AUDIT COMMITTEE

Date of Meeting	Wednesday, 29th January 2020
Report Subject	Treasury Management Strategy 2020/21 and Treasury Management Quarter 3 Update 2019/20
Report Author	Corporate Finance Manager

EXECUTIVE SUMMARY

The report presents the draft Treasury Management Strategy 2020/21 for review and seeks the Committee's recommendation to Cabinet.

The report provides an update on matters relating to the Council's Treasury Management Policy, Strategy and Practices 2019/20:

- 3rd quarter update 1st October – 31st December 2019, presented for the Committee's information.

This report is supplemented by training provided to all Members of the Council on Treasury Management on 11th December 2019.

RECOMMENDATIONS	
1	Members review the draft Treasury Management Strategy 2020/21 and identify any matters to be drawn to the attention of Cabinet on 18th February 2019.
2	Members review the Treasury Management 2019/20 quarterly update.

REPORT DETAILS

1.00	**EXPLAINING THE CHANGES TO THE POLICY STATEMENT, STRATEGY AND PRACTICES**
	BACKGROUND
1.01	The Local Government Act 2003 requires all local authorities to have due regard to both the Chartered Institute of Public Finance and Accountancy's Treasury Management in Public Services: Code of Practice (The CIPFA Code of Practice) and Welsh Government guidance on Local Authority Investments.
1.02	In April 2019 the Council adopted 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. The CIPFA Code of Practice (2017 edition) requires:- • The Council to create and maintain a Treasury Management Policy Statement which states the Council's policies, objectives and approach to risk management of its Treasury Management activities. • The Council to create and maintain suitable Treasury Management Practices (TMPs) and accompanying schedules, stating how those policies and objectives will be achieved and prescribing how those activities will be managed and controlled. • The Council to receive reports on its Treasury Management policies, practices and activities, including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs. • Responsibility for Treasury Management to be clearly defined. The Council delegates responsibility for the implementation and regular monitoring of its Treasury Management policies and practices to the Cabinet, and for the execution and administration of treasury management decisions to the Corporate Finance Manager, who will act in accordance with the organisation's policy statement and TMPs and, CIPFA's *Standard of Professional Practice on Treasury Management*. • A body to be responsible for the scrutiny of Treasury Management Policy, Strategy and Practices. The Council has nominated the Audit Committee to be responsible for ensuring effective scrutiny of the Treasury Management function. The Audit Committee has previously agreed to include Treasury Management as a standing item on each quarterly agenda to receive an update.

1.03	The Welsh Government issue guidance on Local Authority investments that requires the Council to prepare an investment strategy before the start of each financial year. The guidance was updated in November 2019 which comes into force from 1st April 2020.
1.04	In preparation for approving the 2020/21 Treasury Management Strategy training for all Members was held on 11th December 2019. The workshop presented by Arlingclose, the Council's Treasury Management advisors covered a detailed introduction to Treasury Management in Local Authorities, including the regulatory framework and the role of the elected Member in scrutinising the Treasury Management function. The training included an in depth presentation on investments, borrowing and changes made to the Investment Guidance issued by Welsh Government.
	<u>CONSIDERATIONS</u>
	2020/21 Treasury Management Policy Statement, Strategy and Practices
1.05	The Treasury Management Policy Statement was approved by Council in February 2019 and covers the 3 year period from 2019/20 to 2021/22. This document defines the Council's Treasury Management activities, sets out the Council's criteria to measure the effectiveness of Treasury Management activities and includes the Council's high level policies for borrowing and investments. Once approved, it was agreed that the document only be reported to Members during its lifetime in the event of any significant changes. There is no change to this document.
1.06	Similarly the Treasury Management Practices (TMPs) and accompanying schedules to cover the 3 year period from 2019/20 to 2021/22 were approved by Council in February 2019 and it was agreed that these operational documents will only be reported to Members during their lifetime in the event of any significant changes. The TMPs and schedules state how Treasury Management policies and objectives will be achieved and give specific details of the systems and routines employed and the records to be maintained including:- • TMP 1 Treasury risk management • TMP 2 Performance measurement • TMP 3 Decision-making and analysis • TMP 4 Approved instruments, methods and techniques • TMP 5 Organisation, clarity and segregation of responsibilities, and dealing arrangements • TMP 6 Reporting requirements and management information arrangements • TMP 7 Budgeting, accounting and audit arrangements • TMP 8 Cash and cash flow management • TMP 9 Money laundering • TMP 10 Staff training and qualifications • TMP 11 Use of external service providers • TMP 12 Corporate governance

