CYNGOR SIR *POWYS* COUNTY COUNCIL.

FULL COUNCIL

8th March 2018

REPORT AUTHOR:	**County Councillor Aled Davies** **Portfolio Holder for Finance**
SUBJECT:	**TREASURY MANAGEMENT STRATEGY STATEMENT & ANNUAL INVESTMENT STRATEGY**
REPORT FOR:	**Decision**

Summary

1. Introduction

1.1 This Treasury Management Strategy Statement and Annual Investment Strategy report is a requirement of the CIPFA Code of Practice on Treasury Management and a requirement under the Local Government Act 2003. It has regard to the 2010 Guidance on Local Government Investments issued by the Welsh Assembly Government which requires the Treasury Management Strategy Statement and Annual Investment to be approved by Full Council.

1.2 The report details the expected activities of the Treasury function in the forthcoming financial year 2018/19, in respect of borrowing and investments.

1.3 The report requires an appropriate strategy for borrowing and investing for the financial year 2018/19.

1.4 The Strategy will be monitored throughout the year and will be revised for approval by Full Council if there are any significant changes necessary due to such things as the following:-

- updates in legislation/guidance
- changes in the economy/financial outlook which may affect the Authority's Strategy
- changes in the financial position of the Authority.

2. Background

2.1 The Council is required to operate a balanced budget which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned with cash being available when it is needed. Surplus cash is invested.
The second main function of the treasury management service is the funding of the Council's capital plans. These 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 involves arranging short or long-term loans or using longer-term cash flow surpluses.

3. CIPFA Code of Practice on Treasury Management and Prudential Code 2011

3.1 In 2011 CIPFA issued a revised edition of the TM Code of Practice. It is a requirement of the Code that this Authority should formally adopt the key principles of the Code and this was done by Cabinet on 14th February 2012 (see Appendix B).

3.2 The 2011 Code emphasises a number of key areas including the following:-

i. All authorities must formally adopt the revised Code
ii. The strategy report will affirm that the effective management and control of risk are prime objectives of the Authority's treasury management activities
iii. The Authority's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out
iv. Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation
v. Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support
vi. Authorities need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits
vii. Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities
viii. The main annual treasury management reports must be approved by Cabinet/Full Council
ix. There needs to be, at a minimum, a mid-year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved
x. Each Authority must delegate the role of scrutiny of treasury management strategy and policies to a specific named body
xi. Treasury management performance and policy setting should be subject to scrutiny prior to implementation
xii. Members should be provided with access to relevant training
xiii. Those charged with governance are also personally responsible for ensuring they have the necessary skills and training
xiv. Responsibility for treasury management activities must be clearly defined within the organisation
xv. Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the Authority.

3.3 The Authority will adopt the following reporting arrangements in accordance with the revised Code of Practice:-

Report/Document	Committee	Frequency
Treasury Management Policy Statement and Practices	Audit Committee followed by Cabinet	When changes require
Treasury Management Strategy and Annual Investment Strategy	Full Council	Annually before the start of financial year
Treasury Management Quarterly Reports	Audit Committee followed by Cabinet	Quarterly
Treasury Management Annual Review	Audit Committee followed by Cabinet	Annually by 30th Sept after the end of financial year

3.4 CIPFA Code of Practice on Treasury Management and Prudential Code 2017

In December 2017 CIPFA issued a revised TM Code of Practice and a revised Prudential Code. CIPFA has issued a statement that accepts that the issue of revised codes at a late stage of the 2018-19 budget cycle makes it very difficult for most authorities to fully implement both codes. Accordingly, full implementation is not expected until 2019-20. However, for members' information at this stage, a brief overview of the main change is attached at Appendix F.

4. Economic Background and Forecasts

4.1 The economic background is attached at Appendix C. The information contained therein is considered in the formulation of this Treasury Management Strategy Statement and Investment Strategy.

