Appendix E

TREASURY MANAGEMENT STRATEGY STATEMENT

Introduction

1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services requires local authorities to determine their Treasury Management Strategy Statement (TMSS).

2. As per the requirements of the Prudential Code of Practice, 2011, the Authority has adopted the CIPFA Treasury Management Code and reaffirmed its adoption at its annual Budget meeting, most recently on 3 March 2014.

3. The purpose of this TMSS is, therefore, to set out the following:
    i. Treasury Management Strategy for 2017/18
    ii. Annual Investment Strategy for 2017/18

    The approved Strategies will be implemented from the date of approval by the Council.

4. The Authority had borrowed £416m of long term debt and had £201m invested at 30 November, 2016 and, therefore, has potentially large exposures to financial risks including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring and control of risk is central to the Authority's Treasury Management Strategy.

Capital Financing Requirement

5 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with usable reserves, are the core drivers of the Authority's Treasury Management activities.

6 At 30 November, 2016 the Authority's had £416m of long term debt and £201m of investments. These are set out in further detail below.

Existing Investment & Debt Portfolio Position

Table 1

	30/11/2016 Actual Portfolio £m	30/11/2016 Average Rate %	31/3/2016 Average rate %
External Borrowing:			
PWLB – Maturity	288	5.01	5.01
PWLB – EIP	32	2.56	2.56
LOBO Loans	96	4.93	4.82
Total Gross External Debt	416	4.80	4.76
Investments:			
Market Deposits	181	0.38	0.52
Money Market Funds	20	0.33	0.47
Total Investments	201	0.37	0.51
Net Debt	215		

7 The movement in actual external debt and usable reserves combine to identify the Authority's borrowing requirement and potential investment strategy in the current and future years. The Authority's current strategy is to maintain borrowing at the lowest level possible unless interest rate prospects present a clear case for taking long term borrowing ahead of immediate requirements. The Council's CFR is greater than its borrowing. However, the increased emphasis on imaginative capital investment to transform the financial position will require some amendments to the detail of this strategy, although the core principle of minimizing borrowing costs will remain.

Interest Rate Forecast

8 There is significant uncertainty in the marketplace regarding the mid to long-term interest rates but the Council's Treasury Management advisers, Arlingclose, forecast that official UK Bank Rate will remain at 0.25% for the immediate future. However, 30-year gilt yields and PWLB rates have risen by 0.6% in the last three months. Therefore, the market is already pricing in inflation into the longer term interest rates. However, due the uncertainty surrounding Brexit and the Presidential Election in the US, few market commentators see an early rise as likely. Officers will continue to monitor developments with the advice of Arlingclose but giving due regard to other published information.

Borrowing Strategy

9 The Council currently holds a significant cash balance at present and this seems likely to continue for the next two or three years at least. This occurs in a situation in which longer term rates are significantly in excess of short term rates. If borrowing is undertaken in this environment there will be a net cost of holding this money until it is used, sometimes called the “cost of carry”. As borrowing is often for longer dated periods (anything up to 60 years) the cost of carry needs to be considered against a backdrop of uncertainty and affordability constraints in the Authority’s wider financial position. Therefore the Council does not intend to borrow in advance of need to fund its activities.

10 The Authority will adopt a flexible approach to any future long-term borrowing in consultation with, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk;
- Borrowing source.

Sources of Borrowing and Portfolio Implications

11 In conjunction with advice from Arlingclose, the Authority will keep under review the following borrowing sources:

- Internal balances
- PWLB
- Other local authorities
- European Investment Bank
- Leasing
- Structured finance
- Capital markets (stock issues, commercial paper and bills)
- Commercial banks
- UK Municipal Bond Agency

As the Council did not foresee an immediate need to borrow, and as it was aware of the risks of joint and several liability, it did not take any part in setting up the UK Muncipal Bond Agency (UKMBA). However, the option of joining the UKMBA or issuing bonds in our own name, is under constant review. As it is anticipated that the Council will borrow in the near future to fund its ambitious capital programme, a more comprehensive review and decision from whom to borrow will take place at that juncture, after seeking appropriate, formally given advice.

