

# NORTHUMBERLAND

Northumberland County Council

COMMITTEE: AUDIT COMMITTEE

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## TREASURY MANAGEMENT STRATEGY STATEMENT FOR THE FINANCIAL YEAR 2018-19

Report of Alison Elsdon, Director of Finance

Cabinet Member: Councillor Nicholas Oliver – Portfolio Holder for Corporate Services

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### Purpose of Report

The Local Government Act 2003 requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy, which sets out the policies for managing investments and for giving priority to the security and liquidity of those investments. The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policy.

This report sets out the Treasury Management Strategy, Treasury Management Policy Statement, the Annual Investment Strategy for the Financial Year 2018-19, Prudential Indicators 2018-19 – 2020-21 and the Minimum Revenue Provision Policy 2018-19.

### Recommendations

- **Members scrutinise the report and recommend that County Council approve the Treasury Management Strategy Statement which includes the Treasury Management Policy Statement, the Annual Investment Strategy and Borrowing Strategy for the Financial Year 2018-19.**
- **Members recommend that County Council approve the Prudential Indicators (Appendix 4) for three years 2018-19 to 2020-21 to ensure that the Council's capital investment plans are affordable, prudent and sustainable.**
- **Members recommend that County Council approve the Minimum Revenue Provision Policy (Appendix 5) 2018-19.**

## **Link to Corporate Plan**

This report supports the “We want to be efficient, open and work for everyone” priority included in the proposed NCC Corporate Plan 2017-21, due to be approved by Council in February 2018.

## **Key issues**

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to ‘have regard to’ the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010), to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

The Act requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act).

The Treasury Management Strategy Statement details the proposed activities of the Treasury Management function for the financial year 2018-19 and is based upon the treasury management officers’ views on interest rates, supplemented with leading market forecasts provided by the Council’s treasury management advisors, Link Asset Services (formerly Capita).

CIPFA is currently conducting a review of the Treasury Management Code of Practice and the Prudential Code. This review focuses on non-treasury investments (it is possible that this will also include loans to third parties) and especially on the purchase of property with a view to generating income, as well as the proposed introduction of a Capital Strategy document. At the same time DCLG are consulting on associated amendments to their Investment Guidance.

At the time of writing neither of the documents had been finalised or published. However, the following report incorporates the amendments initially proposed.

# TREASURY MANAGEMENT STRATEGY STATEMENT 2018-19

## 1. INTRODUCTION

### 1.1. Background

This Treasury Management Strategy Statement details the expected activities of the Treasury Management function for the 2018-19 financial year. Its production and submission to Council is a requirement of the CIPFA Code of Practice on Treasury Management.

Treasury management is defined as:

“The management of the local 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.”

### 1.2. Statutory and Regulatory Requirements

The Local Government Act 2003 (the Act) and supporting Regulations requires the Council to ‘have regard to’ the Chartered Institute of Public Finance and Accountancy’s (CIPFA) Prudential Code, and the CIPFA Treasury Management Code of Practice (which was adopted by Northumberland County Council in February 2010).

The codes define the manner in which capital spending plans are to be considered and approved, and require the Council to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. In conjunction with this, they also require the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy - as required by the Investment Guidance issued by The Department of Communities and Local Government which came into effect from 01 April 2010.

### **Proposals to Amend the CIPFA Treasury Management and Prudential Codes**

CIPFA is currently conducting a review of the Treasury Management Code of Practice and the Prudential Code. This review focuses on non-treasury investments (it is possible that this will also include loans to third parties) and especially on the purchase of property with a view to generating income, as well as the proposed introduction of a Capital Strategy.

DCLG is also consulting on a proposed update to its Investment Guidance. In the same vein as the CIPFA review, the proposals centre on potential disclosure of non-core investments within the Annual Investment Strategy. Non-core investments are investments outside of the standard investment of cash flow balances.

At the time of writing, none of the documents have yet been finalised. However the focus of both of these reviews, and proposed revisions, have been taken into account in the following strategy. The accompanying papers to this report also include a draft Capital Strategy.

### **1.3. Basis and Content of Treasury Management Strategy for 2018-19**

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 by leading market forecasts provided by the Council's treasury advisors, Link Asset Services (formerly Capita). The strategy covers:

- Current portfolio position;
- Economic outlook and prospects for interest rates;
- Borrowing Strategy for 2018-19;
- Annual Investment Strategy for 2018-19;
- Housing Revenue Account (HRA) treasury costs;
- Treasury management limits and prudential indicators;
- Minimum Revenue Provision Policy Statement;
- Policy on use of external service providers;
- Implementation of the Treasury Management Strategy, scheme of delegation, reporting and training requirements, and;
- Other Issues / Risks – Adoption of IFRS 9 Financial Instruments.