4.2 The most recent forecast of interest rates for 2018/19 by the Authority's advisor is:

	Mar18	Jun18	Sep18	Dec18	Mar19	Jun19	Sep19	Dec19
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%
5yr PWLB	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%
10yr PWLB	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%
25yr PWLB	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%
50yr PWLB	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%

The Bank of England Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate on 2nd November 2017. 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%. At its February 2018 meeting there was no change in Bank Rate but the forward guidance changed significantly to warn of "earlier and greater than anticipated" rate of increases in Bank Rate compared to their previous forward guidance.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. As such, 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.

5. Borrowing Strategy

5.1 The Authority's Capital Financing Requirement (CFR) is the amount of capital expenditure that is not financed from revenue resources, capital grants and other contributions and capital receipts. Any expenditure that is not financed from these resources increases the authority's underlying need to borrow. Part of the Council's treasury activities is to address the funding requirements for this borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure that sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through external borrowing or utilising temporary cash resources within the Council.

The Authority is currently maintaining an under borrowed position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cashflow has been used as a temporary measure. This is a prudent and cost effective approach in the current economic climate of low interest rates and is a good use of the Council's cash. However, members will be aware that internal borrowing is only a temporary situation and officers have advised that, based on capital estimates, it will be necessary for the Authority to borrow at stages over the next few years. Temporary borrowing has been carried out during the 2017/18 financial year and £20m of longer term borrowing has also taken place. This is a prudent approach to ensure some borrowing takes place whilst interest rates are at their low levels as opposed to borrowing at a future date at increased rates.

The Authority's estimated closing Capital Financing Requirement (CFR) for 2017/18 is £339.6M. If no further borrowing takes place within the remainder of the current financial year, the outstanding debt at 31st March 2018 will be £246.4M showing that the Authority is currently borrowed well below its CFR. Analysis of the balance sheet confirms the Authority to be in an internally borrowed position which, as mentioned above, is a prudent and cost effective approach in the current climate of low interest rates.
The approved Capital budget for 2018/19 is £87.7M with Prudential Borrowing of £28.9M.

Borrowing rates have been volatile in 2017-18 and increased sharply after the result of the general election in June 2017, after the September MPC meeting and again in January and February 2018. 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 later times when the Authority will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt. There will remain a cost of carry to any new long-term borrowing that will cause a temporary increase in cash balances due to the difference between borrowing costs and investment returns.

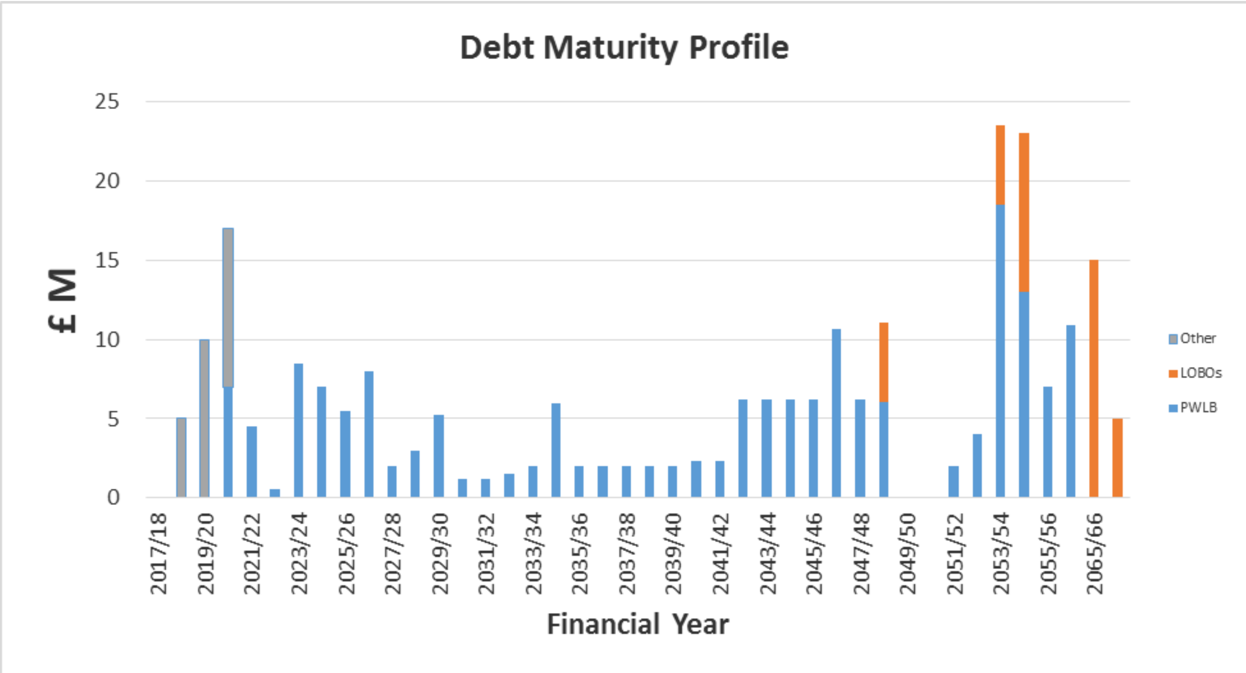
In view of the Authority's position and the above interest rate forecast, officers will monitor interest rates and will, when required, give consideration to new borrowing.

