TREASURY MANAGEMENT

Committee name	Finance and Corporate Services Select Committee
Officer reporting	James Lake – Finance
Papers with report	None
Ward	N/A

HEADLINES

This report provides an overview of the Council's Treasury Management function and the processes required to ensure the Council's investments and borrowing activities are delivered with a focus on risk management whilst also being complemented by efficient financial outcomes.

The Director of Pensions, Treasury & Statutory Accounts, Mr James Lake, will attend the meeting to provide an overview and answer Member's questions.

RECOMMENDATIONS

That the Committee note the contents of the report and provide any comments to officers as appropriate.

SUPPORTING INFORMATION

The Council's Treasury activities are governed by statutory guidance and are covered in two codes of practice issued by the Chartered Institute of Public Finance Accountant (CIPFA); the Prudential Code and Treasury Management in Public Services Code of Practice.

CIPFA defines Treasury Management as the management of the organisation's investments and cash flows, its 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.

It should be noted there is always an element of risk associated with Treasury Management and management of the risks listed below is the key objective when undertaking this activity.

Treasury Management Risks:
- Credit and counterparty risk management
- Liquidity risk management
- Interest rate risk management
- Exchange rate risk management
- Inflation risk management
- Refinancing risk management
- Legal and regulatory risk management
- Operational risk, including fraud, error and corruption
- Price risk management

Treasury Management Practices

The Council is required to prepare Treasury Management Practices (TMPs) which outline how this function operates and is set out in specific categories to ensure each element relating to treasury is addressed and documented with clear procedures and reporting requirements. The requisite categories covered in the TMPs include:

TMP 1 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, Management Information Arrangements
TMP 7 Budgeting, Accounting and Audit Arrangements
TMP 8 Cash and Cashflow Management
TMP 9 (Anti) Money Laundering
TMP 10 Training and Qualifications
TMP 11 Use of External Service Providers
TMP 12 Corporate Governance

Cashflow

The Council receives money into its bank account through various sources including, for example, grants, council tax, business rates, fees and charges, investment income and capital receipts. Payments from the bank account include items such as salaries, supplier payments, benefits, precepts, interest on loans, loan repayments, and capital expenditure. There is a timing difference between monies being received and paid which result in the council holding positive cash balances which are deposited in various institutions and classed as investments.

Investments

Department for Levelling Up Housing and Communities (DLUHC) Statutory Guidance on Local Government Investments states that Treasury investments are required to prioritise security, liquidity and yield in that order.

To meet the first criterion, security, the Council only places its day-to-day funds in highly rated organisations or products, known as counterparties, where there is a very high likelihood that it will not lose any capital value. These primarily include the Government's Debt Management Account Deposit Facility (DMADF), other local authorities, AAA rated Money Market Funds or banks and building societies with a minimum A- rating for UK institutions and A+ for overseas institutions. These counterparties form an approved list and set the framework of where funds may be placed. Due the market environment in recent years, the Council generally only uses the DMADF, local authorities and Money Markey Funds. This is because banks and building societies do not offer an acceptable reward for the additional credit risk.

Counterparty quality is constantly monitored by the Council's treasury advisers and officers to ensure information is up to date. Credit is assessed through credit rating agencies, balance sheet analysis associated with 'bail-in', credit default swap rates, news feeds and a subjective overlay. To diversify credit risk, parameters are in place to avoid concentration and force investments across a number of counterparties and also time limit deposits based on credit quality.

Bank Bail-In vs. Bank Bailout

Bail-ins and bailouts are designed to prevent the complete collapse of a failing bank. The difference between the two lies primarily in who bears the financial burden of rescuing the bank. In a bailout, the government injects capital into banks, enabling them to continue their operations. In 2013, financial reforms eliminated bailouts and introduced bail-in. Bail-ins allow banks to avoid bankruptcy by moving some risks to their creditors rather than to taxpayers. This means that debtholders, unsecured creditors, shareholders, and depositors may shoulder problems within the financial sector when banks use bail-in measures. In this scenario the Council is classed as a depositor and falls above equity and debt in the creditor hierarchy. As such equity and bonds will be accessed before Council deposits and therefore, banks with more equity and debt have a greater buffer before Council deposits are exposed.