12 The Council has no immediate need to borrow externally, due to our current cash balances, so it can avail itself of borrowing. Furthermore, the cost of carry means use of shorter dated borrowing and repayment by Equal Instalments of Principal (EIP) is more cost effective. This increases volatility in the debt portfolio in terms of interest rate risk but is counterbalanced by its lower interest rates and that borrowing costs are closer to investment returns. It also maintains an element of flexibility to respond to possible future changes in the requirement

to borrow. The Authority's exposure to shorter dated and variable rate borrowing is kept under regular review.

13 The Authority has £80.5m exposure to LOBO loans (Lender's Option Borrower's Option) of which £40.0m of these can be "called" within 2017/18. £15m of these were transformed into regular fixed rate loans in 2016/17.

14 LOBOs are so-called because lenders can exercise their rights at set times to amend the interest rate on the loan. At that point, the Borrower can accept the revised terms or reject them and repay the loan without penalty. LOBO loans present a potential refinancing risk to the Authority since the decision to call a LOBO is entirely at the lender's discretion which is compensated for by a lower interest rate being paid. This risk is mitigated by the fact that the Council's current cash holdings mean that any repayment could be accommodated by reducing deposits in a relatively short time and that it would financially advantageous to do so at current interest rates.

15 Any LOBOs called will be discussed with Arlingclose prior to acceptance of any revised terms. The default position will be the repayment of the LOBO without penalty i.e. the revised terms will not be accepted. It is considered a significant possibility that some LOBOs may be called over the next few years due to the need to comply with Basle III regulations for banks in 2019.

Debt Rescheduling

16 The Authority's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.

17 The lower interest rate environment and changes in the rules regarding the premature repayment of PWLB loans have adversely affected the scope to undertake worthwhile debt restructuring although occasional opportunities arise. The rationale for undertaking any debt rescheduling or repayment would be one or more of the following:

- Reduce investment balances and credit exposure via debt repayment
- Align long-term cash flow projections and debt levels
- Savings in risk adjusted interest costs
- Rebalancing the interest rate structure of the debt portfolio
- Changing the maturity profile of the debt portfolio

18 The possible benefit of undertaking a restructuring needs to be carefully evaluated as it depends on how the repayment is resourced. Officers will monitor the portfolio together with Arlingclose and remain alert for opportunities where the potential savings justify the risks involved. Borrowing and rescheduling activity will be reported to the Cabinet and Council in the Annual Treasury Management Report and the mid year report.

Annual Investment Strategy

19 In accordance with investment guidance issued by the Department for Communities and Local Government (CLG), and best practice, this Authority's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Authority's investments is secondary, followed by the yield earned on investments. However, the likely rise in inflation presents a further risk to the Council in so far as current investment yields are likely to be below the rate of inflation. This means that the value of these investments is declining as time goes on. Though not clearly visible, this will progressively erode the purchasing power of Treasury investments.

20 The graph in Annex D shows a comparison between Brent's portfolio and that of Arlingclose's other clients. Brent's portfolio has a very low risk compared with many of the others, but also a lower yield than would be expected for that risk. Brent currently uses quite a narrow range of the instruments which are available, chosen because they are short term and with highly rated counterparties, principally the UK government, local authorities and major UK banks. Additional yield can be offered either in return for higher inherent risk or reduced liquidity (i.e. longer maturities or lower marketability). However, this risk can be mitigated in a number of ways:

- Diversification over a range of counterparties;
- Seeking collateral or additional security for capital invested;
- Focusing on capital strength or sound business models.