5.2 PWLB Certainty Rate:

In 2012-13, the Government introduced a 20 basis points (bps) discount on loans from the Public Works Loan Board (PWLB) under the prudential borrowing regime for those principal local authorities providing improved information and transparency on their locally-determined long-term borrowing and associated capital spending plans. The Government said it would also work with the local authority sector to consider the potential for an independent body to facilitate the provision of PWLB lending at a reduced rate to authorities demonstrating best quality and value for money. This certainty rate continues to be available and this Authority has registered its interest in this preferred rate option.

5.3 Estimated Debt Maturity Profile as at 01.04.18:

(please click on the graph below and increase the percentage in the View option of the toolbar above for an enhanced view)



Members will see that the debt maturity profile is fairly even across the years. This maturity profile has been managed as such, so as to ensure that there is no undue preponderance in any particular year which may put the Authority's financing and cashflow position at risk.

6. Debt Rescheduling

6.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which was compounded on 20th October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than before both of these events.

6.2 However, as short term borrowing rates will be considerably cheaper than longer term rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of any debt repayment i.e. premiums incurred.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings,
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

6.3 All rescheduling will be reported to Cabinet as soon as is practicable.

7. Policy on borrowing in advance of need

7.1 The Authority 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 value for money can be demonstrated and that the Authority can ensure the security of such funds.

8. Investments

8.1 *Investment Policy:*

8.1.1 The Authority has regard to the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") and the Welsh Assembly Government Guidance on Local Government Investments.

8.1.2 The Authority's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

8.1.3 The Authority will aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Authority has been low in order to give priority to security of its investments.

8.1.4 The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Authority will not engage in such activity.

8.1.5 The minimum amount that is to be held during the financial year in investments other than long-term is Nil.

8.2 Definition of Investments – Specified and Non-Specified:

8.2.1 The Local Government Act 2003 refers to specified and non-specified investments. The Welsh Assembly Government's Guidance on Local Government Investments, effective from 1st April 2010, defines the following:-

Specified Investments:

An investment is a specified one if all of the following apply:-

(a) it is denominated in sterling and any payments or repayments in respect of it are payable only in sterling
(b) the investment is not a long-term one i.e. one which is due to be repaid within 12 months of the date on which the investment was made or one which may require to be repaid within that period
(c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]
(d) the investment is made with a body or in an investment scheme of * high credit quality or with one of the following public sector bodies:
    i. the UK Government
    ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
    iii. a parish or community council.

* High credit quality is defined in Paragraph 8.4 below.

Non-specified Investments:

(i) An investment is non-specified if it does not meet the above definition.

