TREASURY MANAGEMENT STRATEGY 2017/18

ANNEX B – Elements of the Treasury Management Strategy 2017/18 - 2019/20

1. Introduction

1.1 The elements of this Treasury Management Strategy are designed to provide a proper framework within which the Council's cashflow banking, money market and capital market transactions, the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks, can be operated.

1.2 The Treasury Management Panel is an important part of the overall financial management of the Council's affairs. The Prudential Indicators in Annex C consider the affordability and impact of capital expenditure decisions and set out the Council's overall capital framework. The Treasury Management Panel considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 2002. There are specific treasury Prudential Indicators included in this strategy which require approval.

1.3 The Council's treasury activities are strictly regulated by statutory requirements, in particular the Local Government Act 2003. This annex contains two of the four key elements referred to in the attached report. They are the Borrowing Strategy and the Investment Strategy, both are in accordance with the Department of Communities and Local Government (DCLG) investment guidance. These two key elements are in accordance with a professional code of practice (the CIPFA Code of Practice and Cross-Sectoral Guidance Notes on Treasury Management – 2011 Edition). This Council has adopted the 2011 edition of the Treasury Management Code.

1.4 The Council's policy requires an annual Strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks and the management of the risks associated with the treasury service. Further treasury reports are produced at the half-year stage and after the year-end to report on actual activity for the year.

1.5 This Strategy covers the following:

- The Council's debt and investment projections (section 2).
- The expected movement in interest rates (section 3).
- The Council's borrowing and investment strategies (sections 4 and 6).
- The Council's investment counterparty and liquidity framework (section 5).
- The Council's power to invest (section 7).
- Specific limits on treasury activities and attitude to risk (section 8).
- The Council's Lender Option Buyer Option (LOBO) strategy (section 9).

2. Debt and Investment Projections 2017/18 – 2019/20

2.1 The borrowing requirement comprises the expected movement in the Capital Financing Requirement (CFR in the table below) and any maturing debt which will need to be re-financed. The table overleaf shows this effect on the treasury position over the next three years. It also highlights the expected change in investment balances:

£'000s	2016/17 Revised	2017/18 Projection	2018/19 Projection	2019/20 Projection
External Debt				
Long-term debt at 1 April	88,574	85,153	123,456	146,680
Repaid debt	(8,421)	(1,697)	(1,776)	(4,694)
Replacement of maturing debt	5,000	-	-	-
Additional long-term debt	-	40,000	25,000	25,000
Long-term debt at 31 March	**85,153**	**123,456**	**146,680**	**166,986**
Short-term debt at 31 March	67,000	119,736	133,239	120,998
LCC/ex-LCC at 31 March	18,818	18,065	17,343	16,649
PFI and Other Liabilities	72,935	71,081	69,144	66,660
Total external debt at 31 March	**243,906**	**332,338**	**366,406**	**371,293**
Annual change in debt	**(3,078)**	**88,432**	**34,068**	**4,887**
Investments				
Total investments at 31 March	(1,000)	-	-	-
Investment change	**12,350**	**1,000**	**-**	**-**
Change in debt less investment	9,272	89,432	34,068	4,887
Annual change in CFR (annex C 3.3)	**31,896**	**44,096**	**41,275**	**(958)**

2.2 The additional long-term debt includes any borrowing in advance and catch-up borrowing. The related impact of the above movements on the revenue budget are:

£'000s	2016/17 Revised	2017/18 Projection	2018/19 Projection	2019/20 Projection
Revenue Budget				
Interest on long-term loans	4,933	7,983	8,833	9,683
Interest on short- term loans	398	519	1,999	1,815
Total Interest Cost	**5,331**	**8,502**	**10,832**	**11,498**
General Fund long-term borrowing cost	4,862	8,074	10,404	11,070
HRA long-term borrowing cost	469	428	428	428
Investment income/Internal Financing	(8)	(138)	(291)	(266)

3. Expected Movement in Interest Rates

Indicative %	Base Rate	5-year Gilt	20-yr Gilt	50-yr Gilt
2016/17 (actual)	0.25	0.70	2.00	1.80
2017/18	0.25	0.90	2.20	2.00
2018/19	0.50	1.00	2.40	2.20
2019/20	0.75	1.20	2.60	2.50

3.1 The interest rate environment became quite volatile following the outcome of the June referendum on EU membership and the Bank of England expects that interest rates will continue to fluctuate during the period of the leave negotiations. In an effort to keep the UK economy buoyant the Bank of England reduced the base rate on the 4 August 2016 from 0.5% to 0.25%. The rate remains at this level at the present time and current market expectations are that it may increase gradually during the period covered by this report. Money market investment rates for temporary surplus cash balances are expected to remain at present levels. The current rate for a three-month fixed-term deposit with a high street bank is typically 0.20% and analysts anticipate that this may change marginally during the next 12 months.