### **1.4. Balanced Budget Requirement**

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. In particular, Section 31 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 means that the impact of increases in capital expenditure - such as interest charges associated with any new borrowing, and any increases in running costs from these capital projects - must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

The Council also has a statutory duty under S.3 of the Local Government Act 2003, and supporting regulations, to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits.

The 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 within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.

## 2. THE PORTFOLIO POSITION AT 30 NOVEMBER 2017

### 2.1. Current Borrowing

The Council's borrowing at 30 November 2017 is shown below:

	General Fund £m	HRA £m	Total Principal 30 Nov 2017 £m	Weighted Average Rate %
Public Works Loan Board Loans	202.70	65.96	268.66	3.40
LOBOs	186.50	23.00	209.50	3.90
Market / Local Authority (>1yr)*	304.00	8.10	312.10	1.60
Salix	0.07	0.00	0.07	0.00
Short Term loans* (<1yr)	15.00	0.00	15.00	0.67
<b>TOTAL EXT BORROWING</b>	<b>708.27</b>	<b>97.06</b>	<b>805.33</b>	<b>2.78</b>

\* Note: above figures are based on the term of loans at their inception

Total external borrowing has increased by £43.72 million from £761.61 million at the start of year to £805.33 million at 30 November 2017. Following further repayments and forward dated loans (agreed previously) the year end figure is expected to be £742.06 million.

### 2.2. Current Investments

The table below summarises the investment position at 30 November 2017:

	Total Principal 30 Nov 2017 £m	Weighted Average Rate %
Money Market Funds and Call Accounts	58.20	0.41
Fixed Term Investments – Short Term (<1yr)*	108.00	0.36
Fixed Term Investments – Long Term (>1yr)*	33.25	3.24
<b>TOTAL EXTERNAL INVESTMENTS</b>	<b>199.45</b>	<b>0.85</b>

\* Note: above figures are based on the term of investments at their inception

## 3. FORECAST FOR INTEREST RATES AND ECONOMIC OUTLOOK

The Council has appointed Link Asset Services (formerly Capita) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link's central view of rates for 2018-19 (at 07 November 2017). A longer view and more detailed forecast, including additional forecasts from Capital Economics, is included at Appendix 1.

	Qtr 1 (Q/E Jun 2018)	Qtr 2 (Q/E Sep 2018)	Qtr 3 (Q/E Dec 2018)	Qtr 4 (Q/E Mar 2019)
Bank Rate	0.50%	0.50%	0.75%	0.75%
5yr PWLB	1.60%	1.70%	1.80%	1.80%
10yr PWLB	2.30%	2.40%	2.40%	2.50%
25yr PWLB	3.00%	3.00%	3.10%	3.10%
50yr PWLB	2.70%	2.80%	2.90%	2.90%

**3.1. Economic Outlook (at December 2017)**

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.

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.

Long-term borrowing rates are largely driven by gilt / bond yields, which are in themselves (inversely) governed by gilt price / demand movements - when demand for gilts increases, prices rise, but the yield received effectively falls.

The overall longer run trend is for gilt yields, and therefore PWLB borrowing rates, to gently rise going forward. It has long been expected that at some point there would be a start to a switch back from gilt/bond purchases to equities purchases, following a historic long term trend of falling gilt/bond yields. Not least because a lot of these gilt/bond purchases were fuelled by the actions of central banks since the financial crash of 2008 in implementing substantial quantitative easing – and position which will inevitably need to be reversed at some point. Notwithstanding this, the sharp rise in bond yields since the US Presidential election may in itself signal the more general start of this reversal; especially since America is likely to lead the way in reversing monetary policy.

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 strong economic growth becomes more firmly established. The US Central Bank 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 would be likely to exert some upward pressure on bond yields in other developed countries but 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 in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have recently been subject to exceptional levels of volatility, which have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that similar levels of volatility could continue to occur at any point during the forecast period.

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

### **3.2. Downside Economic Risks**

Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and therefore PWLB borrowing 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.

### **3.3. Upside Economic Risks**

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 US Federal Bank 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.

## **4. THE BORROWING STRATEGY 2018-19**

### **4.1. Introduction**

The Council borrows to fund the Capital programme, including loans to third parties for policy reasons (such as those to Northumberland's Development Company and Northumbria Healthcare Trust etc.). Its capital expenditure plans are therefore the key driver of treasury management activity.

The output of capital expenditure plans is reflected in the Prudential Indicators, as set out in Appendix 4.