There are various innovative products on offer which fit this criteria, many of which do so because their initial and maturity value can differ. The spirit of the 2004 National Assembly for Wales guidance was to ensure that authorities had the skills to assess any such products prior to possible commitment. Our advisors have confirmed that officers within Powys have the ability and knowledge to assess the value of such products. Any such assessment will involve determining a high credit quality in line with Paragraph 7.4 below.

As per Prudential Indicator 16.3.3 below the Authority has a maximum limit for investments held for a period of over 364 days.

As per Paragraph 8.6 below the Authority has a maximum limit to be held in Money Market Funds of £50M.

8.3 Creditworthiness policy:

8.3.1 This Authority uses the creditworthiness service provided by Link Asset Services although the Authority has adopted a position that is slightly more risk averse than Link's suggested list in respect of counterparties and durations.

8.3.2 Link uses a sophisticated modelling approach with credit ratings from all three main rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays: -

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

This approach is in line with the CIPFA Code of Practice which states that "credit ratings should only be used as a starting point when considering credit risk". Authorities should also use financial press, market data, information on government support for banks and the credit ratings of that government support.

8.3.3 Link's 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 can be used by the Authority to determine the suggested duration for investments and are therefore referred to as durational bands:-

- Yellow - 5 years
  for UK Government debt or its equivalent, Money Market Funds and collateralised deposits where the collateral is UK Government debt
- 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

8.3.4 A copy of the current full credit rating list is being sent to members alongside this report for information regarding which banks fall into each duration.

8.3.5 The TM Code of Practice advises that authorities have regard for all the ratings issued by all three main agencies and to make their decisions based on all ratings. The advisors' creditworthiness service corresponds with this as it uses the ratings from all three agencies but, by using a scoring system, does not give undue preponderance to just one agency's ratings.

8.4 "High" credit quality:

8.4.1 It is proposed that the Authority continue with the following in respect of defining a "high" credit quality. If a rating is not available from any of the rating agencies then the available ratings will be used. Members will note that this proposal excludes investments with some banks off the advisors' suggested list:-

Long Term Ratings (in respect of long-term investments):

Permitted Fitch Ratings	Permitted Moody's Ratings	Permitted S&P Ratings
AAA	Aaa	AAA
AA+	Aa1	AA+
AA	Aa2	AA
AA-	Aa3	AA-

Short Term Ratings (in respect of short-term investments):

Permitted Fitch Ratings	Permitted Moody's Ratings	Permitted S&P Ratings
F1+	N/A	A-1+
F1	P-1	A-1

8.4.2 All credit ratings will be monitored daily. The Authority is alerted to changes to ratings of all three agencies through its use of the advisors' creditworthiness service.

8.4.3 Any institution which drops below any of the above ratings will be removed from the Authority's counterparty list for investments. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

8.4.4 In addition to the use of Credit Ratings the Authority will also be advised of information in movements in Credit Default Swap against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Authority's investment list. Any investments held with the counterparty will also be reviewed in order to establish whether the premature maturity of the investment should be sought.

8.4.5 Sole reliance will not be placed on the use of this external service. In addition the Authority will also use market data and information, information on government support for banks and the credit ratings of that government support.

8.5 Country limits:

8.5.1 It is proposed that the Authority will use approved counterparties from the UK and approved counterparties from other countries with the following sovereign credit ratings:-

Permitted Fitch Ratings	Permitted Moodys Ratings	Permitted S&P Ratings
AAA	Aaa	AAA

The list of countries (excluding the UK) that qualify using this credit criteria as at the date of this report are shown in Appendix D. This list will be added to or deducted from by officers should ratings change.

8.5.2 Our advisor's view is that all Authorities should avoid a concentration of investments in too few counterparties or countries but that a suitable spreading approach in itself is likely to be sufficient given the safeguards already built into its creditworthiness service.