3.2 Long-term borrowing rates, influenced by gilt yields, are generally stable but did fall sharply following the outcome of the UK's vote to leave the European Union. They have now recovered largely but are still marginally below those levels which existed prior to the referendum. Therefore, long-term borrowing rates which are typically priced at UK Gilt +100 basis points have decreased during the year by 0.6% to just over 2.8% and the market expects these longer term rates to increase gradually during the next 12 months.

4. Borrowing Strategy 2017/18 - 2019/20

4.1 Analysts believe that short-term interest rates will remain low reflecting the base rate and are only likely to increase gradually during 2017/18.

4.2 As stated above in 3.1, the interest rate environment became quite volatile following the outcome of the June referendum and the Bank of England expects that interest rates will continue to fluctuate during the period of the leave negotiations.The Treasury Management Panel, under delegated powers, will take the most appropriate form of borrowing in this uncertain economic environment depending on the prevailing interest rates at the time. Because of the risks involved in making temporary investments it is unlikely that there will be any borrowing in advance of the future year's requirements.

4.3 Long-term borrowing rates, influenced by gilt yields, are generally stable. But as explained above in 3.2 rates have fluctuated during the last 12 months. In the light of the volatility in long-term rates and the availability of cheap short-term temporary loans the Council has continued to finance its recent borrowing requirement in this way.

4.4 In order to secure the lowest cost of borrowing Blackpool Council has agreed to disclose estimates of its capital transactions including new borrowing and planned capital expenditure for the next three years to Her Majesty's Treasury. The disclosure of this information in summary format entitles the Council to receive a 20 basis point discount on all new loans borrowed from the Public Works Loan Board during the next 12 months. The information provided to Her Majesty's Treasury is updated annually.

4.5 Along with other local authorities the Council became a shareholder in the Municipal Bond Agency (MBA). The agency is planning to issue its first bond early in the new financial year, enabling it to provide competitive loan finance to existing shareholders and other local authorities. The council sees this as a viable alternative to borrowing from the Public Works Loan Board. The Council has agreed to a lending framework which includes a commitment to a joint and several guarantee with other borrowers. The guarantee will not apply until the Council actually borrows from the Municipal Bond Agency. The Treasury Management Panel will not approve borrowing from the Municipal Bond Agency unless the interest rate quoted on any loan offered by it is deemed to be competitive.

5. Investment Counterparty and Liquidity Framework

5.1 The primary principles governing the Council's investment criteria are security and liquidity. The yield or return on investments is of secondary importance.

5.2 To achieve sufficient liquidity in its investments, guidelines will be used to determine the maximum periods for which funds may prudently be committed. These also apply to the Council's Prudential Indicators covering the maximum principal sums invested.

5.3 In relation to security, a policy will be applied to the categories of investment, the choice of investment counterparties with adequate security, and the monitoring of their security. This is set out in the Specified and Non-Specified investment sections below.

5.4 The Treasury Management Panel will maintain a counterparty list in accordance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to those which determine Specified and Non-Specified investments, as it selects which counterparties the Council will choose rather than defining what its investments are. The criteria are based on information from Fitch, Moody's and Standard & Poors, the three principal credit ratings agencies.

(i) **Banks** - the Council will use banks which have at least the following Fitch or equivalent ratings from Moody's and Standard & Poors:

- Short Term - F1 from Fitch or equivalent from Moody's or Standard & Poors.
- Long Term - Single A from Fitch or equivalent from Moody's or Standard & Poors.
- Individual / Financial Strength – C from Fitch or Moody's or the equivalent from Standard & Poors
- Support - 3 from Fitch or the equivalent from Moody's or Standard and Poors

(ii) **Bank Subsidiary and Treasury Operations** - the Council will use these where the parent bank has the necessary ratings outlined above. The investment limit to be applied will be calculated across the whole group.

(iii) **Building Societies** - the Council will use any United Kingdom Society with assets in excess of £1.5 billion.

(iv) **Local Authorities** - The Council will use upper-tier authorities only.

(v) **Investment in the UK Government** (including short-term gilts and sterling treasury bills) are permitted because of their overall security.