21 Corporate bonds, for example, can give significantly higher yields than our current deposits but give exposure to risks from economic, commercial and operational difficulties. Diversification would involve investing small amounts with a large number of companies or buying diversified Funds. Seeking additional security could involve exchanging our deposit for known high credit quality assets, or a claim on a pool of assets. Seeking capital strength would involve investing in companies with high levels of assets in relation to liabilities or a strong fixed asset base, or whose business is not subject to marked fluctuations in activity or profitability. Annex C compares some readily available options.

22 The Council has a borrowing portfolio of £416m and a Capital Financing Requirement of £584m. This £168m difference generates 0.37% of interest. If borrowed for 25 years on Equal Instalment of Principal terms, it would cost 2.55%. Together, this equals a total 2.92% return, representing a saving of £4.9m to the Council, but also an opportunity to invest.

23 Brent currently holds a historically high level of cash which has risen over the last three years. A significant part of this is related to unspent capital grants and Section 106 contributions, which are already reducing. However, there are other elements that will grow, such as CIL. The Capital programme has increased in scale and the relative ease of direct purchasing of assets (PRS and land) means that spend is more likely to meet ambitious targets than in prior years. Therefore overall, the Council will continue to have significant balances invested for at least the next couple of years.

24 Having an appropriate lending list of counterparties, remains critically important to protecting Brent's investments. A list of extremely secure counterparties would be very small, and the limits with each would be correspondingly high. This would expose the authority to a risk of an unlikely but potentially large loss. This arises because the arrangements for dealing with banks in difficulty now require a loss to be imposed on various categories of liabilities of the banks to allow the bank to recapitalize itself and continue in business (sometimes referred to as bail in).

25 Local authority deposits could be exposed to a loss of up to 40%, beyond which the government would be able to give support. As a consequence, the Council has taken steps to reduce exposure to banks, by shortening maturity limits, by investing principally in instruments which can be sold in the event of warning signs being noticed and by diversifying. The Authority and its advisors remain alert for signs of credit or market distress that might adversely affect the Authority. However, The Council wishes to maintain the option of using a wider range of instruments which are not subject to bail in, where appropriate, and this would include the instruments referred to in Annex C. All of these would be need a thorough vetting by officers and the Council's Treasury advisors, Arlingclose.

26 Investments are categorised as Specified or Non-Specified within the investment guidance issued by the CLG. Specified investments are sterling denominated investments with a maximum maturity of one year. They are also of a high credit quality as determined by the Authority and are not investments that needed to be accounted for as capital expenditure. Non-specified investments are, effectively, everything else. Investments for more than a year remain non-specified until they mature.

27 The types of investments that will be used by the Authority and whether they are specified or non-specified are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Investments with Registered Providers	✓	✓
Certificates of deposit with banks and Building Societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	✗
Bonds issued by Multilateral Development Banks	✓	✓
Local Authority Bills	✓	✗

Commercial Paper	✓	✗
Corporate Bonds	✓	✓
AAA-Rated Money Market Funds	✓	✗
Other Money Market Funds and Collective Investment Schemes	✓	✓
Debt Management Agency Deposit Facility	✓	✗

28 Registered Providers (Housing Associations and Registered Social Landlords) have been included within specified and non-specified investments for 2017/18. Any investments with Registered Providers will be analysed on an individual basis and discussed with Arlingclose prior to investing.

29 The minimum credit rating for non-UK sovereigns is AA+ (or equivalent). For specified investments the minimum long term rating for counterparties is A- (or equivalent). Within these criteria the Chief Finance Officer (CFO) will have discretion to accept or reject individual institutions as counterparties on the basis of any information which may become available. The countries and institutions that currently meet the criteria for investments are included in Annex A. The Council uses the lowest rating quoted by Fitch, Standard and Poor or Moody, as recommended by CIPFA.

30 Any institution will be suspended or removed should any of the factors identified above give rise to concern, and caution will be paramount in reaching any investment decision regardless of the counterparty or the circumstances. Credit ratings are monitored continually by the Authority, using the advice of Arlingclose on ratings changes, and action taken as appropriate.