As such the following limits are proposed:-

Country	Maximum Investment per Country	Credit Rating/Other Assessment of Risk
AAA countries (listed at Appendix C)	£20M (held in call accounts)	As per rating list
UK	No Maximum Investment	As per rating list

8.6 Group/Institutions - Counterparty Criteria/Limits:

The current limits per the 2017/18 Strategy are as follows:-

Specified Investments (2017/18):

Institution	Maximum Investment per Group/Institution £M	Maximum Length	Credit Rating/Other Assessment of Risk
UK Banks	20 (a maximum £10M to be held in fixed term investments)	Up to 364 days	As per Link's matrices and the Authority's definition of a high credit rating
Foreign Banks	5	Up to 364 days	As per Link's matrices and the Authority's definition of a high credit rating
Other Local Authorities	25	Up to 364 days	N/A

It is proposed that the limits above remain the same for 2018/19.

<u>Non-Specified Investments (2017/18):</u>

Institution	**Maximum Investment per Group/Institution £M**	**Maximum Length**	**Credit Rating/Other Assessment of Risk**
UK Banks	10 (£2M limit with any one institution)	Up to 2 years	As per Link's matrices and the Authority's definition of a high credit rating
Lloyds Bank (as a mortgage lender in the LAMS scheme)	5	Up to 5 years	N/A
Foreign Banks	2	Up to 2 years	As per Link's matrices and the Authority's definition of a high credit rating
Money Market Funds (max. of 5)	10	N/A	All are AAA rated plus the parents/owners must meet the Authority's short term investment criteria
Other Local Authorities	10	Up to 2 years	N/A
European Investment Bank Bonds	3	2-3 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

It is proposed that the following limits are in place for 2018/19.

Institution	**Maximum Investment per Group/Institution £M**	**Maximum Length**	**Credit Rating/Other Assessment of Risk**
UK Banks	10 (£5M limit with any one institution)	Up to 2 years	As per Link's matrices and the Authority's definition of a high credit rating
Foreign Banks	2	Up to 2 years	As per Link's matrices and the Authority's definition of a high credit rating
Money Market Funds (max. of 5)	10	N/A	All are AAA rated
Other Local Authorities	10	Up to 5 years	N/A
Note: Limits for Specified and Non-Specified are combined limits. The maximum limit will also apply to a banking group as a whole.			

9. Investment Strategy

9.1 In-house funds*:*
The majority of the Authority's in-house managed funds are cash flow derived. However, this has and will continue to decrease as per the information in 5.1 above.

9.2 Investment returns area likely to remain relatively low during 2018/19. The suggested budgeted investment returns from the Authority's advisors for investments up to 100 days are:

2018/19	0.60%
2018/19	0.90%

Members should be aware that these returns may not be achieved by this Authority whilst cash levels are low and hence being kept in liquid accounts.

9.3 The Authority currently has no investments that are longer-term. It is unlikely that the Authority will lock into further longer term deals while investment rates are down at historically low levels and due to the reduction in cash balances.

9.4 For its cash flow generated balances, the Authority will seek to utilise its business reserve accounts, fixed term deposits (if appropriate) and money market funds.

10. Policy on the use of external service providers

10.1 The Authority currently uses Link Asset Services as its external treasury management advisors. This contract was awarded following a competitive process and runs to 31st August 2018.

10.2 The Authority recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed on external service providers.

10.3 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 Authority 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. This review will incorporate assessing the following:-

- level of technical expertise/advice
- appropriateness of advice given
- value of information provided i.e. market commentaries, forecasts, etc.
- value of training given
- attendance at meetings

11. Scheme of delegation

11.1 (i) Full Council
- approval of annual strategy

(ii) Audit Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

(iii) Cabinet

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of amendments to the Authority's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers.

12. Role of the section 151 officer (Chief Financial Officer)

12.1 The S151 officer will have responsibility for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

13. Treasury Management Training

13.1 The Authority recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: -

- treasury management staff employed by the Authority
- members charged with governance of the treasury management function.

13.2 All treasury management staff should receive appropriate training relevant to the requirements of their duties at the appropriate time. All treasury management staff are required to be members of an appropriate professional body and, in line with the continuing professional development requirements of these professional bodies, the Authority operates a Professional Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities. Additionally, training is also provided in the job and it is the s the level of training appropriate to their duties.