### **4.2. Borrowing Need – Capital Financing Requirement**

The Council's long-term borrowing requirement is measured by the Capital Financing Requirement ("CFR"). The CFR represents total historic outstanding capital expenditure which has not yet been paid for from either revenue or cash-backed capital resources (such as grants and capital receipts). The CFR is repaid over time by an annual charge to revenue, known as the Minimum Revenue Provision (MRP). This charge, which is equivalent to depreciation, effectively spreads the cost of debt associated with capital expenditure over the useful economic life of the underlying assets.

At the same time the Council has significant levels of 'cash-backed' balances that are available for investment. Accordingly, the capital financing requirement (or borrowing requirement) need not always be met or funded externally from physical loans: At least in the short term, investment balances can be 'used' in lieu of borrowing externally; by withdrawing investments (in turn foregoing investment income) and instead using the cash to fund part of the borrowing requirement. This is often referred to as 'internal' or 'under' borrowing. Such an approach also has the added benefit of reducing 'counter-party' credit risk in terms of investments; because it reduces the need to place investments with external institutions.

The following tables summarises the forecast CFR movements for the next three financial years (based on the latest capital expenditure plans) along with the anticipated external borrowing over this period; assuming a significant degree on internal borrowing as proposed further below:

<b>CFR Forecast (exc. PFI)</b>	<b>2018-19 £m</b>	<b>2019-20 £m</b>	<b>2020-21 £m</b>
Opening CFR (exc. PFI)	871.36	967.00	1,044.42
Increase in CFR (exc. PFI)	95.64	77.42	44.43
<b>Closing CFR (exc. PFI) [Need to Borrow]</b>	<b>967.00</b>	<b>1,044.42</b>	<b>1,088.85</b>

<b>External Borrowing Forecast (exc. PFI)</b>	<b>2018-19 £m</b>	<b>2019-20 £m</b>	<b>2020-21 £m</b>
Opening External Borrowing (exc. PFI)	742.06	824.52	911.98
Increase in External Borrowing (exc. PFI)	82.46	87.46	41.46
<b>Closing in External Borrowing (exc. PFI)</b>	<b>824.52</b>	<b>911.98</b>	<b>953.44</b>
Under / (Over) Borrowing	142.48	132.44	135.41

### **4.3. Proposed Borrowing Strategy**

With investment returns anticipated to remain low (at least in the short term), it is proposed to continue with the practise adopted in recent years of wherever possible using investments in lieu of external borrowing – i.e. operating an under-borrowing position.

Whilst the principle strategy of maintaining an under-borrowing position will reduce short term revenue costs, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs.

As identified above, by the end of 2018-19 14.8% (£142.48 million) of the Council's borrowing requirement is proposed to be covered by internal borrowing. The effective cost of this 'borrowing' is the foregone investment income. For 2018-19 this is estimated at 0.6% or around £0.81 million (based on the average mid-year internal borrowing position). Taking into consideration a forecast average cost for external borrowing (i.e. average interest rate on actual loans) for 2018-19 of 3.05%, this equates to a notional saving of 2.45% or around £3.32 million (or alternatively the notional cost of externalisation).

However, it is important to point out that this element of the borrowing requirement is subject to interest rate movements and therefore not without risk. Clearly if investment returns were to increase, or the borrowing had to instead be externalised (and funded by actual loans), the costs associated with this would increase accordingly. In order to identify and quantify this risk, a new (local) indicator has been included in the Council's prudential indicators (see Appendix 4), identifying the level of internal borrowing and the impact of interest rate movements on this proportion of the borrowing requirement.

Despite utilising investments balances to support the borrowing need, as identified above a significant amount of external borrowing will still be required during 2018-19

(around £190m, including maturing loans) and going forward to fund the proposed capital programme. Against the above backdrop and the risks within the economic forecast, it is envisaged this requirement will be met primarily from short to medium term borrowing but also from some longer term loans.

The Section 151 Officer will however continue to monitor the interest rate market and scrutinise all lending opportunities to ensure borrowing is taken at the most advantageous time and limit the risk of exposure to increased borrowing costs in the future.

For example, if it was felt that there was a significant risk of a sharp rise in long rates than that currently forecast (perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK), then the portfolio position will be re-appraised and consideration given to increased long-term borrowing being drawn down whilst interest rates remain low.

Conversely, if it was felt that there was a significant risk of a sharp fall in rates (perhaps due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowing may be postponed and the potential for rescheduling from fixed rate funding into short term borrowing perhaps considered.

In line with the scheme of delegation set out in the Treasury Management Practices (TMP's, section 10 below), The Section 151 Officer will continue to approve all borrowing.