31 The Authority banks with National Westminster Bank (Natwest). At present, Natwest does not meet the Authority's minimum credit criteria (its Moody's rating is Baa1). While it does not give cause for immediate concern, its status is being monitored and the necessary actions should it deteriorate have been considered. In the meantime, as far as is consistent with operational efficiency, no money is being placed with Natwest and credit balances in the various Council accounts are being kept to a minimum level. This is why the Pension Fund, in the midst of restructuring its investments, recently agreed to make use of the Treasury function to loan to other organisations.

Investment Strategy

32 With short term interest rates expected to remain low for many years, an investment strategy will typically result in a lengthening of investment periods, where cash flow permits, in order to lock in higher rates of acceptable risk adjusted returns.

33 Following on from the banking crisis of 2008/09 and government interventions to prevent the collapse of the banking system, there has been an increase in legislative restrictions on the extent and manner in which public money can be used in the event of an impending bank failure. In future, governments will be unable to invest public money to rescue banks in difficulty until a significant contribution has been made by those who have certain kinds of investments in

the bank concerned, a process called “Bail in”. These include deposits by those deemed to be in a position to assess the risk involved, including local authorities.

34 Secured deposits of various kinds are not included in bail in provisions. Some other forms of deposits are, but can be sold if felt to be at risk. It is likely that the Council’s preferred instruments in lending to institutions without some kind of government guarantee will increasingly be in the form of secured or marketable instruments.

35 In order to diversify a portfolio largely invested in cash, investments will be placed with a number of approved counterparties over a range of maturity periods. Maximum investment levels with each counterparty will be set by the Chief Finance Officer to ensure that prudent diversification is achieved.

36 Money market funds (MMFs) will be utilised but good treasury management practice prevails, and whilst MMFs provide good diversification, the Authority will also seek to mitigate operational risk by using at least two MMFs where practical. The Authority will also restrict its exposure to MMFs with lower levels of funds under management and will not exceed 0.5% of the net asset value of the MMF. In addition, each Fund will be limited to a maximum deposit of £10m and no more than half the Council’s deposits will be placed with MMFs.

37 The investment strategy will provide flexibility to invest cash for periods of up to 370 days in order to access higher investment returns, although lending to UK local authorities can be for up to 5 years. The upper limit for lending beyond a year is £40m. In practice, lending for more than one year will be only to institutions of the highest credit quality and at rates which justify the liquidity risk involved. Marketable instruments may have longer maturities, though the maturity will be considered in conjunction with the likely liquidity of the market and credit quality of the institution.

38 Annex C summarises the main features of some instruments which the Council does not use at present but would like to reserve the option to use in the future. Before using any of these, officers would take advice from Arlingclose and adopt suitable guidelines to manage risk from exposure to the new instruments.

39 Collective Investment Schemes (Pooled Funds):
The Authority has evaluated the use of Pooled Funds and determined the appropriateness of their use within the investment portfolio. Pooled funds enable the Authority to diversify the assets and the underlying risk in the investment portfolio and provide the potential for enhanced returns. Investments in pooled funds will be undertaken with advice from Arlingclose. The Authority currently has no investments in Pooled Funds at present, but may make prudent use of them in the future.

40 Investment Policy:
Treasury Management in the Public Services: Code of Practice (the Code) was updated in November 2011, with a greater focus on risk management and significance of capital security as the Council's primary objective in relation to investments.

41 The Council maintains, as the cornerstones for effective treasury

management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities;
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

Policy on Use of Financial Derivatives

42 The Authority does not currently use standalone financial derivatives (such as swaps, forwards, futures and options) and will only do so where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority 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 will not be subject to this policy. Where schemes contain an embedded derivative they will be subject to evaluation as part of the appraisal of the particular scheme.

43 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 any relevant foreign country limit.

44 The Authority will only use derivatives after seeking expertise, receiving a legal opinion and ensuring officers have the appropriate training for their use.