13.3 Details of Approved Training Courses

Treasury management staff and members will go on courses provided by our treasury management advisors, CIPFA, etc.

13.4 Records of Training received by Treasury Staff

As required by their relevant professional bodies, treasury management staff will maintain records of training they receive.

13.5 Approved Qualifications for Treasury Staff

It is the Authority's policy that the Treasury Manager and the Technical Accountancy Assistants are qualified to at least AAT level.

13.6 Members

The CIPFA Code of Practice states that members charged with governance (all members as the annual strategy requires approval by Full Council) have a personal responsibility to ensure that they have the appropriate skills and training for their role. To aid this, the Authority normally holds two briefing sessions per year for members and members should ensure that they attend at least one of these each year.

14. <u>Pension Fund Cash</u>

The Authority will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st Jan 2010. From 1st April 2010 the Pension fund has its own bank accounts although, due to use of the Authority's financial systems, a small amount of pension fund cash remains pooled with the Authority's cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 393.

15. <u>Treasury Management Budget</u>

A requirement of the Authority's Treasury Management Policy Statement is that a summary treasury management budget is included in the Strategy report. This is attached at Appendix E.

16. <u>CIPFA Prudential Code - Prudential and Treasury Indicators</u>

16.1 The following indicators, required by the CIPFA Prudential Code, are included as part of the annual budget report :-

- authorised limit for external debt
- operational boundary for external debt
- actual external debt

16.2 Prudential and Treasury Indicators are relevant for the purposes of setting an integrated treasury management strategy and, as such, the indicators required to be included as part of this strategy are as follows:-

16.3.1 *Interest Rate Exposure:*

The setting of upper and lower limits for interest rate exposures has the effect of creating ranges within which the Authority will limit its exposure to both fixed and variable interest rate movements.

The current limits are as follows:-

Fixed rates	140%
Variable rates	60%

As dictated by the Code of Practice, this indicator for fixed and variable limits is calculated by looking at the net position between debt and investments. The following table shows an example of the Authority's position and clearly shows what the Indicator is trying to achieve in that the investments we hold in variable rate contracts easily outweigh those in fixed rates:

	Debt	Investments	Net Debt
	£,000	£,000	£,000
Total at Fixed Rates	115,804	4	115,800
Total at Variable Rates	35,000	25,295	9,705
Total	150,804	25,299	125,505
	%	%	%
Fixed Debt less investments (net position)	76.79%	0.02%	92.27%
Variable Debt less investments (net position)	23.21%	99.98%	7.73%

It is proposed that the limits above remain the same for 2018/19.

16.3.2 Maturity Structure of Borrowing:

Local authorities are exposed to the risk of having to refinance debt at a time in the future when interest rates may be volatile or uncertain. This indicator is designed to assist authorities in avoiding large concentrations of fixed rate debt that has the same maturity structure and would therefore need to be replaced at the same time. It is recommended that the Authority sets upper and lower limits in each period as a percentage of its total borrowings.

The current limits are as follows:-

	Upper Limit	Lower Limit
Under 12 months	40%	0%
12 months to 2 years	40%	0%
2 years to 5 years	40%	0%
5 years to 10 years	40%	0%
10 years to 20 years	40%	0%
20 years to 30 years	40%	0%
30 years to 40 years	40%	0%
40 years to 50 years	40%	0%

It is proposed that the limits above remain the same for 2018/19.

16.3.3 Principal sums invested for periods longer than 364 days:

This indicator is used to demonstrate that the Authority has taken into account all the resources available for investment. This is to minimise the possibility that longer-term investments will need to be realised early which might have disadvantageous results. This indicator is also used to demonstrate that the Authority is not borrowing more than it needs to, or in advance of its needs, purely to profit through investment from the extra borrowing.

The current limit is set at £10M.