#### **4.4. Policy on borrowing in advance of need**

While not expected to happen due to the internal/under borrowing policy, the Council does have flexibility to borrow funds this year for use in future years. Where there is a clear business case for doing so, borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial. Risks associated with any advance borrowing activity will be subject to appraisal in advance and subsequent reporting through the mid-year or annual reporting mechanism.

#### **4.5. Debt Rescheduling**

As short term borrowing rates are forecast to be considerably cheaper than longer term fixed interest 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 debt repayment and in particular the 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).

The Council will monitor the situation and seek advice from Link Assets Services before any rescheduling of debt. All rescheduling will be reported to the Council at the earliest meeting following its action.

#### **4.6. Municipal Bond Agency and European Investment Bank**

The Municipal Bond Agency, which is currently in the process of being set up, may be in a position to offer loans to local authorities in the near future; perhaps at rates lower than those offered by the PWLB. Consideration may therefore be given to making use of this new source of borrowing as and when appropriate.

Consideration will also be given to borrowing from the European Investment Bank (EIB), where rates can be forward fixed, if this represents better value of money.

### **5. ANNUAL INVESTMENT STRATEGY 2018-2019**

#### **5.1. Introduction – Investment Policy**

The Council has significant levels of ‘cash-backed’ balances that are available for investment – in the form of General Fund and HRA balances, and the numerous earmarked reserves and provisions etc.

#### **5.2. Investment Returns Expectations**

As outlined section 3 above, Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Against this background, Link Assets Services’ suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

	2018-19	2019-20	2020-21	2021-22	2022-23
Budgeted Rate	0.60%	0.90%	1.25%	1.50%	1.75%

#### **5.3. Investment Strategy**

As proposed in section 4 above, it is expected that during 2018-2019 a significant proportion of available investment balances will be used as ‘internal borrowing’ to support the financing of the CFR. As a result, external investments will be limited and may decrease further during the year.

All remaining funds will be invested in-line with the following Investment Policy, which has regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”).

The overall aim of the Investment Strategy is to provide security of capital and minimisation of risk while ensuring the Council has sufficient liquidity.

The Council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity. The risk appetite of the Council is medium, therefore specified and unspecified investments (see below) will be considered. However security and liquidity will continue to take precedence over yield. All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices (Appendix 3).

#### **5.4. Investment objectives**

The general policy objective for this Council is the prudent investment of its surplus cash balances, which includes monies borrowed for the purpose of expenditure in the reasonably near future (i.e. over the 4 year medium term planning cycle). The Council's investment priorities are:

- the security of capital;
- the liquidity of its investments and;
- achievement of optimum yield.

Security and liquidity of principal have always been the priority, and will continue to be so. In CIPFA's view "The priority is to protect capital rather than maximise return. However the avoidance of all risk is neither appropriate nor possible and a balance must be struck with a keen responsibility for public money." In times of budget constraints, making the Council's funds work and generate increased returns is becoming increasingly important. CIPFA encourage Local Authorities to look carefully at their Counterparty Lists to ensure return on investments is achieved.

CIPFA recommends that - "Responsibility for local authorities investment decisions lies, and must continue to lie with the local authorities themselves". The best authorities;

- explicitly balance risk and reward;
- review and scrutinise policies and procedures regularly;
- have well trained staff and engaged elected members and
- use a wide variety of information.

The Credit and Counterparty Criteria List (Appendix 2), which has not changed, offers diverse counterparties and take into account country, sector and group limits.

This list clearly sets out the minimum acceptable credit criteria for organisations with which the Council will place funds.

The risk appetite of the Council is medium, therefore specified and unspecified investments will be considered, however security and liquidity continue to take precedence over yield. All investments will be placed only with organisations which meet the criteria and will always be scrutinised and approved in line with approved Treasury Management Practices. (Appendix 3).

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

### **5.5. Security of Capital and Creditworthiness (Credit and Counterparty Policy)**

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 when determining which organisations it can place investments with. These criteria are set out in Credit and Counterparty Policy which is attached at Appendix 2.

The Council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly it will ensure that its counterparty policy and limits reflect a prudent attitude towards organisations with which funds may be deposited.

The 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 and 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.

The Council is alerted daily of changes to ratings of all three agencies. If a downgrade results in the counterparty no longer meeting the Council's minimum criteria, no new investment will be made. Consideration will also be given to whether or not existing investments will be withdrawn, which is dependent on whether the bank concerned is agreeable.

As with previous practice, ratings and the use of this external service 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. In addition, the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

The assessment will also take account of information that reflects the opinion of the markets. 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.

### **5.6. Types of investments the council may use**

The Council may use various financial instruments for the prudent management of its treasury balances (as listed in the Credit and Counterparty Policy).