	Some minor changes have been made to bring the practices and schedules in line with the draft 2020/21 strategy.
	Treasury Management Strategy 2020/21
1.07	The 2020/21 Treasury Management Strategy is attached at Appendix 1 for review and discussion. The Strategy is updated and reported annually to Members in accordance with the CIPFA Code of Practice (2017 edition) and the revised Welsh Government guidance. The Treasury Management Strategy details the approach that the Council will take for investing and borrowing over the next year, including the budgetary implications of the planned investment and borrowing strategy, and a number of Treasury Management indicators that the CIPFA Code requires.
1.08	The main body of the 2020/21 Strategy has not changed significantly from that of the 2019/20 Strategy. Matters that merit the attention of Members are summarised below:- • Section 2 – Economic context, provided by Arlingclose, the Council's Treasury Management advisor, highlights that the major external influence on the strategy continues to be negotiating the UK's exit from the European Union and agreeing future trading arrangements, as it was in 2019/20. The Bank of England have made no recent changes to monetary policy with interest rates held at 0.75%. At its November 2019 meeting the Monetary Policy Committee indicated that it would be prepared to cut rates should Brexit uncertainty drag on or global growth fail to recover. The downward revisions to some of the growth projections in their report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal. Arlingclose forecasts that interest rates will be held at 0.75% throughout 2020/21 and into 2022. A very modest rise in gilt yields is forecast from their current low levels based on Arlingclose's interest rate projections (the Council's borrowing costs are linked to gilt yields). • Section 4 – Local context. This section summarises the anticipated treasury position in 2020/21. Activity in 2020/21, as it has in previous years, will focus more on borrowing and less on investing; as the Council's requirement to borrow is forecast to grow due to a planned increase in capital expenditure, and there is less surplus cash to invest as services plan to spend reserves. • Section 5 – Investment Strategy for Treasury Management investments. This section is largely a continuation of the Council's 2019/20 strategy, the aim being to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

	• Section 6 - Borrowing Strategy. Again, this section is largely a continuation of the 2019/20 strategy. The Council continues to forecast a significant long term borrowing requirement. The required amounts need to be confirmed before a commitment to long term borrowing is made and the use of short term borrowing will be used to assist during this period.
	Changes to Welsh Government Investment Guidance
1.09	The previous guidance issued by Welsh Government was last updated in 2010 and its focus was on investments in financial institutions. It required local authorities to set out clearly their policies for the prudent management of investments, giving priority, firstly to the security of those investments (protecting the capital sum from loss), and secondly liquidity (keeping money readily available for expenditure). The generation of investment income was distinct from these prudential objectives, however, provided that proper levels of security and liquidity were achieved, it may (but only then) be reasonable to seek the highest yield consistent with those priorities. The guidance stipulated that the following details should be included in the investment strategy: • Specified Investments • Non-specified Investments • Credit Risk Assessment • Investment Consultants • Investment Training • Investment of money borrowed in advance of need
1.10	In the revised guidance Welsh Government includes the details in 1.09 above and has widened the definition of an investment to bring non-financial yield bearing investments into scope. Reflecting that changes in the economic and regulatory landscape have led local authorities to consider different and more innovative types of investment activity. Welsh Government's aims are to ensure local authorities demonstrate good governance, accountability, transparency and openness of all types of investment decisions, whilst considering stewardship of public funds and levels of debt and aggregate risk is proportionate.
1.11	There are now four categories of investments: • Specified investments • Non-specified investments • Loans to third parties, joint ventures, or wholly-owned companies or associates • Non-financial investments – investing in non-financial assets primarily or partially for the purpose of generating a surplus including investment property.