Policy on apportioning Housing Revenue Account (HRA)

45 Local authorities are required to recharge interest expenditure and income attributable to the HRA in a way which is fair to the HRA without detriment to the General Fund. The guidance is non-specific, so the Council is required to adopt a policy that will set out how interest charges attributable to the HRA will be determined. The CIPFA Code recommends that local authorities outline this policy in their TMSS.

46 As of 1 April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. Individual loans or parts of loans have been allocated to the HRA, on the basis of achieving the same long term rate as that which applied to the General Fund at the self-financing date. In the future, new long-term borrowing will be assigned in its entirety to one pool or the other, allocating the costs and benefits to each accordingly.

47 Differences between the value of the HRA loans pool and the HRA’s underlying need to borrow results in a notional element of internal borrowing. This balance will be assessed over the year and interest charged to the HRA at an appropriate rate for short term borrowing. The HRA will also hold reserves and balances which will be invested with the Council, and interest will be paid on identified balances at a rate which recognises that any investment risk is borne by the General Fund.

Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

48 The CFO will report to the Audit Committee, Cabinet and Full Council on treasury management activity as follows:

- Annually, against the strategy approved for the year.
- A mid-year report on the implementation of strategy and main features of the year's activity to date.

Training

49 CIPFA's Code of Practice requires the CFO to ensure that all members with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. Arlingclose delivered a training session for members on 19 November, 2015. Staff regularly attend training courses, seminars and conferences provided by Arlingclose, CIPFA and others. Relevant staff are also encouraged to study for professional qualifications from CIPFA and other appropriate organisations.

Treasury Management Advisers

50 The Authority uses Arlingclose as Treasury Management Advisors and receives the following services:

- Credit advice
- Investment advice
- Technical advice
- Economic & interest rate forecasts
- Workshops and training events
- HRA support
- Other matters as required

The Authority maintains the quality of the service with its advisers by holding quarterly meetings and tendering periodically.

Annex A

ANNUAL INVESTMENT STRATEGY 2017/18

List of institutions which meet the Council's credit worthiness criteria:

Jurisdiction	Counterparty
UK	Lloyds/Bank of Scotland plc
UK	Barclays Bank plc
UK	Close Brothers ltd
UK	Goldman Sachs International Bank
UK	HSBC Bank plc
UK	Abbey National/Santander (UK) plc
UK	Coventry Building Society
UK	Leeds Building Society
UK	Nationwide Building Society
Australia	Australia and NZ Banking Group
Australia	Commonwealth Bank of Australia
Australia	National Australia Bank Ltd
Australia	Westpac Banking Corporation
Canada	Bank of Montreal
Canada	Bank of Nova Scotia
Canada	Canadian Imperial Bank of Commerce
Canada	Royal Bank of Canada
Canada	Toronto-Dominion Bank
Denmark	Danske Bank a/s
Germany	FMS Wertmanagement
Germany	Kreditanstalt fuer Wieferauf
Germany	Landesbank Hessen-Thuringen
Germany	Landeskred Baden-Wuerttenburg
Germany	Landwirtschaftliche Rentenbank
Germany	Landesbank Sachsen-Anhalt
Netherlands	Bank Nederlandse Gemeenten
Netherlands	Cooperatieve Rabobank UA
Netherlands	ING Bank NV

Singapore	DBS Bank Ltd
Singapore	Overseas-Chinese Banking Corporation
Singapore	United Overseas Bank Ltd
Sweden	Nordea Bank AB
Sweden	Svenska Handelsbanken a shs
Switzerland	Credit Suisse AG
USA	JPMorgan Chase Bank NA

The list above represents the institutions which meet the criteria at the time of preparation of the strategy. It does not include institutions to whom we are prepared to lend on the basis of sovereign or quasi sovereign status. The Authority's Chief Finance Officer may introduce new names which meet the criteria from time to time and may adopt more restrictive limits on maturity or value as seems prudent. The Council may also lend any amount to any UK national or local government body for up to 5 years. However, in light of the reductions of central government funding, additional credit worthiness criteria will be required, so smaller bodies with weaker balance sheets would be unlikely to meet the Council's rigorous standards.

