READING BOROUGH COUNCIL

DIRECTOR OF RESOURCES

TO:	**COUNCIL**		
DATE:	**26 FEBRUARY 2019**	**AGENDA ITEM:**	
TITLE:	**TREASURY MANAGEMENT STRATEGY 2019/20**		
LEAD COUNCILLOR:	**COUNCILLOR LOVELOCK**	**PORTFOLIO:**	**LEADERSHIP**
SERVICE:	**FINANCE**	**WARDS:**	**BOROUGHWIDE**
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1. Introduction

1.1 In accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 and the CIPFA Prudential Code, the Council is required to approve a Treasury Management Strategy before the start of each financial year. This report fulfils that obligation.

1.2 The Council's Treasury Management Strategy Statement (TMSS), attached at Appendix A, sets out the parameters for the Council's planned Treasury activity during 2019/20 under which the Council's Treasury Team will manage day to day activity. The TMSS reflects the Council's Capital Programme 2019/20 to 2021/22.

1.3 The successful identification, monitoring and control of financial risk is central to the Strategy. Non-treasury investments will be reflected in the Council's Commercial Investment Strategy.

2. RECOMMENDATIONS

That Council approve the:

- **Treasury Management Strategy Statement for 2019/20 as set out in Appendix A;**
- **Treasury Management Policy for 2019/20 as set out in Appendix B; and**
- **Minimum Revenue Provision (MRP) Policy for 2018/19 and 2019/20 as set out in Appendix C; and**
- **Note the existing investment and debt portfolio position as set out in Appendix D**

3. Appendices:

Appendix A - Treasury Management Strategy Statement 2019/20 (including the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators)

Appendix B - Treasury Management Policy 2019/20

Appendix C - Minimum Revenue Provision (MRP) Policy 2018/19 & 2019/20

Appendix D - Existing investment and debt portfolio position

4. Economic background

4.1 The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will influence future interest rates and potentially the Council's financial position. It is impossible to predict what the impact will be but the situation will be closely monitored to determine: a) when best to borrow funds and for how long and b) to ensure that investments are as secure as possible.

4.2 The Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rise in the Base Rate in August 2018 to 0.75%. The expectation is that there will be a slow rise in interest rates over the next few years. The Council's Treasury Advisors, Arlingclose, predict the Bank Base Rate will rise twice in 2019 to 1.25%.

4.3 Growth in Gross Domestic Product (GDP) recovered in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average previously achieved. The implications of this are that investment returns are likely to remain relatively low during 2019/20 and beyond.

5. Borrowing

5.1 Historically the Council has borrowed to pay for new assets including schools, roads and community facilities etc. The value of the Council's assets is circa £1bn which includes £470m Housing assets. As at 31st December 2018, the Council had £374m of loans outstanding in respect of these assets.

5.2 The Council has kept external borrowing at a similar level to that at the start of the year despite spending additional sums on capital. It has achieved this by reducing the level of short-term investments that were returning a lower rate of interest than that charged on new loans, thus minimising the net cost of interest.

5.3 Market projections indicate that long term borrowing costs will remain relatively low for some time and already take account of anticipated increases in the bank Base Rate. Consequently the Council does not intend to borrow until it needs to, thereby avoiding the "cost of carry" (the difference between the cost of borrowing and return on investing the funds until such time as the capital expenditure is incurred).

5.4 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

5.5 Based on its proposed Capital Programme over the period 2019/20 – 2021/22 the Council has a projected increase in its CFR of £284m. The Programme (circa £500m) aims to improve the Council's infrastructure and asset base as well as generate revenue savings and thereby improve service provision for the residents of Reading.

5.6 The Capital Programme, after specific grants, s106 contributions and capital receipts has a borrowing requirement of £306m, £260m General Fund and £46m Housing Revenue Account (HRA). The majority of General Fund borrowing (£249m) relates to 'invest to save' projects or those that generate a financial return, such as Commercial Investment and Leisure Development. The remaining £11m is to improve the Council's infrastructure and asset base. The cost of borrowing together with any associated revenue savings is included within the Council's Medium Term Financial Strategy 2019/20 – 2021/22. The increase in the level of borrowing compared to previous years reflects the lifting of HRA borrowing cap by Government on 30 October 2018 and the Council's Commercial Investment Strategy.

5.7 The Head of Finance has delegated responsibility for borrowing decisions and fulfils this through the Treasury Management Team which takes advice from the Council's treasury management advisors, Arlingclose. Decisions on when to borrow and for how long take into account several factors:

- The relative cost of borrowing short or long-term
- Anticipated changes in the cost borrowing
- The level of cash balances held under investment
- The anticipated return on invested balances

5.8 The Council's long-term borrowing (loans over 12 months in length) is from the Public Works Loans Board (PWLB) and Lender Option Borrower Option loans (LOBO loans). For short term borrowing the Council will continue to use other sources of finance, e.g. loans from other local authorities that it can borrow from at lower rates of interest than PWLB where available. The Council has taken out new, long-term loans of £30m in 2018/19.

5.9 The framework for taking borrowing decisions in the coming year is set out in the Council's Treasury Management Strategy Statement (TMSS), attached at Appendix A.

5.10 The Council's self-imposed limits on sustainable, affordable and prudent borrowing and investment, the Prudential Indicators that need to be approved by Council are set out in Appendix A.

