APPENDIX B

TREASURY MANAGEMENT STRATEGY STATEMENT 2019-20

Introduction

1. Treasury management is the management of the authority's cash flows, borrowing and investments. The council is exposed to financial risks from treasury management activity including possible losses associated with council investment and potential for increased borrowing costs arising from market movements. The identification, monitoring and control of financial risks is a crucial part the financial management and governance arrangements of the council.

2. Treasury risk management is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the council to approve a treasury management strategy before the start of each financial year. This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

3. Investments held for service purposes or for commercial profit are considered in the Capital Strategy.

4. Under financial delegation, the strategic director of finance and governance is responsible for all executive and operational decisions on treasury management. This treasury management strategy, together with supporting prudential indicators and policies will ensure that these responsibilities can be carried out effectively.

Net Borrowing Position

5. As at 31 March 2018 the council held £563m of borrowing and £126m of investments.

6. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, known as internal borrowing.

7. The Council has an increasing CFR due to an ambitious capital programme. Based on current forecasts there is an estimated need to borrow up to £250m by 31 March 2020.

Borrowing strategy and debt management activity and position

8. The council's debt management strategy since 2011-12 was to pursue a policy of internal borrowing, which is the use of existing reserves and balances to temporarily fund capital expenditure rather than the use of external borrowing.

9. The use of internal borrowing allows the council to minimise unnecessary external borrowing costs by only borrowing when needed for liquidity, or to benefit from advantageous borrowing rates. Borrowing in advance of need from a cashflow perspective creates a 'cost of carry' which is the difference between

the short term investment income earned through holding cash balances compared against longer term external debt financing costs

10. During the period from 2011-12 to 2017-18 the rate of return on short term investments was consistently much lower compared to longer term borrowing. The savings for the council from deferring external borrowing in this way equate to circa £20m

11. Efficient use of existing council resources to fund capital expenditure through internal borrowing also reduces the council's counterparty risk inherent in the investment of cash balances

12. During 2017-18, it became necessary to undertake new borrowing in order to finance prior internal borrowing from the capital programme and to maintain target cash balances. During the course of the financial year 2017-18 the council elected to borrow £110m in short term loans from other local authorities.

13. The approach to utilising short term borrowing, rather than longer term borrowing from the PWLB, continued during the first half of 2018-19, with an outstanding balance on short term local authority loans of £147m as at 31 December 2018

14. The use of short term borrowing to finance prior capital expenditure allowed the council to delay interest expense associated with longer term debt. This decision was made in consideration of expectations for future interest rates, medium term cash forecasts and planned capital expenditure.

15. The extent of the council's capital financing requirement necessitated the use of long term debt financing to secure long term financial stability in 2018-19.

16. During December 2018 the council borrowed £76m from the Public Works Loans Board, as part of HM Treasury, in 10 separate loans, with maturity terms ranging from 35 to 49 years at an average interest rate of 2.57%.

17. Projections for approved capital expenditure and cashflow indicate that the council might need to borrow up to an additional £250m by March 2020.

18. All historical long term debt for the council has been drawn from the PWLB, however future borrowing could come from a variety of different sources. The council could borrow through other financial institutions and banks, or directly from other local authorities. All short term borrowing during 2018-19 was via other local authorities. Borrowing from other local authorities is typically at lower rates than from other sources for short duration debt.

Investment Position and Activity.

19. The council holds sizable investment balances, representing income received in advance of expenditure plus balances and reserves held. Investments as at 31 December 2018 were £107m (£93m at 31 December 2017).

20. Council resources that are not immediately required for current expenditure are invested in money market instruments in accordance with the MHCLG Guidance on Local Authority Investments and the approved investment strategy. The MHCLG guidance gives priority to security and liquidity and the council's aim is to achieve a yield commensurate with these principles.

21. Council investments are managed both in-house and delegated to two fund managers: Alliance Bernstein and Aberdeen Standard (formerly Aberdeen Asset Management). The focus for in-house investment is to meet variable near term cash liquidity requirements, principally using money market funds and other highly secure, liquid financial instruments

22. Any surplus cash resources not required in the short term to fund council activities is placed with the council's two external fund managers. The fund managers invest for a longer term in UK government gilts, supranational bank bonds, certificates of deposits issued by major banks/ building societies and other financial instruments.

23. The use of fund managers has the advantage of diversification of investment risk, coupled with the services of professional fund managers, which over the longer-term, provides enhanced returns within the council's risk appetite. Although investments can be redeemed from the fund managers at short notice, the intention is to hold them for the medium term. Their performance and suitability in meeting the council's investment objectives are regularly monitored.

24. The distribution of council investments across counterparties by rating and maturity as at 31 December 2018 is set out in the table below:

	A		AA		AAA		Total
Investment Maturity	**£m**	**%**	**£m**	**%**	**£m**	**%**	**£m**
Up to 1 Year	6.4	6%	31.9	30%	46.1	43%	**84.4**
1 - 2 Years	-	0%	5.0	5%	6.1	6%	**11.1**
2 - 5 Years	-	0%	-	0%	11.5	11%	**11.5**
Total	**6.4**	**6%**	**36.9**	**35%**	**63.7**	**60%**	**107.0**

25. The annualised rate of return for council treasury management assets for the first nine months of the financial year was 0.74%. Uncertainty surrounding the UK planned exit from the EU alongside mixed economic data led to fall in short term market interest rates. The benefit to the portfolio from the increase in market value of existing assets from the fall in market rates was offset by widening of the interest spread between UK Government debt and non government debt securities.

26. To assess the treasury management portfolio performance, the council measures the return against a composite investment benchmark of three month LIBID and one to three year gilt index. For the equivalent nine month period of the financial year the benchmark index annualised return was 0.64% indicating an outperformance of 0.10%.