An operational list of institutions which are approved to take deposits from the Council will be prepared and circulated to dealing and approving Officers from time to time. This includes money market funds. A protocol will also be maintained describing how investments will be chosen and managed.

Group Limits - for institutions within a banking group, the authority may lend the full limit to a single bank within that group, but may not exceed the limit for all group members. All direct investments with a bank or group will be subject to that limit.

Annex B

Non-Specified Investments

Instrument

Call accounts, term deposits and Certificates of Deposit (CDs) with banks, building societies and local authorities which do not meet the specified investment criteria (on advice from Arlingclose)

Deposits with registered providers

Gilts

Bonds issued by multilateral development banks

Sterling denominated bonds by non-UK sovereign governments

Money Market Funds rated below AAA and Collective Investment Schemes

Corporate and debt instruments issued by corporate bodies

Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No 534 or SI 2007 No 573. These would be capital expenditure.

The Authority will hold up to a maximum of £40m in non-specified investments at any time, which may all be in one category subject to individual counterparty limits.

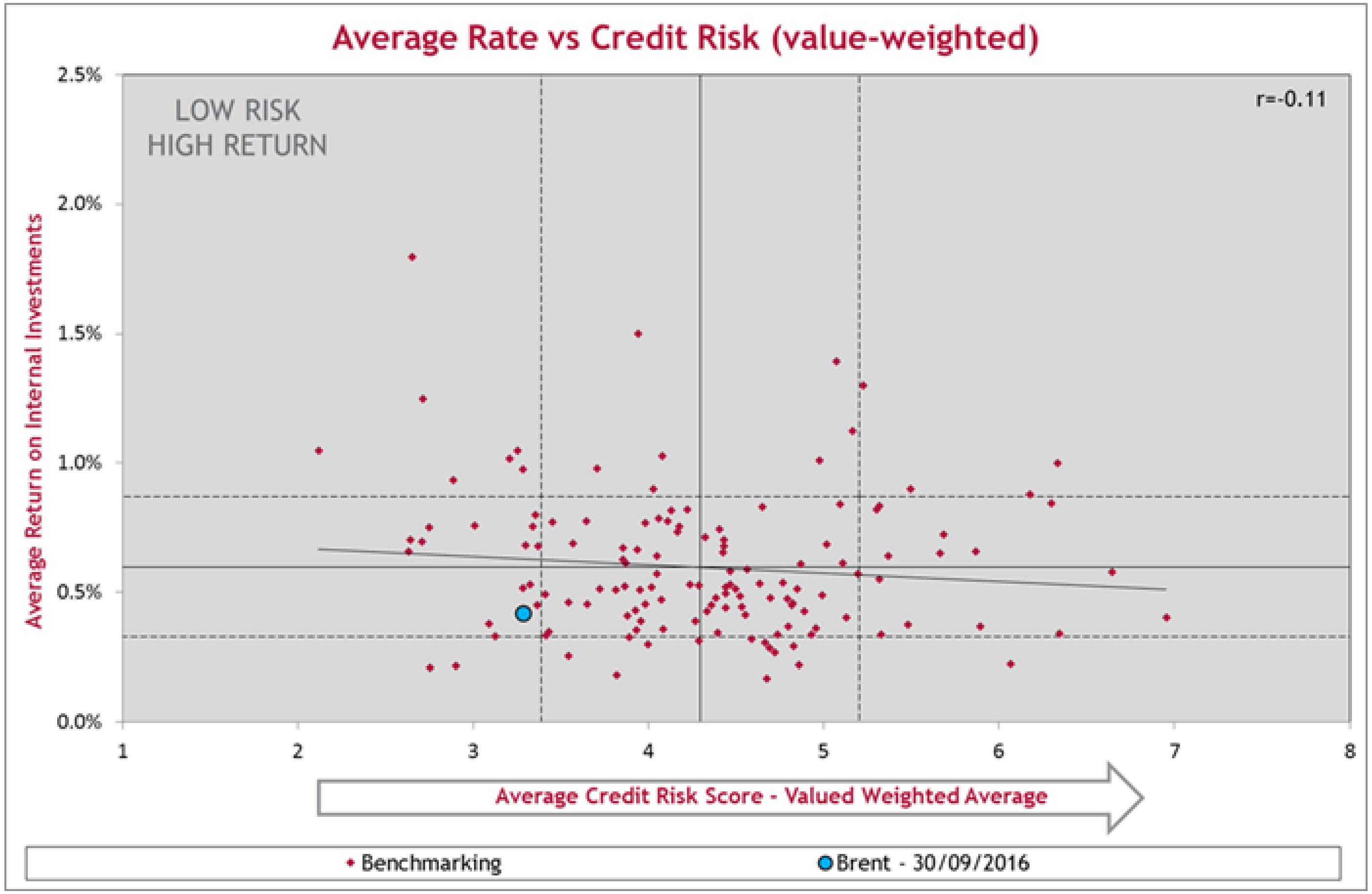
Annex C

Other available options

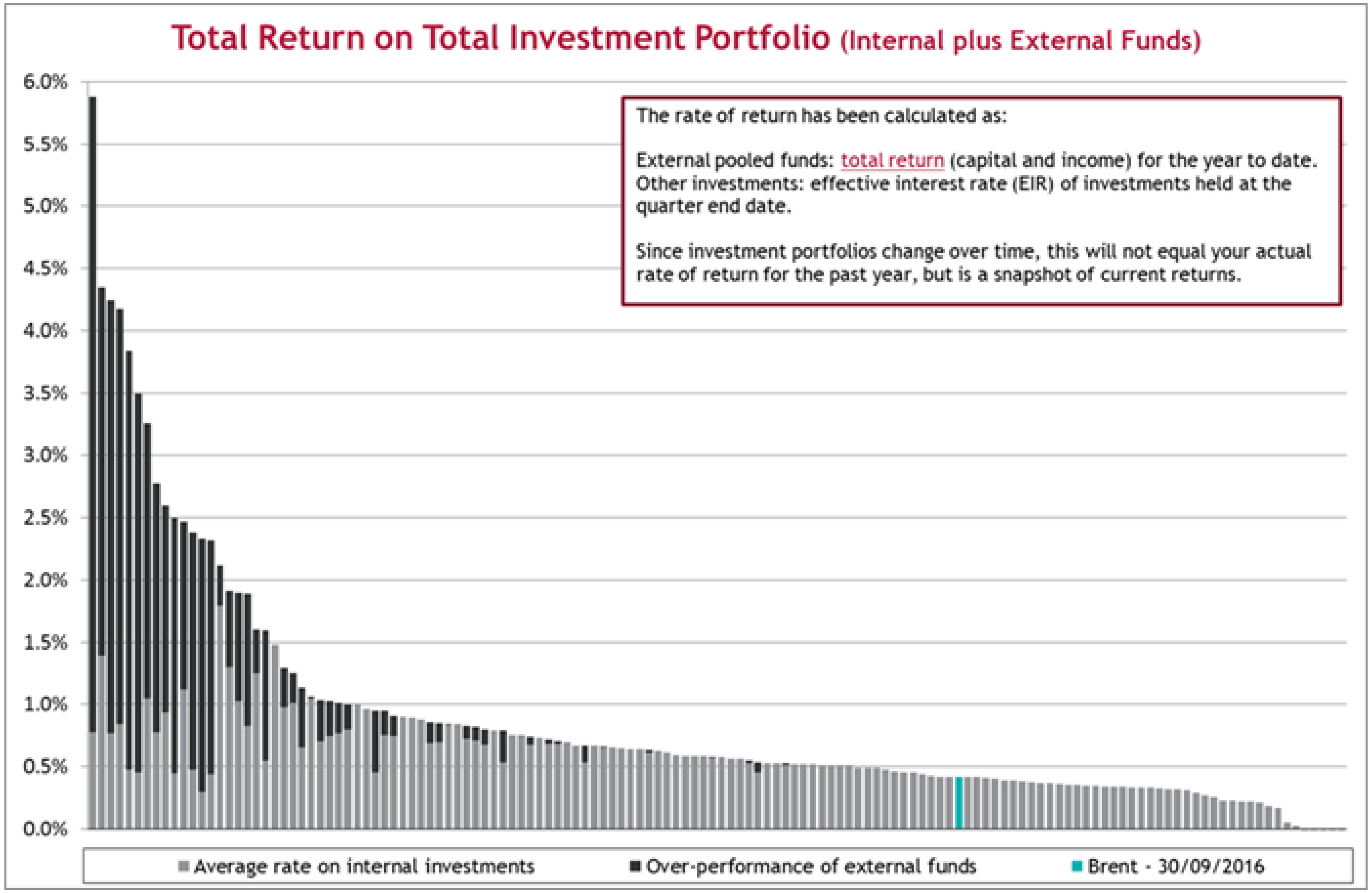
All of the instruments are exempt from the risk of being bailed in if the institution borrowing the Council's money is eligible for bail in.

