Appendix D

WELWYN HATFIELD COUNCIL
TREASURY MANAGEMENT STRATEGY 2017/18

1 Introduction

1.1 In accordance with the CIPFA Treasury Management in the Public Services: Code of Practice (2011) and the Guidance on Local Government Investments issued by the Department for Communities and Local Government (2010) the Council sets out in this document its treasury management strategy for 2017/18.

1.2 The strategy has three prime objectives:

- to set clear policies and practices to enable the effective management and control of treasury activities
- to establish the importance of prudent management and control of risk within those activities, giving priority to security and liquidity
- to reflect the benefit of pursuing value for money and the use of suitable performance measures in support of business and service objectives, within the risk management framework

2 Investment Strategy

2.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held and it is expected that investment balances are likely to range between £35 and £60 million in the 2017/18 financial year.

2.2 Both the CIPFA Code and the CLG guidance require that funds be invested prudently and regard be given to the security and liquidity of investments before seeking the highest rate of return, or yield. The Council’s objective when investing is therefore to strike a balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

2.3 Given the increased risk and falling returns from short-term unsecured bank investments, it is the intention to continue to look for opportunities to diversify into more secure and/or higher yielding asset classes in 17/18 and to identify core cash that can be invested for longer periods to improve yield.

3 Approved investment counterparties

3.1 The Council may invest its surplus funds with any of the counterparties in the following table, subject to the cash limits (per counterparty) and time limits shown. The table must be read in conjunction with the notes below.

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£4m 20 years	£4m 50 years	£3m 20 years	£3m 20 years
AA+	£3m 5 years	£4m 10 years	£4m 25 years	£3m 10 years	£3m 10 years
AA	£3m 4 years	£4m 5 years	£4m 15 years	£3m 5 years	£3m 10 years
AA-	£3m 3 years	£4m 4 years	£4m 10 years	£3m 4 years	£3m 10 years
A+	£3m 2 years	£4m 3 years	£4m 5 years	£3m 3 years	£3m 5 years
A	£3m 13 months	£4m 2 years	£4m 5 years	£3m 2 years	£3m 5 years
A-	£3m 6 months	£4m 13 months	£3m 5 years	£3m 13 months	£3m 5 years
BBB+	£2m 100 days	£3m 6 months	£2m 2 years	£2m 6 months	£2m 2 years
None	£1m 6 months	n/a	£3m 25 years	n/a	£3m 5 years
Pooled funds	£4m per fund				

3.2 **Credit Rating:** Investment limits are set by reference to the lowest published long term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. Investment decisions, however, are never made solely based on credit ratings and all other relevant factors, including external advice, will be taken into account.

3.3 **Banks Unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

3.4 **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks or building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

3.5 **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

3.6 **Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent.

3.7 **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

3.8 **Pooled Funds:** Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used alongside instant bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

3.9 Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short term. These allow diversification into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

3.10 **HSBC Group:** As an exception to the criteria in the table above, the maximum limit for unsecured deposits in HSBC banking group is increased to £4m, subject to the bank's lowest long term credit rating remaining at A+ or above. This is to allow balances up to £1m to be invested in an interest bearing call account when it is not cost effective to place the funds elsewhere. Overnight balances in the Council's operating bank accounts at HSBC will not count towards their investment limit, on the basis that they cannot always be controlled and unexpected payments are often received.

3.11 **Limits:** The maximum that will be lent to any one organisation (other than the UK government) will be £4m in order that no sum in excess of available reserves is put at risk in the case of a single default. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Investment in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

3.12 The Council's treasury consultants, Arlingclose Ltd, generally recommend a secured bank deposit limit of 30% of general fund reserves and unsecured limit of 15%, to ensure resilience in the event of a default. On the basis GF reserves are anticipated to be £5.6m at 31.3.16, this would mean limits of £1.68m and £0.84m respectively. Reducing limits to these levels would result in greater use of pooled funds and the Debt Management Office and a reduction in yield. Due to the short dated nature of the majority of the Council's investments and reserves being able to absorb more than one default, it is believed that the limits in the above table are currently acceptable. The situation will, however, be kept under continuous review.

4 Specified investments

4.1 The CLG Guidance defines specified investments as those:

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

4.2 The Council defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

5 Non-specified investments

5.1 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council will not to make any investments denominated in foreign currencies. Non-specified investments will therefore comprise long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, investments with bodies and schemes not meeting the definition of high credit quality and pooled property funds that may be defined as capital expenditure by legislation.

5.2 The limits on non-specified investments are shown in the table below. It is to be noted that certain investments may count towards the limit of more than one category.

