AUDIT COMMITTEE

Date of Meeting	Wednesday 27 January 2016
Report Subject	Treasury Management Strategy 2016/17 Treasury Management Policy Statement 2016-19 Treasury Management Practices 2016-19 Treasury Management Mid-Year Review 2015/16 Treasury Management Update 2015/16
Cabinet Member	Cabinet Member for Finance
Report Author	Corporate Finance Manager
Type of Report	Strategic

EXECUTIVE SUMMARY

The report presents the draft Treasury Management Strategy 2016/17 for review and seeks the Committee's recommendation for approval to Cabinet, in conjunction with:-

- Draft Treasury Management Policy Statement 2016 – 2019,
- Draft Treasury Management Practices 2016 – 2019.

The report provides an update on matters relating to the Council's Treasury Management Policy, Strategy and Practices 2015/16.

- Draft Mid-Year review 1st April – 30th September 2015, presented for Committee's comments and recommendation for approval to Cabinet
- 3rd quarter update 1st October – 31st December 2015, presented for the Committee's information.

This report is supplemented by training available to all Members of the Council on treasury management on 26th January 2016.

RECOMMENDATIONS	
1	Members review the draft documents listed and identify any matters to be drawn to the attention of Cabinet on 16th February 2016:

	• Draft Treasury Management Strategy 2016/17 • Draft Treasury Management Policy Statement 2016-2019 • Draft Treasury Management Practices and Schedules 2016-2019
2	Members review the draft Treasury Management Mid-Year Report 2015/16 and identify any matters to be drawn to the attention of Cabinet on 16th February 2016.
3	Members note the Treasury Management 2015/16 quarterly update.

REPORT DETAILS

1.00	EXPLAINING THE APPENDICIES
	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	The Council has adopted The CIPFA Code of Practice which 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 guidance on Local Authority investments requires that the Council prepares an Investment strategy before the start of each financial year which sets out the Council's policies for the prudent management of its 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 is distinct from these prudential objectives, however provided that proper levels of security and liquidity are achieved, it may (but only then) be reasonable to seek the highest yield consistent with those priorities. The guidance stipulates that the investment strategy must also include the following: • Specified Investments • Non-specified Investments • Credit Risk Assessment • Investment Consultants • Investment Training • Investment of money borrowed in advance of need.
	CONSIDERATIONS **2016/17 Treasury Management Policy, Strategy and Practices** Treasury Management Strategy 2016/17
1.04	The 2016/17 Treasury Management Strategy is attached as Appendix 1 for review and discussion. The Strategy is updated and reported annually to Members in accordance with the CIPFA Code of Practice and Welsh Government guidance.
1.05	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.
1.06	The contents and layout of the 2016/17 Strategy have not materially changed from that of the 2015/16 Strategy. Matters that merit the attention of Members along with any changes made are summarised below:- • Section 2 – Economic context, provided by Arlingclose the Council's treasury management advisor, estimates that the first rise in bank interest rates to be in quarter 3 of 2016 at 0.25%. The Strategy assumes that the average rate for investments in 2016/17 will be around 0.65%, and that the average rate for any new borrowing will be around 3.35%.