Instrument (and suitable time scale)	Features	Advantages	Disadvantages
Short bond or cash plus funds 6 months – 2 years	Purchase shares Cash invested in a diversified portfolio of liquid securities	Improved yield from various sources Redeemable asset	Volatility low but value could be below purchase price for some periods
Repurchase arrangement (repo) 1 month – 1 year	Loan to counterparty secured by exchange of collateral as security repayment (usually government stocks)	Offers improved yield by allowing extension of maturity limits	Not easily marketable, so would normally be held to maturity
Covered bonds 3 months – 3 years	Bond guaranteed by nomination of a pool of assets as security. Bond will have its own credit rating	Offers improved yield by allowing extension of maturity limits and use of counterparties who would be excluded by their own rating	Marketable but the market price would fluctuate so should be bought with the intention of holding to maturity
Corporate bonds 1 month – 2 years	Loan to company in marketable form. Security is the companies credit rating and assets	Improved yield because of lower liquidity and economic risk. Corporate capital structures are often more secure than financial counterparties	Risks of a different nature to financial counterparties: more exposed to market and economic risk
Corporate bond funds 6 months – 3 years	Purchase shares Cash invested in a diversified portfolio of corporate borrowing	Diversification means reduced risk Wide range of yields depending on liquidity and risk appetite	Higher level of volatility so may have to be prepared to wait to liquidate investment on favourable terms
Property Funds 5 years	Purchase shares Cash invested in a diversified portfolio of properties	Yields can be high by Treasury standards	Can be very volatile and may need long periods to be able to achieve value

Annex D



Average Rate vs Credit Risk (value-weighted)
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
LOW RISK
HIGH RETURN
r=-0.11
Average Return on Internal Investments
1
2
3
4
5
6
7
8
Average Credit Risk Score - Valued Weighted Average
Benchmarking
Brent - 30/09/2016


Total Return on Total Investment Portfolio (Internal plus External Funds)
6.0%
5.5%
5.0%
4.5%
4.0%
3.5%
3.0%
2.5%
2.0%
1.5%
1.0%
0.5%
0.0%
The rate of return has been calculated as:
External pooled funds: total return (capital and income) for the year to date.
Other investments: effective interest rate (EIR) of investments held at the quarter end date.
Since investment portfolios change over time, this will not equal your actual rate of return for the past year, but is a snapshot of current returns.
Average rate on internal investments
Over-performance of external funds
Brent - 30/09/2016