27. The rate of investment return generated by the treasury management portfolio is a consequence of the council's prudent, low risk approach to treasury management investing. This is in line with the requirements of the statutory guidance for local government treasury investment issued by MHCLG.

28. The priorities for treasury management investment are, in order of priority, security, liquidity and yield. The objective therefore is to ensure that funds are available to meet council liabilities as they fall due.

29. It is important however, that the treasury management strategy is suitably flexible such that the council can take advantage of market opportunities and maintain appropriate asset diversification within the portfolio to best support the council's revenue budget, whilst retaining the overriding objectives of security and liquidity. It is this ambition that underlies the proposed treasury investment strategy for 2019-20.

Proposed Investment Strategy

30. The council's investment objectives are to preserve principal, provide liquidity and secure a reasonable return. This is in line with investment guidance produced by the Ministry of Communities and Local Government

31. The annual investment management strategy 2019-20 is attached at Appendix C. The strategy will allow investment access to highly rated sovereigns, banks and other corporates, quasi-sovereigns, covered bonds whilst limiting excessive exposure to market volatility and maintaining the overarching objective of ensuring appropriate security and liquidity. External fund managers will be utilised to implement the strategy when appropriate.

32. In considering the investment strategy for 2019-20 the council has taken advice from the external treasury advisor Arlingclose, in addition to ongoing engagement with the council's external fund managers, to ensure that any investment limits and restrictions remain appropriate to meet the investment objectives.

33. The investment strategy for the council for 2019-20 is proposed to remain broadly unchanged as it is considered overall to be well structured to limit any undue risks to the security of assets and preservation of liquidity whilst also allowing the council and delegated managers to access suitable investment opportunities.

34. The changes as proposed for 2019-20 have the intention of expanding the available investment opportunities for the council but without materially altering the risk profile. The change will allow for greater diversification by financial instrument type and individual counterparty.

35. The proposed treasury strategy also takes account of the reduction in the overall level of investable balances for the council which warrants a reduction in the absolute limit of exposure to particular assets and counterparties.

36. The changes to the proposed treasury strategy for 2019-20 from the existing strategy for 2018-19 are set out below. This does not include any such changes to absolute investment limits that have been amended to reflect changing levels of investment balances

Investment Category/Counterparty	Minimum Credit Criteria	Existing Strategy 2018-19	Proposed Strategy 2019-20	Rationale for Proposed Amendment
Maximum Maturity Greater than 1 Year	n/a	50%	65%	These changes will allow for a larger allocation of the portfolio to longer duration assets. Assets with a longer duration to maturity typically have a higher counterparty risk and market value volatility; but importantly the yield that can be achieved on these assets is typically higher to compensate. It is not expected that the portfolio will operate a weighted average maturity of greater than the previous 2 year target for any significant length of time but increasing the target will allow for greater flexibility should market conditions warrant holding slightly longer duration assets. In a rising interest rate environment this is unlikely but the strategy seeks to build in flexibility to take advantage of different market conditions that may occur. The portfolio allocation as at 31 December 2018 is 72% under 1 year with a weighted average maturity of 0.4 years.
Maximum Weighted Average Maturity	n/a	2 years	2.5 years	
Foreign Sovereign, Supranational Entity, Quasi Sovereign	Minimum Rating **AA-**	10% per issuer Up to 5.5 years	12.5% per issuer Up to 5.5 years	The maximum allocation to individual foreign sovereign, supranational entities and quasi sovereign entities rated as a minimum AA- is proposed to increase marginally to 12.5% alongside the limited introduction of minimum A- rated assets for less than one year duration. There is increasing issuance and depth in the GBP denominated market for foreign sovereigns and for supranational entities and the extension of this asset class provides greater flexibility take advantage of short term pricing and volatility. The portfolio allocation as at 31 December 2018 to foreign and supranational entities is 7.1% with a weighted average maturity of 0.9 years
	Minimum Rating **A-**	n/a	5% per issuer up to 1 year	
Banks and Building Societies	Minimum Rating **AAA**	20% per issuer up to 1 year 12% in covered bonds no longer than 5.5 years	20% per issuer up to 5.5 years	The proposed change to bank and building society investment limits for the 2019-20 investment strategy better reflects the risks and opportunities associated with the large and varied financial instruments issued by banks and building societies. Covered bonds and other asset backed financial instruments provide highly rated, secure investments with reduced exposure to risks associated with bail-in regulations.
	Minimum Rating **AA-**		12.5% per issuer up to 3 years	
	Minimum Rating **A-**		5% per issuer up to 1 year	

Investment Category/Counterparty	Minimum Credit Criteria	Existing Strategy 2018-19	Proposed Strategy 2019-20	Rationale for Proposed Amendment
Other Corporate Entity	Minimum Rating **AA-**	n/a	10% per issuer up to 3 years	The inclusion of highly rated corporate bonds within the 2019-20 treasury strategy will offer greater asset class diversification as well as alternative return opportunities. Short dated corporate instruments are not expected to form a substantial part of the portfolio given current market pricing for high quality low duration assets.
	Minimum Rating **A-**		5% per issuer up to 1 year	
Multi Asset Income Funds	n/a	n/a	£10m total	The council's risk averse, prudent approach to treasury investment will, in a low interest rate environment, result in a correspondingly low rate of return. The council strategy for 2019-20 includes the option to allocate to a pooled fund diversified across a significant variety of assets designed to generate a high rate of income. This could include equity, property, global bonds, and infrastructure debt among other asset classes. A limited allocation to a multi asset fund can lead to an increase in overall investment yield return to support council revenue budgets without leading to a material increase in risk exposure.