Welwyn Hatfield Borough Council

Treasury Management Strategy and Minimum Revenue Provision Policy

WELWYN
HATFIELD

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 2018/19.

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 Balance sheet summary and forecast

2.1 To take a view on likely treasury activity in 2018/19 it is necessary to look at the Council's balance sheet to estimate the level of funds available for investment purposes and any borrowing requirements, as shown in the table below:-

	31.3.17 Actual £000	**31.3.18 Estimate £000**	**31.3.19 Forecast £000**	**31.3.20 Forecast £000**	**31.3.21 Forecast £000**
General Fund CFR	22,756	31,856	36,116	35,252	35,386
HRA CFR	251,899	245,228	241,332	244,156	250,877
Total CFR	**274,655**	**277,084**	**277,448**	**279,407**	**285,263**
Less: Other debt liabilities	(2,668)	(2,333)	(2,174)	(2,159)	(2,144)
Borrowing CFR	**271,987**	**274,751**	**275,274**	**277,248**	**283,119**
Less: External borrowing	(251,899)	(236,599)	(219,499)	(200,699)	(180,699)
Under/(over) borrowing	**20,088**	**38,152**	**55,775**	**76,549**	**102,420**
Less: Usable reserves	(60,180)	(44,379)	(41,384)	(45,064)	(47,727)
Less: Working capital	(8,053)	(8,000)	(8,000)	(8,000)	(8,000)
New Borrowing (Cumulative)	-	(8,629)	(21,833)	(43,457)	(70,178)
Investments	**48,145**	**22,856**	**15,442**	**19,972**	**23,485**

3 Investment Strategy

3.1 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 £15 and £35 million in the 2018/19 financial year.

3.2 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.

3.3 Although investments balances are forecast to reduce in 2018/19, given the increased risk and low 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 and to identify core cash that can be invested for longer periods to improve yield.

4 Approved investment counterparties

4.1 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
None	£1m 6 months	n/a	£3m 25 years	n/a	£3m 5 years
Pooled funds	£4m per fund				

4.2 **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.

4.3 **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.

4.4 **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.

4.5 **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.

4.6 **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.

4.7 **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.

4.8 **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.

4.9 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.

4.10 **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.

4.11 **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.

4.12 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 £15m at 31.3.18, this would mean limits of £4.5m and £2.25m respectively. 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.

5 Specified investments

5.1 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".

5.2 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.

6 Non-specified investments

6.1 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.

6.2 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	£20m
Total investments without credit ratings or rated below A- (except UK Government and local authorities)	£20m
Total investments deemed as capital expenditure	£10m
Total investments (except pooled funds) in foreign countries rated below AA+	£6m
Total non-specified investments	£30m

7 Non-Treasury Investments

7.1 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or DCLG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes.

7.2 Such loans and investments will be subject to the Council's normal approval process for revenue and capital expenditure and need not comply with this treasury management strategy.

8 Risk assessment and use of credit ratings

8.1 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.

8.2 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.

9 Other information on the security of investments

9.1 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.

9.2 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.

10 Liquidity management

10.1 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.

11 Borrowing strategy

11.1 At 1 April 2018 the Council will hold £236.6m of long term HRA loans, having repaid £68.2m 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 and provide for all loans to be repaid by 2028. The impact of changes in government policy, particularly the four year rent reduction policy, means that the Council will need to refinance part of its existing borrowing in future years. This refinancing is fully incorporated into the Council’s 30 Year HRA Business Plan.

11.2 The majority of the borrowing requirement is generated in the Housing Revenue Account, which is continually seeing a high level of right to buy sales. In order to maximise the use of the receipts it can retain, the Council is committed to the continuation of the Affordable Housing Programme (AHP). This programme will create income generating assets, which will cover the cost of external borrowing costs.

11.3 In addition to this, the Governments rent reduction policy has impacted on the Council’s ability to repay loans as quickly as it intended. This means that loans in the medium term of the 30 Year HRA Business Plan, will in part, need to be refinanced.