(vi) **Investment in Money Market Funds** are not permitted.

(vii) **Non-UK Exposure Limits** - The Treasury Management Panel may impose overall sector or country limits to restrict the level of exposure within non-UK financial institutions. The Panel has no short-term plans to start investing in non-UK financial institutions, but it can foresee the possibility in future years covered by the Strategy when it may invest up to 25% of temporary cash investments in non-UK financial institutions which satisfy the criteria in (i) above and whose sovereign government rating is triple A according to Fitch or the equivalent from Moody's or Standard & Poors.

5.5 It is not considered necessary to apply different maximum time limits for investing with different counterparties according to their precise credit rating. Institutions are either on the list of potential counterparties for any timescale (subject to the overriding restriction of 364 days or less) or they are not on the list at all. The Treasury Management Panel has placed a temporary 3-month time limit on deposits placed with all Banks and Building Societies on its counterparty list.

5.6 The proposed criteria for Specified and Non-Specified investments are shown in section 7 for approval.

5.7 In the normal course of the Council's cashflow operations it is expected that only Specified Investments will be utilised for the control of liquidity.

5.8 The use of longer-term instruments (greater than one year from inception to repayment) would fall in the Non-Specified Investment category. These instruments will not be used for the control of liquidity. This will also be limited by the investment Prudential Indicator below.

6. Investment Strategy 2017/18 – 2019/20

6.1 In managing the Council's treasury on a day-to-day basis, the Treasury Management Panel takes heed of a quotation contained in a House of Commons Treasury & Civil Services Committee report of 1991 following the Bank of Commerce and Credit International closure which stated: "*in balancing risk and return, local authorities should be more concerned to avoid risks than to maximise returns.*"

6.2 Expectations on shorter-term interest rates, on which investment decisions are based, are that rates will remain low during 2017 increasing by 0.3% by the middle of 2018. Rates may then rise incrementally during the following 18 months. The Council's investment decisions are based on comparisons between the current low level of interest rates and the market's expectation of gradual increases during the following 18 months. As a result it is likely that investment decisions will continue to be made for shorter periods until investment rates start to rise during 2017. However, the overriding principle is to maintain sufficient security and liquidity within the cash balances and a shorter profile of temporary investments will help achieve this. The Treasury Management Panel, under delegated powers, will undertake the most appropriate form of investments based on current market conditions as surplus funds become available. The three-month time limit for temporary investments will continue during 2017 but may be relaxed in future years covered by this Strategy. The current restrictions are explained in more detail in paragraph 6.3

6.3 The Treasury Management Panel currently operates a restriction of 3 months or less on all fixed term deposits placed with those counterparties included in paragraph 5.4 (i), (ii), (iii), (iv) and (v). It also considered it necessary to restrict temporary fixed-term investments to UK Banks and Building Societies and those subsidiaries of non-UK financial institutions which are incorporated in the UK. However, as market conditions improve the Panel is likely to lift these restrictions and extend the term of temporary investment back to a maximum of 364 days. Moreover, the Treasury Management Panel may invest up to 25% of temporary cash investments in non-UK financial institutions which satisfy the requirements set out in paragraph 5.4 (vii).

7. Power To Invest

7.1 Blackpool Council has the power to invest:

(i) for any purpose relevant to its functions under any enactment, and

(ii) for the purposes of the prudent management of its financial affairs.

This includes investments which are not directly linked to statutory functions but are simply made in the course of treasury management. This allows for the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future.

7.2 **Speculative borrowing purely in order to invest is unlawful.**

7.3 **The speculative purchase and subsequent disposal of property is generally also unlawful.** However, there may be occasions when such purchase and resale are necessary as part of a strategic development. This is permitted only where this is part of an approved project plan which is covered by proper statutory powers in pursuance of the Council's approved objectives. Examples of this are in the pursuit of delivery of projects related to Blackpool's regeneration strategy - such as the planned phases of the Central Business District.

7.4 Priority is to be given to the security of investments and then to liquidity. The highest rate of return (yield) can only be sought once officers are satisfied that the principal sums invested are secure.

7.5 The Council is expanding its Business Loans Fund to £100m by borrowing in order to promote, develop and support local businesses and public sector partners within the Blackpool area. Before any lending is authorised the Loans Panel (which includes the Chief Executive, Director of Place and Director of Resources) supported by both Accountancy and Legal, will analyse and validate the business case for each loan.