5.11 The Council has undertaken a review of its policy on the prudent repayment of debt: it's Minimum Revenue Provision (MRP). As a result, two key changes are recommended to the policy attached at Appendix C as follows:

1) That no MRP is charged on short term capital loans (those with a full repayment date of five years or less), as they will generate a capital receipt on their maturity which will be utilised to repay the debt; and
2) The 2% MRP charge for the HRA will be removed to provide greater flexibility within the HRA Business Plan over when to make prudent provision for the repayment of debt.

6. Investment

6.1 The Council's Treasury Management investments seek to manage in year fluctuations in cash-flow. Treasury investments can be called on at short-notice and in the main are held in Money Market Funds. These are low-risk investments and give higher rates of interest than leaving the balance in the Council's bank account. Other investments include the CCLA property fund and loans to the Council's wholly owned companies.

6.2 The level of investments fluctuates throughout the year dependant on cash balances. The balance of investments was £56m at the end of December 2018 with an average weighted rate of return of 1.1%. This will earn approximately £500k for the Council that has been assumed in its Treasury Management budget.

6.3 The Council can legally invest in the following funds and instruments:

- Deposits (Government and public sector bodies)
- Deposits (Banks and Building Societies)
- Callable deposits (Banks and Building Societies)
- Money Market Funds
- Certificates of Deposit (tradable term deposits)
- Governments Gilts and Treasury Bills
- Corporate Bonds
- Derivatives (where used for risk management)

6.4 The Ministry for Housing Communities & Local Government (MHCLG) published updated guidance on investments in February 2018. The previous edition covered treasury investments only, but the current edition focuses on non-treasury investments. These are commercial investments such as the purchase of investment properties, investments in subsidiaries or investments for service objectives including regeneration.

6.5 Provision for commercial property acquisition is included within the Council's Capital Programme. The Council's Commercial Investment Strategy rather than its Treasury Management Strategy deals with the acquisition and management of such assets. The borrowing to fund the investments is part of the Treasury Management Strategy.

7. Markets in Financial Instruments Directive (MiFID) II

7.1 MiFID II is the EU directive regulating the provision of financial services within the European Economic Area and became effective on 3 January 2018. The objective of MFID II is to provide greater safeguards for non-professional clients who invest or trade in financial instruments.

7.2 Local authorities are now classified as retail clients by default, unless they exercise the option to 'opt-up' to 'elective professional client status' subject to meeting certain qualitative and quantitative tests.

7.3 The Council has successfully opted up to professional client status which means it has maintained its ability to maximise interest on its balances and its current range of investments is not limited. This status has to be agreed individually with each financial institution, broker and adviser and certain conditions have to be met relating to the quantity of transactions carried out and the experience and knowledge of those carrying out those transactions.

7.4 Under the legislation, professional status requires the Council to assume more direct responsibility for its investment decisions. Effectively this is incorporated into the due diligence the Council already undertakes before making any investment.

8. Approved Investments and Counterparties

8.1 The counterparty criteria have been reviewed for 2019/20 and are detailed in Appendix A along with those institutions currently meeting them. The criteria set out the value and duration limits which are applied in the day to day investment of the Council's cash balances.

8.2 The value and duration limits as well as the minimum credit ratings required of individual institutions seek to minimise the Council's exposure to counterparty risk, i.e. limit any potential loss due to the failure of any single institution or group.

8.3 The credit ratings agencies' criteria are relative measures of financial strength, any changes are notified to the Council's Treasury team on the same day. Over recent years the agencies have downgraded many financial institutions by removing the implied sovereign support. However, financial institutions have improved their capital ratios to meet new regulatory standards to enable them to withstand market shocks like that experienced in 2008. This requirement for increased resilience is designed to give higher assurance that institutions will be going concerns in the medium to long term. This has not impacted ratings as it has been universally complied with, so all institutions now meet a higher standard.

8.4 In addition, central banks such as the Bank of England and the European Central Bank provide financial support to financial institutions through Term Funding Schemes (TFS) that ensures that they have access to sufficient liquidity at low rates. The TFS was launched in 2016 and provides funding to banks and building societies at rates close to Base Rate. It is therefore recommended that investment duration limits for 2019/20 remain at the same levels as approved for 2018/19.

9. Risk Controls

Investment Risk

9.1 The main risk of investing with others is that the borrower or counterparty defaults on the loan and cannot repay it.

9.2 The main controls on investment risk are the application of counterparty criteria which limit the amount and duration of investments with both individual and groups of related counterparties. The criteria are generally based on rating agency evaluations as detailed in Appendix A, para A40.

Borrowing Risk

9.3 The main risk when deciding to borrow is the timing of the decision. The Council receives regular interest rate forecasts which are used to inform decisions on the timing of external borrowing.

Other Mitigations

9.4 The Treasury team are notified of credit rating changes on a daily basis by our treasury advisors. There are regular internal and external meetings for the Treasury team to keep abreast of latest topics. The monthly updates from Arlingclose include other market sources of information, such as prices of financial instruments and shares. In addition professional publications and sector specific reports are reviewed by the team.

9.5 The Treasury Management policies deal with risk controls, decision making and reporting processes, along with high level administration of the Treasury Management activities.

10. FINANCIAL IMPLICATIONS

10.1 Financial implications are contained in the body of this report

11. LEGAL IMPLICATIONS

11.1 This report assists the Council in fulfilling its statutory obligation to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy for the coming year setting out the Council's policies for managing its borrowing and investments and giving priority to the security and liquidity of those investments.

12. BACKGROUND INFORMATION

- CIPFA Code of Practice for Treasury Management in the Public Services 2017
- CIPFA The Prudential Code 2017
- MHCLG guidance February 2018
- CIPFA Bulletin Treasury and Capital Management Update October 2018

13. CONTACTS

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