	• Section 4 – Local context. This section summarises the anticipated treasury position in 2016/17. Activity in 2016/17 will focus more on borrowing and less on investing than in recent years; as the Council's requirement to borrow is forecast to grow due to a planned increase in capital expenditure, whilst there less surplus cash to invest as services plan to spend reserves. • Section 5 – Investment Strategy. Members will be aware from previous update reports that the consequences of the legislation introduced to reform procedures should financial institutions fail in the future (commonly referred to as 'bail-in'), have led to an increase in risk associated with unsecured bank investments. The Council therefore aims to further diversify into more secure asset classes during 2016/17. • Section 6 - Borrowing Strategy, a new paragraph has been added explaining that the Council may arrange forward starting loans in 2016/17, if conditions are suitable. That is a future loan and associated interest rate may be agreed during 2016/17, but the cash wouldn't be paid until it is required at some future date, which is pre agreed as part of the loan transaction. This would enable certainty of cost to be achieved, by fixing the interest rate, without suffering a cost of carry in the intervening period.
1.07	A training session open to all Members on treasury management was run by Arlingclose, the Council's Treasury Management advisors, on the morning of 26th January. The aim of the workshop was to aid Members' understanding of the Treasury Management Strategy.
1.08	<u>Treasury Management Policy Statement 2016-19</u> Attached at Appendix 2 for review and discussion is the Treasury Management Policy Statement to cover the 3 year period from 2016/17 to 2018/19. 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, the document will only be reported to Members during its lifetime in the event of any significant changes. The Policy Statement remains unchanged from the version approved 1st March 2013, which covered the 3 year period from 2013/14 to 2015/16.
1.09	<u>Treasury Management Practices and Schedules 2016-19</u> The Treasury Management Practices (TMPs) and accompanying schedules to cover the 3 year period from 2016/17 to 2018/19 are attached in Appendix 3 and Appendix 4 for review and discussion. As with the Policy Statement, once approved, this document will only be reported to Members during its 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
	<u>Treasury Management 2015/16 Updates</u>
1.10	The draft Treasury Management Mid-Year Report for 2015/16 is attached as Appendix 5 for review. This will be reported to Cabinet and Council in February 2016.
1.11	The Mid-Year Report reviews the activities and performance of the treasury management operations during the period 1st April to 30th September 2015.
1.12	In summary, the key points of the Mid-Year Report are: • The UK economy remained resilient over the six month period. Although the rate of economic growth slowed, GDP has now increased for ten consecutive quarters. Inflation remains low, and briefly turned negative in April. There have been further improvements in the labour market, with unemployment decreasing and average earnings excluding bonuses rising in the three months to July. (Section 3) • Arlingclose at the time of writing (September) expected the first rise in UK interest rates in the second quarter of 2016 (Section 3). This has subsequently been revised (see paragraph 1.06 above). • Local authorities in Wales reached a voluntary agreement to change the financing arrangements for council housing in Wales in April as reported previously. For Flintshire this resulted in a settlement payment to Welsh Government of £79.2m on 2nd April 2015. This was financed with new long term borrowing from the Public Works Loans Board (PWLB), resulting in an increase in long term borrowing from £172.1m on 2nd April to £251.3m. There was no further borrowing activity during the period. (Section 4) • Investments have been made with UK banks and building societies up to periods of 12 months, as well as utilising investment opportunities afforded by money market funds, instant access accounts, Debt Management Office, other Local Authorities and other financial instruments such as Certificates of Deposit (CD's). The average investment balance for the period was £55.6m and the average rate of return was 0.48%. (Section 5)

	• The treasury function operated within the limits detailed in the Treasury Management Strategy 2015/16.
1.13	Treasury Management 2015/16 Quarter 3 Update A statement setting out the Council's investments at 31st December 2015 is attached as Appendix 6. The investment balance at this time was £39m across 20 counterparties with an average interest rate of 0.54%.
1.14	A statement analysing the Council's long-borrowing portfolio as at 31st December 2015 is attached as Appendix 7. There has been no change in the third quarter, with total long-term borrowing remaining at £251.3m with a weighted average interest rate of 5.02%.
1.15	During the quarter debt rescheduling was considered as part of 2016/17 budget setting. Current market conditions have led to very low gilt yields which result in premiums being payable should the Council seek early repayment of debt which continue to be cost prohibitive.

2.00	**RESOURCE IMPLICATIONS**
2.01	Financial implications are addressed in the report; no other resource implications directly as a result of this report.

3.00	**CONSULTATIONS REQUIRED / CARRIED OUT**
3.01	Arlingclose Ltd, being the Council's treasury management advisors.

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

5.00	**APPENDICES**
5.01	1. Draft Treasury Management Strategy 2016/17 2. Draft Treasury Management Policy Statement 2016-2019 3. Draft Treasury Management Practices 2016-2019 Part 1: Principles 4. Draft Treasury Management Practices 2016-2019 Part 2: Schedules 5. Draft Treasury Management Mid-Year Report 2015/16 6. Investment Portfolio as at 31 December 2015 7. Borrowing Portfolio as at 31 December 2015

6.00	**LIST OF ACCESSIBLE BACKGROUND DOCUMENTS**
6.01	**Contact Officer:** Liz Thomas – Technical Finance Manager **Telephone:** 01352 702289 **E-mail:** liz.thomas@flintshire.gov.uk

7.00	**GLOSSARY OF TERMS**
7.01	**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):** Government Body that sets the Bank Rate. Its primary target is to keep 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. **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):** In relation to the UK, it is the process used by the Bank of England to directly increase the quantity of money in the economy. It does not involve printing more banknotes. Instead, the Bank buys assets from private sector institutions – that could be insurance companies, pension funds, banks or non-financial firms – and credits the seller's bank account. So the seller has more money in their bank account,

while their bank holds a corresponding claim against the Bank of England (known as reserves). The end result is more money out in the wider economy.

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.