7.6 No other types of (Non-Specified) investments are identified as being permissible, other than those explicitly allowed as share or loan capital under paragraph 7.7.

7.7 Investments in share or loan capital are restricted to shareholdings in Blackpool Transport Services Ltd., Blackpool Operating Company Ltd., Blackpool Entertainments Company Ltd., Blackpool Housing Company Ltd. and a minority interest in 50,000 'B' shares in the Regional and City Airports (Blackpool) Airport Ltd. The guidance defines acquisition of share or loan capital in a corporate body as capital or revenue expenditure (rather than as an investment). This means that such expenditure needs to be funded out of capital or revenue resources respectively.

8. Treasury Management Prudential Indicators, Limits on Activity and Attitude to Risk

8.1 Blackpool Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities is measured. It uses the Treasury Management Prudential Indicators as part of the risk control process to limit activity and monitor performance.

8.2 There are five treasury Prudential Indicators. The purpose of these Prudential Indicators is to contain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs. The indicators are:

8.3 **Gross debt and the Capital Financing Requirement (CFR)** - In order that over the medium-term, debt will only be taken for a capital purpose, the Council should ensure that external debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. If in any of these years there is a reduction in the CFR, this reduction is ignored in estimating the cumulative increase in the CFR which is used for comparison with gross external debt. This is a key indicator of prudence.

8.4 **Upper limits on variable interest rate exposure** - This indicator identifies a maximum limit for variable interest rates based upon the debt position net of investments. In cases where the terms of the borrowing or investment raise questions as to whether it should be treated as fixed or variable, it is to be treated as variable for the purposes of these Prudential Indicators. Advice previously received from Butlers suggests that this indicator is best calculated using the principal capital value rather than percentages where there are significant levels of investments.

8.5 **Upper limits on fixed interest rate exposure** - This indicator is similar to the previous indicator but covers a maximum limit on fixed interest rates.

8.6 **Maturity structures of borrowing** - These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits. They show the amount of projected borrowing that is fixed rate maturing in each period as a percentage of the total projected borrowing that is fixed rate.

8.7 **Total principal funds invested for greater than 364 days** - These limits are set to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

8.8 The Council is asked to approve the following Prudential Indicators (in the table over the page). Note that for each year, the upper limits on fixed interest rates equate to the expected Capital Financing Requirement for that year

	2017/18	2018/19	2019/20
Gross debt (£M)			
	Upper	**Upper**	**Upper**
Gross Debt	332	366	372
Capital Financing Requirement	354	395	394
Interest rate exposures (£M)			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	354	395	394
Limits on variable interest rates based on net debt	177	198	198
Maturity structure of fixed interest rate borrowing 2017/18 (%)			
		Lower	**Upper**
Under 12 months		-	18%
12 months and within 2 years		-	18%
2 years and within 5 years		-	30%
5 years and within 10 years		2%	60%
10 years and within 30 years		2%	70%
30 years and above		15%	90%
Maximum principal sums invested > 364 days			
Principal sums invested > 364 days	£ nil	£ nil	£ nil

9. Lender Option Borrower Option debt (LOBOs)

9.1 Lender Option Borrow Option debts (LOBOs)typically carry a cheaper initial rate of interest than new debt available from other sources. They are structured with an initial period in which a fixed rate of interest is paid, followed by a much longer ‘variable’ period. During this period at the agreed ‘call’ dates (typically between every six months to every five years) the Lender has the option to increase the interest rate. If the Lender exercises their Option to increase the rate, the Borrower has the Option to repay the debt.

9.2 When general interest rates are rising, the interest the Council pays on its LOBOs will tend to ratchet up at call dates, lagging just below other available market rates. The higher rate chosen by the lender is always likely to be enticingly below other immediately available market rates so that at the decision points when the borrower has the option to repay, it will be seduced into a longer relationship with the LOBO at higher rates. However, when general interest rates are falling, the interest the borrower pays on its LOBOs will remain fixed at the higher rates.

9.3 The Treasury Management Panel notes that whenever a lender calls an increase in the rate of a LOBO there will be a great temptation to accept the higher rate and remain tied into the LOBO (as the alternative borrowing is likely to be slightly more expensive in the short term). The Council will continue to take advantage of the beneficial rates available through LOBOs as part of a balanced portfolio of fixed and variable debt, especially through the early fixed period of the instrument.

9.4 The Council’s policy is that on every occasion when a lender opts to increase the interest rate on one of its LOBOs there is a presumption that the Council will repay the LOBO.