The Credit and Counterparty Policy does not identify individual counterparty names in order to ensure that the Section 151 Officer has the flexibility to place investments with the most suitable organisations, which meet the agreed criteria, in a timely manner.

Treasury staff investigates various products and instruments as they become available to see if they meet the Council's investment priorities and criteria list.

In line with the CLG Guidance, the Credit and Counterparty Policy categorises investments instruments between 'Specified' and 'Non-Specified' investments:

Specified Investments offer high security and high liquidity. All such investments are;

- in pounds sterling;
- due to be repaid within 12 months or which may be required to be repaid within 12 months;
- not capital expenditure;
- made with high credit quality organisations, (for the purpose of this strategy high credit ratings are "A-" and above for long term and "F2/P-2" and above for short term investments), or;
- made with the United Kingdom Government or local authority (including the North East Combined Authority), parish council or community council.

Non-Specified Investments are those which do not meet the criteria for specified investments and give greater potential risk. The CLG do not discourage the use of non-specified investments but state that there is a need for these to be dealt with in more detail.

As in previous years, it is anticipated that the majority of investments will be specified but it is proposed a maximum of 25% of total Council investments may be held in non-specified investments at any one time during the year. This is primarily to allow the use of large, non-rated, building societies as well investments beyond 1 year with other local authorities.

Investments will only be placed with organisations which meet the criteria set out in the approved Credit and Counterparty Policy. Individual investments or aggregate of investments to one organisation should comply with the monetary limits set out in Credit and Counterparty Criteria List.

Nationalised/part-nationalised banks in the UK have credit ratings which do not comply with the credit criteria used by the Council however due to significant Government ownership the Council feels more comfortable applying higher limits for investments.

Investments are to be arranged in line with Treasury Management Practices (Appendix 3) and all investments with new counterparties must be approved by the Section 151 Officer or in his absence the Deputy Section 151 Officer or Finance Managers. There is currently no proposed change to this practice.

## **5.7. Forecast Investment Balances and Liquidity**

Based on current reserves and balances forecast, and allowing for the proposed strategy of using some of the investable balances as 'internal borrowing' to support the financing of the CFR (see Section 4), it is anticipated that in 2018-19 the Council

external investment balances will fluctuate throughout the year within a range between £40.0 million and £100.0 million.

To ensure liquidity a minimum of 20% of its overall investments or £5.0 million, whichever is lower, will be held in liquid accounts. For cash flow generated balances, the Council will seek to utilise its money market funds, call accounts and short-dated deposits (overnight to six months).

As investment rates are forecast to remain low and there is a requirement for liquid funds to support the under-borrowing position, it is envisaged the Council will avoid locking into longer term deals, however if exceptionally attractive rates are available then they will be considered. Close contact will be maintained with the money market to ascertain the most favourable interest rates on offer to achieve best value from the return on surplus monies available.

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates.

#### **5.8. Non Treasury Management Investments Defined as Capital Expenditure**

In addition to the above standard treasury management activity, the Council also receives interest from two other 'non-treasury' activities – namely the investment shares NIAL Holdings (Newcastle Airport) [£13.4 million] and Northumberland's Development Company [£3.3 million], and the loans to Newcastle Airport, Northumbria Healthcare NHS Foundation Trust, Northumberland's Development Company and other organisations.

These non-treasury activities are deemed by Statutory Regulations as capital expenditure and are provided to support Council service objectives and corporate priorities. They are not made or regarded as part of the 'core' treasury management activity - i.e. the investment of surplus cash flow balances, as made under the power to invest inferred by s12 of the Local Government Act 2003. As a result these activities were previously outside of the scope of the Investment Strategy.

Proposed amendments to the DCLG's investment guidance recommend that these non-financial or non-core investments should now be included within the Annual Investment Strategy.

Whilst it is entirely appropriate to highlight the scope of these activities, there is a view amongst some practitioners that it may be misleading to refer to items of expenditure in the context of an investment strategy, and that a more suitable mechanism to explain and cover these activities would be within the (newly introduced recommendation from the review of the Prudential Code) Capital Strategy.

Because of their nature, it is difficult (and perhaps inappropriate) to assess and consider non-financial or non-core investments in the context of liquidity and security, which arguably does not apply to these activities, at least not in the same way as it does for standard cash investments. Beyond the terms of the underlying agreement, loans to third parties are not liquid and have no need to be. The expenditure is incurred in the support of service objectives and funded from capital resources, which is different to the requirements and policies surrounding management of the Council's

investments and cash flows. Similarly, whilst the return of the funds advanced is key, security for third party loans may need to be considered differently to the credit ratings modelling approach utilised for core-treasury investments.