	The revised guidance stipulates that the following details should be included for Loans and Non-financial investments : • Description of types included within each investment category • Contribution made towards service delivery objectives and / or promote wellbeing • Arrangements for ensuring the security of the investment • Arrangements for ensuring the liquidity of the investment Other requirements include: • Information on proportionality – if the local authority is dependent on the profit generating investment activity to achieve a balanced budget. • Information on borrowing in advance of need – if the local authority is undertaking the activity purely to profit from the investment. • Information on Capacity, Skills and Culture – relates to Members, and Officers. • Disclosure of the extent investment decisions consider long-term and climate risk to support a low carbon economy.
1.12	In the main, the additional requirements introduced, all relate to non-Treasury Management investments. (Treasury Management investments are temporary surplus cash arising as a result of timing differences in receiving and spending cash.) For simplicity and following advice from Arlingclose, the approach has been to include the Council's response to the additional requirements in an Appendix to the main Treasury Management Strategy – Appendix B – Non-Treasury Management Investments.
1.13	All assets have been reviewed and the material types of non-treasury investment that the Council has are 'Loans to wholly owned subsidiaries' and 'Investment Properties'. Information has been included in Appendix B to the Treasury Management Strategy at Appendix 1 of this report. Loans to wholly owned subsidiaries are the loans to North East Wales Homes (NEW Homes) Limited for the development and purchase of homes for affordable rent. The Council when approving the loans to NEW Homes had already considered all of the requirements that have been included by Welsh Government in its revised guidance. The Council has made a critical judgement in its accounts to classify its agricultural estate and its industrial units as investment properties. Proper accounting practice defines an investment property as those that are used solely to earn rent and / or for capital appreciation. These assets are legacy assets, and the Council has made an informed decision to reduce its agricultural estate and review the use of its industrial units.

	The spirit of the revised guidance is to focus on a more active portfolio of investment assets with a higher risk profile than the investment properties the Council owns. Due to the length of time that has passed since these assets have been acquired, which pre date Flintshire Council, it has not been possible to include all of the required information, such as including current fair value comparison with purchase price.
1.14	The majority of the additional requirements set out by Welsh Government have been complied with. Further work will be undertaken in year to review other investments that the Council is considering that possibly need to be included in the non-treasury investments section of the strategy, and compliance with disclosures around skills, culture and climate change.
	Treasury Management 2019/20 Quarter 3 Update
1.15	<u>Investments update</u> A schedule setting out the Council's investments at 31st December 2019 is attached at appendix 2. The investment balance at this time was £17.5m across 7 counterparties with an average interest rate of 0.71%.
1.16	<u>Borrowing update</u> Appendix 3 shows the Council's long term borrowing portfolio as at 31st December 2019, a total of £289.5m with a weighted average interest rate of 4.58%. No further long term borrowing has been undertaken during the third quarter of 2019. Appendix 4 shows the Council's short-term borrowing portfolio as at 31st December 2019, a total of £32.0m with an average interest rate of 0.77%. The borrowing strategy in 2019/20 has been to monitor capital expenditure to confirm the Council's long term borrowing need, ensuring that the Council does not commit to long term borrowing too early and borrow unnecessarily which will be costly. This is balanced against not compromising the long term stability of the debt portfolio by securing low long term interest rates currently available. The amounts of short term borrowing undertaken throughout the year to date have confirmed the borrowing requirement. The Council has taken two new long-term loans from the Public Works Loans Board (PWLB) during 2019/20 to date: • £10m Equal instalment of Principle Loan at 1.65% for 15 years, and; • £7.5m Equal instalment of Principle Loan at 1.28% for 18 years. The Council has a forecast borrowing requirement over and above the additional long term borrowing already undertaken during the year and therefore further long term borrowing may possibly be undertaken before the end of this financial year. Short term borrowing continues to be used to assist with managing the position, and is available at lower rates than long term. This position will be reviewed and monitored closely during the last few months of 2019/20 with support from Arlingclose.

2.00	**RESOURCE IMPLICATIONS**
2.01	Financial implications are set out within this report and supporting appendices; there are no other resource implications directly as a result of this report.