	Cash limit
Total long-term investments	£30m
Total investments without credit ratings or rated below A-	£30m
Total investments deemed as capital expenditure	£10m
Total investments (except pooled funds) in foreign countries rated below AA+	£6m
Total non-specified investments	£45m

6 Risk assessment and use of credit ratings

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

- no new investments will be made,

- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to recall or sale of all other existing investments with the affected counterparty.

6.2 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it is likely to fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long term direction of travel rather than an imminent change of rating.

7 Other information on the security of investments

7.1 The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the approved rating criteria.

7.2 When deteriorating financial market conditions affect the creditworthiness of all organisations, as in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of “high credit quality” are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

8 Liquidity management

8.1 The Council uses cash flow analysis to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long term investments are set with reference to the Council’s medium term financial strategy and cash flow forecast.

9 Borrowing strategy

9.1 At 1 April 2017 the Council will hold £251.9m of long term HRA loans, having repaid £52.9m of the original self financing debt. The debt portfolio was structured to mirror projected cash surpluses arising from the HRA business plan at that point in time. The impact of changes in government policy affecting these projections is therefore monitored regularly and borrowing requirements reviewed on an ongoing basis.

9.2 It is anticipated that while investment balances remain high, any need to finance unfunded capital expenditure in the forthcoming year will be met by these internal resources, rather than entering into additional long term borrowing.

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9.3 By doing this, the Council is able to reduce its net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short term.

9.4 Alternatively, the Council may arrange forward starting loans where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

9.5 Borrowing for short periods of time to cover unexpected cash flow shortages may also be undertaken.

9.6 Approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board and any successor body
- any institution approved for investments (see above)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Hertfordshire Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency and other special purpose companies created to enable local authority bond issues

9.7 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

9.8 The Council has previously raised all of its long-term borrowing from the PWLB but will consider other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

9.9 **Municipal Bond Agency:** The UK Municipal Bonds Agency was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance then the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Cabinet.

9.10 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

10 Treasury Management Indicators

10.1 The Council measures and manages its exposures to treasury management risks using the following indicators:

10.2 Interest rate exposures

This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest exposures, expressed as an amount of net principal borrowed will be:

	2017/18	2018/19	2019/20
Upper limit on fixed interest rate exposures	£300m	£300m	£300m
Upper limit on variable interest rate exposures	£0m	£0m	£0m

Fixed rate investments and borrowings are those where the interest rate is fixed for at least 12 months from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate. Investments count as negative borrowing.

10.3 Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	80%	0%
10 years and within 20 years	100%	0%
20 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

10.4 Principal sums invested for periods longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2017/18 £'000	2018/19 £'000	2019/20 £'000
Limit on principal invested beyond year end	30,000	28,000	25,000

10.5 Borrowing Limits

The Council is being asked to approve these Prudential Indicators as part of the capital budget report, however they are repeated here for completeness.

Authorised Limit for External Debt			
	2017/18	**2018/19**	**2019/20**
	£000	**£000**	**£000**
Borrowing	8,000	8,000	8,000
Other Long Term Liabilities	2,103	2,103	2,103
Housing Self Financing Borrowing	304,799	304,799	304,799
TOTAL	**314,902**	**314,902**	**314,902**

The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Operational Boundary for External Debt			
	2017/18	**2018/19**	**2019/20**
	£000	**£000**	**£000**
Borrowing	6,000	6,000	6,000
Other Long Term Liabilities	2,103	2,103	2,103
Housing Self Financing Borrowing	251,900	236,600	219,500
TOTAL	**260,003**	**244,703**	**227,603**

The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

11 Policy on Use of Financial Derivatives

11.1 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits).The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code does however require authorities to clearly detail their policy on the use of derivatives in the annual strategy.

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

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

12 Treasury Management Advisors

12.1 The Council's treasury management advisors, Arlingclose Limited, provide advice and information on investment, debt and capital finance issues although responsibility for final decision making remains with the Council and its officers. The quality of this service is controlled by quarterly review meetings with the Head of Resources, Finance Manager and treasury staff.

13 Investment training

13.1 The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Officers attend, as required, training courses, seminars and conferences provided by Arlingclose and CIPFA.

14 Investment of money borrowed in advance of need

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

14.2 The total amount borrowed will not exceed the authorised borrowing limit of £8m for General Fund purposes and £304.799m for HRA. The maximum period between borrowing and expenditure is expected to be two years although the Council is not required to link particular loans with particular items of expenditure.

15 Policy on apportioning interest to the Housing Revenue Account

15.1 On 1 April 2012, the Council assigned the entire long term loans portfolio to the HRA pool and in the future, new long-term loans borrowed will also be assigned in their entirety to either the General Fund or the HRA pool. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account.

15.2 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured each month and interest transferred between the General Fund and HRA at the Council's average rate on investments, adjusted by credit risk.