For this reason, the Council's policy on non-financial or non-core investments, specifically the loans to third parties, is covered separately within the Capital Strategy document. A draft of this document, which will be approved by County Council in February 2018, is attached at Appendix 6.

A summary of value of (capital) loans to third parties and the interest expected to be received is summarised below:

<b>Borrower</b>	<b>Estimated Balance at 01 Apr 2018 £m</b>	<b>Interest Rate</b>	<b>Forecast Interest Income 2018-19 £m</b>
Northumbria Healthcare Foundation Trust	133.00	3.8%	5.01
Northumberland's Development Company- Commercial Enterprises	190.46	5.6%	10.70
Northumberland's Development Company - Developments	35.61	2.7%	0.98
Northumberland's Development Company - Housing	40.63	4.8%	1.96
Newcastle Airport	11.92	8.6%	1.02
Northumberland College	6.18	4.6%	0.28
Northumberland Aged Miners	2.06	3.5%	0.07
Cramlington Town Council	0.34	4.0%	0.01
Arts Groups (The Maltings, Alnwick Playhouse, Queen's Hall)	0.21	3.9%	0.01
Berwick Core	0.04	4.0%	0.00
<b>Total</b>	<b>420.45</b>	<b>4.8%</b>	<b>20.04</b>

The Medium Term Capital Programme 2018-22 includes a provision of £22.0 million per annum for further loans to third parties.

Whilst the income from these advances is significant, the intention is largely only to cover the associated underlying borrowing costs to the Council. The loans are considered and approved to support the Council's service and policy objectives not to generate a financial return for the Council.

#### **5.9. Provision for credit related losses**

If any of the Council's investments appear at risk of loss due to default (i.e. a credit-related loss, and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

## **6. HOUSING REVENUE ACCOUNT (HRA) TREASURY MANAGEMENT COSTS**

### **6.1. Overview**

Following implementation of the HRA self-financing reforms in April 2012, a separate pool of specific loans is now maintained for the HRA. The interest costs associated with these loans are charged direct to the HRA. This arguably negates the need for the former HRA Item 8 charge; which allocated a share of the Authority's overall borrowing costs to the HRA.

For the most part, the HRA will aim to ensure that new loans are taken out (or repaid) to match any anticipated movement in its borrowing requirement - known as the HRA Capital Financing Requirement (HRA CFR). There will however be instances during the year when the balance of the HRA loan pool - i.e. actual external borrowing charged to the HRA - does not equate exactly to the HRA CFR. In such circumstances the HRA is in effect borrowing from (or lending to) the General Fund and an additional charge (or credit) is necessary in order to reflect the notional cost of this imbalance. The Council's proposed policy for this arrangement is as follows, the policy remains unchanged from the previous year :

### **6.2. Policy for HRA Under and Over Borrowing**

#### **HRA Under-Borrowing**

Where the weighted average balance of the HRA (external) loans pool is less than the weighted average HRA CFR for the same period, notional interest will be charged to the HRA at the average rate of interest for 30-year PWLB borrowing for the period.

#### **HRA Over-Borrowing**

Where the weighted average balance of the HRA (external) loans pool is greater than the weighted average HRA CFR for the same period, notional interest will be paid to the HRA at the average 3-month London Interbank Bid (LIBID) rate for the period.

### **6.3. Other Treasury Management Charges to HRA**

As under the former Item 8 arrangements, the HRA will continue to receive interest (or investment income) on its weighted average balances for the year, based on the Council's overall average investment rate.

The HRA will also continue to be charged a proportion of the authority's overall debt management expenses (based on the CFR proportions), as well its share of any historic premiums or discounts associated with the premature repayment of borrowing. Any future / new premiums or discounts will be met fully by the relevant fund of the underlying loan – i.e. premiums or discounts related to loans within the HRA loan pool will be charged fully to the HRA, and vice versa.

## **7. PRUDENTIAL INDICATORS and TREASURY LIMITS 2018-19 to 2020-21**

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans are reflected in prudential indicators, which are designed to assist members overview and confirm capital expenditure plans.

Councils are required to approve a set of Prudential Indicators for the new financial year and adhere to these indicators during the course of that year. The indicators are to be set on a rolling basis, for the forthcoming financial year and two successive financial years. Prudential Indicators for 2018-19 – 2020-21 are set out in Appendix 4.

## **8. THE ANNUAL MINIMUM REVENUE PROVISION POLICY STATEMENT**

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to make additional voluntary payments if required.

DCLG Regulations have been issued which require the full Council to approve an MRP policy in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

DCLG are currently consulting on their MRP guidance. However, none of the proposals being considered would impact on the Council's policy.