It is proposed that this limit remains at £10M for 2018/19.

Proposal

It is proposed that Council approves the Treasury Management Strategy Statement and Annual Investment Strategy.

Statutory Officers

The Head of Financial Services (Acting s151 officer) has made the following comment:

“The Treasury Management Strategy Statement and Annual Investment Strategy forms a key part of the Council`s overall approach to borrowing and investments. The report ensures the authority complies with relevant legislation and the Code of Practice on Treasury Management.”

The Solicitor to the Council (Monitoring Officer) has made the following comment:

“I have nothing to add to the report.”

Future Status of the Report

Not applicable

Recommendation:	Reason for Recommendation:
That Council approves the Treasury Management Strategy Statement and Annual Investment Strategy	**Statutory Requirement**

Relevant Policy:		Treasury Management Policy	
Within Policy:	**Y**	**Within Budget:**	**Y**
Person(s) To Implement Decision:		**Ann Owen – Treasury Manager**	
Date By When Decision To Be Implemented:			**1st April 2018**

Contact Officer Name:	Tel:	Fax:	Email:
Ann Owen	01597 826327	01597 826290	ann.owen@powys.gov.uk

Background Papers used to prepare Report:

CIPFA Code of Practice on Treasury Management and Cross Sectoral Guidance Notes
Treasury Management Policy Statement
Advisors' Information
WAG Guidance on Local Government Investments 2010

Appendix A:

Treasury Management Policy Statement

1. This organisation defines its treasury management activities as: “The management of the authority’s investments and 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”.

2. This organisation 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 organisation and any financial instruments entered into to manage these risks.

3. This organisation 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.”

Appendix B:

1. This Authority adopts the key principles of CIPFA's *Treasury Management in the Public Services : Code of Practice (2011 Edition),* as described in Section 4 of that Code as follows:-

   Key Principle 1:
   Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.

   Key Principle 2:
   Their policies and practices should make clear that the effective management and control of risks are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.

   Key Principle 3:
   They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that, within the context of effective risk management, their treasury management policies and practices should reflect this.

   In framing these recommendations, CIPFA acknowledges the difficulties of striving for effective risk management and control, whilst at the same time pursuing value for money. This code does not seek to be prescriptive about how this issue should be handled, particularly since it covers such a wide variety of organisations. However, where appropriate, the sector specific guidance notes give suitable advice. CIPFA recognises that no two organisations in the public services are likely to tackle this issue in precisely the same manner but success in this area of treasury management is likely to be viewed, especially in value for money terms, as an indicator of a strongly performing treasury management function.

   Even though it dates back to 1991, CIPFA considers that the report by the Treasury and Civil Service Committee of the House of Commons on the BCCI closure is still pertinent, wherein it was stated that:

   In balancing risk against return, local authorities should be more concerned to avoid risks than to maximise returns.

   Indeed this view was supported by the Communities and Local Government Select Committee report into local authority investments in 2009.
   It is CIPFA's view that throughout the public services the priority is to protect capital rather than to maximise return. The avoidance of all risk is neither appropriate nor possible. However, a balance must be struck with a keen responsibility for public money.

2. Accordingly, the Authority will create and maintain, as the cornerstones for effective treasury management:

- a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable treasury management practices (TMPs) setting out the manner in which the Authority will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the Code, subject only to amendment where necessary to reflect the particular circumstances of the Authority. Such amendments will not result in the Authority materially deviating from the Code's key principles.

3. The Authority will also have regard for the Guidance on Local Government Investments issued by the Welsh Assembly Government and effective from 1st April 2010.

4. Full Council will receive the annual strategy report as recommended in the Welsh Assembly Guidance on Local Government Investments and the Authority's Cabinet will receive reports on its treasury management policies, practices and activities, including, as a minimum, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

5. The Authority delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Chief Financial Officer, who will act in accordance with the Authority's policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

6. The Authority nominates Audit Committee to be responsible for ensuring effective scrutiny of treasury management policies, practices and performance.