3.00	**RISK MANAGEMENT**
3.01	Risk Management directly addressed within the appendices including identification of risks and measures to mitigate likelihood and impact of risks identified.

4.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
4.01	Arlingclose Ltd, being the Council's Treasury Management advisors.

5.00	**APPENDICES**
5.01	1. Draft Treasury Management Strategy 2020/21 2. Investment Portfolio as at 31 December 2019 3. Long-term Borrowing Portfolio as at 31 December 2019 4. Short-term Borrowing Portfolio as at 31 December 2019

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	None

7.00	**CONTACT OFFICER DETAILS**
7.01	**Contact Officer:** Liz Thomas – Strategic Finance Manager **Telephone:** 01352 702289 **E-mail:** liz.thomas@flintshire.gov.uk

8.00	**GLOSSARY OF TERMS**
8.01	**Authorised Limit:** A statutory limit that sets the maximum level of external debt for the Council. **Balances and Reserves**: Accumulated sums that are held, either for specific future costs or commitments (known as earmarked) or generally held to meet unforeseen or emergency expenditure.

Bank Rate: The official interest rate set by the Bank of England's Monetary Policy Committee and what is generally termed at the "base rate".

Basis Point: A unit of measure used in finance to describe the percentage change in the value or rate of a financial instrument. One basis point is equivalent to 0.01% (1/100th of a percent). In most cases, it refers to changes in interest rates and bond yields. For example, if interest rates rise by 25 basis points, it means that rates have risen by 0.25% percentage points.

Bond: A certificate of debt issued by a company, government, or other institution. The bond holder receives interest at a rate stated at the time of issue of the bond. The price of a bond may vary during its life.

Capital Expenditure: Expenditure on the acquisition, creation or enhancement of capital assets.

Capital Financing Requirement (CFR): The Council's underlying need to borrow for capital purposes representing the cumulative capital expenditure of the local authority that has not been financed.

Certificates of Deposits (CD's): A savings certificate entitling the bearer to receive interest. A CD bears a maturity date, a specified fixed interest rate and can be issued in any denomination. CDs are generally issued by commercial banks. The term of a CD generally ranges from one month to five years.

Cost of Carry: The "cost of carry" is the difference between what is paid to borrow compared to the interest which could be earned. For example, if one takes out borrowing at 5% and invests the money at 1.5%, there is a cost of carry of 3.5%.

Consumer Price Index (CPI): The UK's main measure of inflation (along with Retail Price Index or 'RPI') The Monetary Policy Committee of the Bank of England set the Bank Rate in order to try and keep CPI at or close to the target set by the Government. The calculation of CPI includes many items of normal household expenditure but excludes some items such as mortgage interest payments and Council Tax.

Credit Rating: Formal opinion by a registered rating agency of a counterparty's future ability to meet its financial liabilities; these are opinions only and not guarantees.

Corporate Bonds: Corporate bonds are bonds issued by companies. The term is often used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Counterparty List: List of approved financial institutions with which the Council can place investments.

Debt Management Office (DMO): The DMO is an Executive Agency of Her Majesty's Treasury and provides direct access for local authorities into a government deposit facility known as the Debt Management Account Deposit Facility (DMADF). All deposits are guaranteed by HM Government and therefore have the equivalent of a sovereign credit rating.

Federal Reserve: The US central bank, the equivalent of the Bank of England. (Often referred to as “the Fed”).

Financial Instruments: Financial instruments are tradable assets of any kind. They can be cash, evidence of an ownership interest in an entity, or a contractual right to receive or deliver cash or another financial instrument.

Gilts: Gilts are bonds issued by the UK Government. They take their name from ‘gilt-edged’. They are deemed to be very secure as the investor expects to receive the full face value of the bond to be repaid on maturity.

LIBID: The London Interbank Bid Rate (LIBID) is the rate bid by banks on Eurocurrency deposits (i.e. the rate at which a bank is willing to borrow from other banks).

