFA TM Code").

2. Economic Context

2.1 The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

Recent data presents a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending. Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

The currency-led rise in CPI inflation (currently 1.2% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to muted or negative real wage growth.

2.2 Interest rate forecasts

The Authority's treasury advisor Arlingclose projects the UK Bank Rate to remain at 0.25% for the foreseeable future, but advise there is a low possibility of a drop to close to zero.

2.3 *Arlingclose central interest rate forecast – December 2016*

Period	Bank Rate	20-year PWLB rate
Mar 2017	0.25	2.30
June 2017	0.25	2.25
Sept 2017	0.25	2.25
Dec 2017	0.25	2.25
Mar 2018	0.25	2.30
June 2018	0.25	2.30
Sept 2018	0.25	2.30
Dec 2018	0.25	2.35
Mar 2019	0.25	2.40
Jun 2019	0.25	2.45
Sept 2019	0.25	2.50
Dec 2019	0.25	2.55
Mar 2020	0.25	2.60

* The Council can currently borrow from the PWLB at 0.80% above gilt yields

3. Current and Expected Treasury Portfolios

3.1 Investments

3.2 The Council's current investments as at 1st December 2016 was as follows:

Property Funds

Amount	Investment	Dividend Yield
5,000,000	CCLA - LAMIT Fund	4.86%

Money Market Funds

Amount	Investment	Interest Rate
5,000,000	Standard Life	0.43%
5,000,000	Federated Investors	0.41%
1,500,000	Amundi Asset Management	0.34%
1,500,000	BlackRock	0.29%

Fixed Term Deposits

Amount	Investment	Interest Rate	No of Days Invested	Maturity Date
3,000,000	Woking Borough Council	0.35%	182	22/05/2017
3,000,000	Commonwealth Bank of Australia	0.30%	112	30/01/2017
3,000,000	United Overseas Bank	0.28%	91	12/12/2016
3,000,000	Nationwide Building Society	0.28%	91	31/01/2017

Borrowings

3.3 The Council's short term borrowing is currently £10m, this increased from £5m with effect from 1 February 2016. Long term borrowing remains at £56.884m. Details of the loans are set out below.

Existing Loans

Amount	Lender	Interest rate	Date of repayment
£10,000,000	Oxfordshire County Council	0.98%	01/02/2018
£56,884,000	PWLB	3.48%	28/03/2062

3.4 Expected changes

According to current cash flow forecasts, net borrowing is expected to remain at £10 million on 31st March 2017. The future cash flow forecast includes planned borrowing of £3 million as part of the 2017/18 capital programme. The decision of whether to take external long-term borrowing will be made in light of current and forecast interest rates and the decision is delegated to the section 151 Officer and Leader of the Council.

3.5 Budget implications

The net budget for interest payments in 2017/18 is £150,000 in respect of the General Fund. The HRA covers the interest costs relating to the long term borrowing of £56.9 million. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

4. Investment Strategy

4.1 The Council holds surplus funds, which represent income received in advance of expenditure plus balances and reserves held. Much of the Council's cash has been used to reduce the amount of debt taken on during the current financial year. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the **security** and **liquidity** of its investments before seeking the highest rate of return, or **yield**.

4.2 Specified Investments

Specified investments are those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The CLG Guidance defines specified investments as those:

- denominated in pounds sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

4.3 The Council defines the following as being of "high credit quality" for making specified investments, subject to the monetary and time limits shown.

In-house investment	Monetary limit[1]	Time limit
UK owned banks and building societies holding short-term credit ratings no lower than F1+ and P-1	£4m each	12 months
Foreign owned banks that deal in sterling holding short-term credit ratings no lower than F1+ and P-1	£3m each	6 months
UK owned banks and building societies holding short-term credit ratings no lower than F1 and P-1	£3m each	3 months
Money market funds[2] and similar pooled vehicles holding the highest possible credit ratings (AAA)	£5m each	3 months
Property Funds	£10m each	3 months
UK Central Government	no limit	12 months
UK Local Authorities[3] Upper Tier Lower Tier	£5m each £3m each	12 months 12 months

[1] banks within the same group ownership are treated as one bank for limit purposes
[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003

4.4 The maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. For an individual bank, the limit is £4 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

4.5 Non specified Investments

- No non specified investments will be made by the Council.

4.6 Foreign countries

Investments in foreign countries will be limited to those that hold a AAA or AA+ sovereign credit rating from all three major credit rating agencies, and to a maximum of £3 million per country. Only banks that are domiciled in the UK but are owned in another country will be used and need to meet the rating criteria of and will count against the limit for both countries. There is no limit on investments in the UK.

4.7 Liquidity management

The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

4.8 Credit ratings

The Council uses credit ratings from two main rating agencies Fitch Ratings Ltd and Moody's Investors Service to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality.

Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an institution has its credit rating downgraded so that it fails to meet the above criteria then:

- no new investments will be made,
- any existing investments that can be recalled at no cost will be recalled, and
- full consideration will be given to the recall of any other existing investments

Where a credit rating agency announces that it is actively reviewing an organisation's credit ratings with a view to downgrading it so that it is likely to fall below the above criteria, then no further investments will be made until the outcome of the review is announced.

4.9 Other information on the security of investments

Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

4.10 Investment instruments

Investments may be made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the Council can demand repayment)

- certificates of deposit
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks
- shares in money market funds

5. Planned investment strategy for 2017/18 – In-house

5.1 The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

5.2 The Council's in-house managed funds are based on the likely cash-flow position and rarely exceed three months. Investments will be made to ensure that cash flow is protected and borrowing is minimised. However, on occasion, money has been invested for a longer period up to 364 days. These are funds which are not required for day-to-day cash management purposes.

5.3 The Council will seek to utilise its call accounts (which are linked to base rate), money market funds (Standard Life, Blackrock, Federated, Amundi and CCLA) and use short-dated deposits to ensure liquidity of assets for day-to-day cashflow. Although these are essentially cash, a monetary limit in line with the banks credit rating is retained on the accounts. The Council will also make use of the Government's Debt Management Office to ensure the highest possible security for cash. Additionally, the Council will hold a balance on its general account to cover any payments due. On occasion, where significant payments are to be made, there may be in excess of £3 million in this account.

5.4 The 2016/17 strategy requested approval to allow investments to be made in property funds. Such funds are pooled investment products and are accessed on a traded share basis rather than a fixed cash deposit sum. The investment in the property fund is a long term commitment which means that there has been a small fluctuation on the return from the investment to date and this will continue to be the case.

An initial amount of £3m was placed in the fund in April 2016 with a further £2m added at the end of November. The dividend yield on this investment is currently 4.86% and it has fluctuated between 4.8% and 5% between April and November.

6. Borrowing Strategy

6.1 The Council's capital financing requirement (CFR, or underlying need to borrow) as at 31st March 2017 is expected to be £96.1 million, and is forecast to rise to £110.5 million by March 2018 as capital expenditure is incurred.

6.2 The maximum expected long-term borrowing requirement for 2017/18 is:

	£m
Not borrowed in previous years	39.2
Long term borrowing (HRA)	56.9

Forecast increase in CFR	14.4
Loans maturing in 2016/17	0.0
TOTAL	**110.5**

6.3 The Council made a one-off payment on 28 March 2012, to buy itself out of the HRA subsidy system. The final settlement figure of £56.884 million was confirmed in February 2012. The amount was borrowed from the Public Works Loans Board over a 50 year period and in repayable on maturity at the end of the loan term. The interest rate was 3.48% fixed for the term of the loan.

6.4 However, to reduce risk and minimise cost on the General Fund, it has been decided to defer borrowing until later years, and to reduce the size of the Council's investment balance instead.

6.5 In addition, the Council will borrow for short periods of time (normally up to two years) to cover cash flow shortages.

Currently the Council has borrowing of £10 million, which was taken for a period of 2 years at a rate of 0.98%.

6.6 Sources of borrowing

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list.

6.7 Debt instruments

Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest
- lender's option borrower's option (LOBO) loans.

As an alternative to borrowing loans, the Council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative.

6.8 Borrowing strategy to be followed

With short-term interest rates currently much lower than long-term rates, it continues to be more cost effective in the short-term to not borrow and reduce the level of investments held instead, or to borrow short-term loans. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against potential longer-term costs.

If required, the council may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in a later period.

7. Policy on Use of Financial Derivatives

7.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

7.2 The Localism Bill 2011 includes a general power competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

7.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

7.4 <u>Derivative counterparties</u>
Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

7.5 In reality, whilst the Council is required to include the above policy, the only type of transaction used is the forward deal, which means the Council agrees to borrow funds at a set price for a set period, in advance of the date the loan is actually taken. This is done to ensure the availability of funds at the time that they are needed.

8. Treasury Management Prudential Indicators

8.1 The Council sets each year, in February, prudential indicators for Treasury Management, to ensure that proper control of borrowing and investing is maintained. These indicators can be found in the Council's budget book.

9. Other Matters

9.1 The revised CLG Investment Guidance also requires the Council to approve the following matters each year as part of the investment strategy:

9.2 <u>Investment consultants</u>
The Council contracts with Arlingclose to provide advice and information relating to its investment and borrowing activities. However, responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- training courses.

The quality of the advisory service is monitored by the Assistant Director Finance.

9.3 <u>Investment training</u>
The needs of the Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

9.4 Investment of money borrowed in advance of need

The Council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit. The maximum periods between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

10. Investment Reports

10.1 At the end of the financial year, the Council will prepare a report on its investment activity as part of its Annual Treasury Report. Progress will also be reported after six months of the financial year.

CHIEF FINANCE OFFICER
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