Appendix C:

ECONOMIC BACKGROUND

UK

After the UK surprised with strong economic growth in 2016, growth in 2017 has confounded pessimistic forecasts of weak growth by coming in at 1.8%, only marginally down on the 1.9% rate for 2016. The outstanding performance came from the manufacturing sector which showed a 1.3% increase in Q4 and +3.1% y/y, helped by an increase in exports due to the lower value of sterling over the last year and robust economic growth in our main trade partners, the EU and US. It is also notable that there has been a progressive acceleration in total GDP growth during the year which gives ground for optimism looking forward into 2018.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak. Inflation fell to 3.0% in December and January.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This was, therefore, not quite the 'one and done' scenario but was, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

The 8 February 2018 MPC meeting did not change Bank Rate but the forward guidance changed significantly to warn of "earlier, and greater than anticipated" rate of increases in Bank compared to their previous forward guidance. The Link Asset Services forecast has therefore added an additional 0.25% increase in Bank Rate in May 2018 compared to the previous forecast, and then increases occurring November 2018, November 2019 and August 2020 to end at 1.50%

However, some forecasters are flagging up that they expect growth to accelerate significantly in 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate further its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the contradiction within the Bank of England between action in 2016 and in 2017 by two of its committees. After the shock result of the EU referendum, the Monetary Policy Committee (MPC) voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the Financial Policy Committee (FPC) of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y), +0.7% in quarter 3 (2.8% y/y) and quarter 4 +0.6% (2.7%y/y) However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in December inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 started erratically with quarter 1 coming in at an annualised rate of only 1.2%, quarter 2 at 2.3%, quarter 3 3.1% and quarter 4 2.6% This gave an overall figure for annual growth in 2017 of 2.6%, an acceleration from 1.5% in 2016. Unemployment in the US has also fallen to the lowest level for seventeen years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with five increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

JAPAN. GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

<u>Brexit timetable and process</u>

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

Appendix D:

Approved Countries for Investment

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

Appendix E:

Summary Treasury Management Budget

	2018/19 £	2017/18 £
Employees	165,000	165,000
Transport	1,266,450	1,514,310
Supplies and Services	200,000	205,000
Interest Paid	12,699,120	10,791,945
Debt Management Expenses	6,000	6,000
Gross Expenditure	**14,336,570**	**12,682,255**
Interest Received	0	0
Gross Income	**0**	**0**
Net Expenditure	**14,336,570**	**12,682,255**

Notes:

- Transport is the Authority's leasing costs – leasing is classified as a Treasury Management activity.

- Supplies and Services includes the following main items:-

  Bank and dr/cr card charges 175k
  Treasury /Leasing Advice 15k

- The Interest Paid figure for 2018/19 does not include Prudential Borrowing costs but does include potential replacement borrowing.

- Interest Received has no budget as cash balances have significantly reduced. Any interest received in respect of cash surpluses may need to be used to offset borrowing costs for negative cash balances.

Appendix F:

<u>CIPFA 2017 revised TM Code of Practice – further responsibilities of the s151 officer</u>

The 2017 Code has introduced a major extension of the functions of this role, especially in respect of non-financial investments which CIPFA has defined as being part of treasury management.

These functions are:-

- preparation of a Capital Strategy to include capital expenditure, capital financing, non-financial investments and treasury management with a long-term timeframe
- ensuring that the Capital Strategy is prudent, sustainable, affordable and prudent in the long-term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by the authority
- ensuring that the authority has adequate expertise, either in-house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non-treasury investments will be carried out and managed, to include the following:-
    - risk management including investment and risk management criteria for any material non-treasury investment portfolios
    - performance measurement and management including methodology and criteria for assessing the performance and success of non-treasury investments
    - decision making, governance and organisation, including a statement of the governance requirements for decision making in relation to non-treasury

investments and arrangements to ensure that appropriate professional due diligence is carried out to support decision making

- reporting and management information, including where and how often monitoring reports are taken

- training and qualifications, including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.