11.4 For these reasons, the Council will seek to borrow externally for the HRA to support the continuation of the AHP, and to refinance part of its current debt.

11.5 Taking the Council’s finances as a whole, the General Fund borrowing requirement makes up a much smaller proportion of its overall borrowing requirement. Given the HRA will be borrowing to finance the AHP and refinancing needs, the General Fund requirement can continue to be managed through internal borrowing. This will mean an interest payment on any negative cash position to the HRA, which will be calculated in line with the Interest Policy in section 17.

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

11.7 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

11.8 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

11.9 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.

11.10 **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.

12 Treasury Management Indicators

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

12.2 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:

	2018/19	2019/20	2020/21
Upper limit on fixed interest rate exposures	£320m	£319m	£319m
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.

12.3 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.

12.4 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:

	2018/19 £'000	2019/20 £'000	2020/21 £'000
Limit on principal invested beyond year end	20,000	10,000	10,000

12.5 Borrowing Limits

The Council is being asked to approve these Prudential Indicators as part of its requirement to set limits on borrowing activity,

Authorised Limit for External Debt			
	2018/19	**2019/20**	**2020/21**
	£000	**£000**	**£000**
Borrowing	13,000	12,000	11,500
Other Long Term Liabilities	2,103	2,103	2,103
Housing Self Financing Borrowing	304,799	304,799	304,799
TOTAL	**319,902**	**318,902**	**318,402**

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

Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Operational Boundary for External Debt			
	2018/19	**2019/20**	**2020/21**
	£000	**£000**	**£000**
Borrowing	11,000	10,000	9,500
Other Long Term Liabilities	2,103	2,103	2,103
Housing Self Financing Borrowing	245,228	241,332	244,156
TOTAL	**254,028**	**255,911**	**262,192**

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 Council'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 Council's debt.

13 Policy on Use of Financial Derivatives

13.1 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.

13.2 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.

13.3 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.

14 Treasury Management Advisors

14.1 The Council recognises that there is value in employing external providers of treasury management services in order to access specialist skills and resources. The Council will ensure that the terms of appointment and methods by which their value will be assessed are properly agreed and documents, and are subject to regular review.

14.2 The Council's current treasury management advisors, Arlingclose Limited, provide advice and information on investment, debt and capital finance issues. The Council recognises that 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.

15 Investment training

15.1 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.

16 Investment of money borrowed in advance of need

16.1 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 considered as part of the Council's overall management of its treasury risks.

16.2 The Council will ensure that its gross external debt does not exceed its total capital financing requirement in the preceding year, plus estimates for current and the next two financial years.

17 Policy on apportioning interest to the Housing Revenue Account

17.1 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.

17.2 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.

18 Policy on the Council's Minimum Revenue Position

18.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2012.

18.2 The Government is currently consulting on the guidance, and any significant revisions to the guidance will mean the Council may need to review its policy later this year.

18.3 The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

18.4 The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP.

18.5 The Council's policy for the calculation of MRP shall be the Asset Life Method (Option 3 of the guidance), the principal (capital) element reflects the true nature of the rent/ charge over the life of the assets.

18.6 For newly created assets that will attract a rental income, the annuity method of allocating the MRP will be used. This method reflects the fact that more income will be received in later years of the asset life due to inflationary increases.

18.7 All other financed assets will have the MRP calculated on an equal instalment basis, where a charge is made equal to the element of the charge that goes to write down the balance sheet liability.

18.8 The Council's policy is to charge MRP in the financial year following completion of the capital scheme / purchase.

18.9 Based on these policies, the Council's estimated MRP for 2018/19 is £449k which is included in the budget as part of the Capital Financing Costs.

19 Economic Update provided by Arlingclose Ltd (External Content)

19.1 The following section has been provided by the Council's Treasury Management Advisors to provide some economic context to support the Council's Strategy.

Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.

- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.

- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.

- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.

- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.

- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.

- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.

- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.

- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.