The Council is recommended to approve the Annual Minimum Revenue Provision Policy Statement including Additional Voluntary Provision as detailed within Appendix 5.

## **9. POLICY ON USE OF EXTERNAL SERVICE PROVIDERS**

The Code recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council 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.

The Council uses Link Asset Services Ltd (previously known as Capita Asset Services) as its treasury management consultants. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and templates of Member reports;
- Economic and interest rate analysis;
- Debt services which include advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;

- On line up to date credit ratings.

Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remain with the Council. The Section 151 Officer will ensure that undue reliance is not placed upon external service providers and that the service is subject to regular review.

## **10. IMPLEMENTATION OF THE TREASURY MANAGEMENT STRATEGY, SCHEME OF DELEGATION, TRAINING AND REPORTING REQUIREMENTS**

### **10.1. Implementation of the Treasury Management Strategy**

The continued implementation of the above strategy and procedures is the responsibility of the Section 151 Officer, who is authorised to arrange the necessary borrowings within the limits set out in the Prudential Indicators, and necessary investments as set out in the investment strategy.

Northumberland County Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet.

The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

There are no proposed changes to this methodology.

### **10.2. Treasury Management Practices (TMPs)**

Treasury Management Practices (Appendix 3) set out the manner in which the Council will seek to achieve the treasury management policies and objectives. The Council has adopted the recommended form of words defining the Council's treasury management practices (TMPs), in compliance with CIPFA's Treasury Management in the Public Services: Code of Practice and the Prudential Code for Capital Finance in Local Authorities. These set out the specific details of the systems to be employed and the records to be maintained. There are no proposed changes to these practices, only minor grammatical updates which do not affect procedure or practice.

These practices are as follows:

- TMP1 Credit and Counterparty Risk management;
- TMP2 Best value and performance measurement;
- TMP3 Decision-making and analysis;
- TMP4 Approved instruments, methods and techniques;
- TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements;
- TMP6 Reporting requirements and management information;
- TMP7 Budgeting, accounting and audit arrangements;
- TMP8 Cash and cash flow management;
- TMP9 Money laundering;

- TMP10 Training and qualifications;
- TMP11 Use of external service providers;
- TMP12 Corporate governance.

TMPs have been updated following a staffing restructure in October 2016.

### **10.3. Responsible Officers**

Daily treasury management activities will be undertaken by a Senior Accountant within the Corporate Finance team, as set out in TMP5. If they are absent a Principal Accountant within Corporate Finance will undertake these activities.

The three annual Treasury Management reports submitted to Cabinet and Council will be produced by the Technical Accountant.

The Finance Manager will ensure all treasury management activities are made in accordance with agreed policies and practices.

### **10.4. Training**

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Members received training in October and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed. Each officer concerned will receive appropriate training and guidance on their duties and the constraints within which they operate.

### **10.5. Reports and Monitoring**

To ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities, reports need to be submitted to full Council which need to be reviewed by Members of the Council in both Cabinet and Scrutiny functions.

The adequacy of the strategy statement will be monitored and reports requesting amendments to the statement will be produced when changes are thought to be necessary. The changes will be made in consultation with the Cabinet Portfolio holder for Corporate Services, whose role relates to the strategy and associated risks. Any strategy changes will be reported to the Audit Committee.

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. The following reports are required to be adequately scrutinised by Audit Committee before being recommended to the Council.

#### **Treasury Management Strategy Statement**

The first, and most important report covers:

- the capital plans (including prudential indicators);

- a Minimum Revenue Provision Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

### **A Mid Year Treasury Management Report**

This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

### **An Annual Treasury Report**

This provides details of prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

It is proposed that the Council follow reporting arrangements in accordance with the requirements of the revised Treasury Management Code of Practice.

<b>Area of Responsibility</b>	<b>Council/ Committee/ Officer</b>	<b>Frequency</b>
Scrutiny of treasury management strategy	Audit Committee or Risk Appraisal Panel	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy and Treasury Management Practices	Cabinet / Full Council	Annually before the start of the year
Annual Treasury Outturn Report	Cabinet / Full Council	Annually by 30 September after the end of the year
Treasury Management Budget Monitoring Reports	Incorporated within the Budget Monitoring report and reported separately to Scrutiny Committee	Quarterly
Scrutiny of treasury management performance	Audit Committee	As required
Updates or revisions to Treasury Management Strategy / Annual Investment Strategy / MRP policy –	Cabinet / Full Council	Ad- hoc

The policies and strategies set out in this document will ensure that the management and administration of treasury management will be robust, rigorous and disciplined.

The procedures for monitoring treasury management activities through audit, scrutiny and inspection will be applied with an openness of access to information and provide well-defined arrangements for review and implementation of changes.