LIBOR: The London Interbank Offered Rate (LIBOR) is the rate of interest that banks charge to lend money to each other. The British Bankers' Association (BBA) work with a small group of large banks to set the LIBOR rate each day. The wholesale markets allow banks who need money to borrow from those with surplus amounts. The banks with surplus amounts of money are keen to lend so that they can generate interest which it would not otherwise receive.

LOBO: Stands for Lender Option Borrower Option. The underlying loan facility is typically very long-term - for example 40 to 60 years - and the interest rate is fixed. However, in the LOBO facility the lender has the option to call on the facilities at pre-determined future dates. On these call dates, the lender can propose or impose a new fixed rate for the remaining term of the facility and the borrower has the ‘option’ to either accept the new imposed fixed rate or repay the loan facility.

IFRS: International Financial Reporting Standards.

Maturity: The date when an investment or borrowing is repaid.

Maturity Structure / Profile: A table or graph showing the amount (or percentage) of debt or investments maturing over a time period.

Monetary Policy Committee (MPC): A committee of the Bank of England, which meets to decide the Bank Rate. Its primary target is to keep CPI inflation within 1% of a central target of 2%. Its secondary target is to support the Government in maintaining high and stable levels of growth and employment.

Money Market Funds (MMF): Pooled funds which invest in a range of short term assets providing high credit quality and high liquidity.

MiFID II (Markets in Financial Instruments Directive): EU legislation that regulates firms who provide services to clients linked to 'financial instruments'. As a result of MiFID II, from 3rd January 2018 local authorities will be treated as retail clients but can "opt up" to professional client status, providing that they meet certain qualitative and quantitative criteria.

Minimum Revenue Provision (MRP): An annual provision that the Council is statutorily required to set aside and charge to the Revenue Account for the repayment of debt associated with expenditure incurred on capital assets.

Non Specified Investment: Investments which fall outside the WG Guidance for Specified investments (below).

Operational Boundary: This linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

Premiums and Discounts: In the context of local authority borrowing,
(a) the premium is the penalty arising when a loan is redeemed prior to its maturity date and
(b) the discount is the gain arising when a loan is redeemed prior to its maturity date.

Prudential Code: Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice.

Prudential Indicators: Indicators determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable; they are not intended to be comparative performance indicators.

Public Works Loans Board (PWLB): The PWLB is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury. The PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Quantitative Easing (QE): QE is a form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This cash injection lowers the cost of borrowing and boosts asset prices to support spending.

Revenue Expenditure: Expenditure to meet the continuing cost of delivery of services including salaries and wages, the purchase of materials and capital financing charges.

Retail Price Index (RPI): A monthly index demonstrating the movement in the cost of living as it tracks the prices of goods and services including mortgage interest and rent.

Term Deposits: Deposits of cash with terms attached relating to maturity and rate of return (Interest).

Specified Investments: Term used in the Welsh Assembly Guidance for Local Authority Investments. Investments that offer high security and high liquidity, in sterling and for no more than one year. UK government, local authorities and bodies that have a high credit rating.

Supported Borrowing: Borrowing for which the costs are supported by the government or third party.

Supranational Bonds: Instruments issued by supranational organisations created by governments through international treaties (often called multilateral development banks). The bonds carry an AAA rating in their own right. Examples of supranational organisations are the European Investment Bank, the International Bank for Reconstruction and Development.

Treasury Bills (T-Bills): Treasury Bills are short term Government debt instruments and, just like temporary loans used by local authorities, are a means to manage cash flow. They are issued by the Debt Management Office and are an eligible sovereign instrument, meaning that they have an AAA-rating.

Treasury Management Code: CIPFA's Code of Practice for Treasury Management in the Public Services, initially brought in 2003, subsequently updated in 2009 and 2011.

Treasury Management Practices (TMP): Treasury Management Practices set out the manner in which the Council will seek to achieve its policies and objectives and prescribe how it will manage and control these activities.

Temporary Borrowing: Borrowing to cover peaks and troughs of cash flow, not to fund capital spending.

Unsupported Borrowing: Borrowing which is self-financed by the local authority. This is also sometimes referred to as Prudential Borrowing.

Yield: The measure of the return on an investment instrument.