## **11. OTHER ISSUES / RISKS – IMPACT OF LOCAL GOVERNMENT ADOPTION OF INTERNATIONAL FINANCIAL REPORTING STANDARD (IFRS) 9 ‘FINANCIAL INSTRUMENTS’**

CIPFA is currently consulting on the impact of changes resulting from amendments to International Accounting Standards which will be introduced in April 2018.

One of the new rules, IFRS 9 ‘Financial Instruments’, will see the removal of the “available-for-sale” classification in the Code of Practice on Local Authority Accounting, which currently allows gains and losses to be held in reserves until realised. This ensures that there is no bottom line impact on general fund balances.

Assets held in this category will now move into the “fair value through profit or loss” category. This means gains and losses from changes in fair value of assets (including the risk of default and expected credit losses on financial instruments) would need to be reflected in the “Surpluses and Deficits in the Provision of Services” line within the Income and Expenditure Accounts of local authorities.; This change would result in an change/impact t on the bottom-line general fund balance.

Subject to interpretation of the standard, this category may also encompass financial assets such as the Council’s loans to third parties, namely the advances to Northumberland’s Development Company, Northumbria Healthcare Foundation Trust and the other Third Party loans.

Officers are currently consulting with the Council’s external auditors (EY) on the matter and also considering guidance and best practice from CIPFA. If these assets are ultimately deemed to fall within this category and require revaluation then there could be a significant financial impact for the Council’s Comprehensive Income and Expenditure account.

However, where the Council provides loans to third parties for service and policy reasons they may not fall under the “fair value through profit or loss” classification, on the basis that they are being provided to support Council service objectives and corporate priorities. In addition because the loans are classed as capital items, existing statutory regulations would allow the reversal of any bottom-line revenue effect. This would therefore mitigate the requirement to reflect any changes which would impact on the bottom line Comprehensive Income and Expenditure Account of the authority. Officers are currently investigating this matter and members will be kept informed of progress.

### **Background Papers:**

CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance notes. (revised 2011).

CIPFA Prudential Code for Capital Finance in Local Authorities.

Guidance on Local Government Investments The Local Government Act 2003,  
Local Authorities (Capital Finance and Accounting) Regulations 2012 (S.I.2012/265)

## **Implications**

<b>Policy</b>	The report sets out the Treasury Management Policy Statement for 2018-19, and is consistent with “We want to be efficient, open and work for everyone” priority included the proposed NCC Corporate Plan 2017-21, due to be approved by Council in February 2018.
<b>Finance and value for money</b>	The financial implications of the 2018-19 investment and borrowing transactions have been taken into account within the revenue budget for 2018-19 and Medium Term financial Plan 2018-22. Northumberland County 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 within the context of effective risk management, and to employing suitable performance measurement techniques, for example comparison with other members of the CIPFA and Link benchmarking clubs.
<b>Legal</b>	The Local Government Act 2003 (the Act) and supporting regulations requires the Council to ‘have regard to’ the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice (which were adopted by Northumberland County Council in February 2010).
<b>Procurement</b>	There are no direct procurement implications for the County Council.
<b>Human Resources</b>	There are no direct staffing implications for the County Council.
<b>Property</b>	There are no direct property implications for the County Council.
<b>Equalities</b>  (Impact Assessment attached)  Yes <input type="checkbox"/> No <input type="checkbox"/> N/A <input type="checkbox"/>	Not applicable for the County Council.

<b>Risk Assessment</b>	The report highlights the principal financial risks within the Treasury Management function. The identification, monitoring and control of risk are the prime criteria by which the effectiveness of the County Council's Treasury Management activities will be measured. Accordingly, the analysis and reporting of Treasury Management activities will focus on their risk implications for the Council. The investment priority is security and liquidity rather than yield, which is a secondary aim.
<b>Crime &amp; Disorder</b>	There are no Crime and Disorder implications for the County Council.
<b>Customer Consideration</b>	There are no Customer Considerations for the County Council.
<b>Carbon reduction</b>	None.
<b>Wards</b>	All divisions.

### **List of Appendices**

Appendix 1 – Economic Forecasts

Appendix 2 – Credit and Counterparty Criteria Policy

Appendix 3 – Treasury Management Practices

Appendix 4 – Prudential Indicators

Appendix 5 – Minimum Revenue Provision Policy

Appendix 6 – Draft Capital Strategy

**Report sign off:-**

	Name
Finance Officer	Alison Elsdon
Monitoring Officer/Legal	Liam Henry
Human Resources	Not applicable
Procurement	Not applicable
I.T.	Not applicable
Chief Executive	Daljit Lally
Portfolio Holder(s)	Nick Oliver

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