Liquidity is management through daily cashflow monitoring and longer-term forecasting to ensure funds are available to meet cash requirements as they fall due. This is achieved by structuring term deposits to meet large outflows, normally with the DMADF or other local authorities, and having an allocation to instant access facilities, normally AAA rated Money Market Funds, to meet smaller commitments and allow daily flexibility.

Yield is only considered once the first two criteria have been satisfied. The Council will then select the counterparty which delivers the best yield on a like for like security and liquidity basis.

Within the Treasury Management framework an emerging consideration is being introduced as best practice and covers Environmental, Social and Governance (ESG) considerations. In terms of the Council's investments, day-to-day Treasury is operational rather than strategic, so is very short-term in nature. However, despite there not being a need for a strategic ESG requirement, the Council aims to be a responsible investor. As such all banks, building societies and money market funds appearing on the Council's current counterparty list are signatories to the UN Principles for Responsible Investment. In addition, all money market funds are signatories to the Net Zero Asset Managers Alliance and/or the UK Stewardship Code.

Capital Financing Requirement

The Council has a statutory requirement to deliver a balanced budget which means that from a Treasury revenue perspective, money paid out is balanced with money received. Therefore, other than any potential cashflow timing differences, the Council will only need to borrow for long-term capital purposes.

Capital expenditure plans must be prudent, affordable, and sustainable.

- Prudent in meeting service needs and providing value for money
- Affordable in terms of acceptable Council Tax / Rent levels
- Sustainable over the long-term – i.e. requires asset management planning

The Capital Financing Requirement (CFR) reflects the Council's underlying need to finance capital expenditure by debt. This is the underlying requirement to hold debt, not a requirement to borrow more money in-year.

Debt in this sense includes borrowing including short and long-term loans and other long-term liabilities such as finance leases and, PFI's. Actual debt will rarely equal the CFR exactly due to timing differences between expenditure and loans being raised. This results in under or over borrowing against CFR. Under borrowing is sometimes referred to as internal borrowing.

To illustrate this concept the table below shows a simplified example.

Activity	Value £k
Capital Spend	1,000
Less Capital Receipts	(100)
Less Capital Grants	(200)
Less MRP	(100)
CFR	**600**
Less Reserves	(300)
Less Working Capital	(100)
Balance	200
Borrowing	**(300)**
Cash in Bank	100

This example shows a CFR of £600k but borrowing of only £300k. The internal borrowing is made up of £400k of reserves and working capital. This approach is generally preferred as debt costs normally exceed investment income. It is therefore more cost efficient to use reserves and working capital to cover borrowing rather than to seek investment return from those reserves and working capital.

Borrowing

Borrowing is split between the General Fund and Housing Revenue Account (HRA) and will have a cost implication on either council tax or housing rents in the form of a MRP, Minimum Revenue Provision (or debt repayment equivalent for the HRA) and loan interest. The MRP is the amount set aside to ultimately repay debt. Interest is the cost of having access to capital funds. Increasing capital spend therefore has the effect of increasing council tax and housing rents respectively.

The Council mainly sources long-term borrowing from the Public Works Loan Board (PWLB) managed by the Government's Debt Management Office. This is the generally the most cost efficient and flexible source of funding. Interest rates are directly linked to UK gilts and are therefore one of the cheapest sources of borrowing for a local authority. Rates are currently gilts +1% but the Council has access to a certainty rate of gilts +0.8%. There is also currently a temporary special rate assignable to the HRA to encourage new house building of gilts +0.4%.

For shorter term borrowing, better value can be found in the inter-local authority market. The Council sources this borrowing from other councils.

When borrowing the Council needs to take into consideration interest rate risk and refinancing risk. As such maturities of loans are spread over a number of years to ensure when debt needs to be refinanced only an element is subject to the prevailing rates. In addition, the Council needs to have an element of stability relating to interest costs so will have a portion of its loan portfolio at fixed rates. Conversely to have access to flexibility and potential for short-term cost savings an element of debt is designated at variable rates. To hedge the risk of increasing rates this allocation broadly matches investment levels so any increase in cost is offset by an increase in investment income.

The Council is not allowed to borrow solely for the purposes of investment return.

Reporting and Oversight

There are numerous reports associated with Treasury Management and as a minimum management receive daily investment decision approval, weekly and monthly summary reporting. Cabinet receive monthly updates and Full Council receive the Annual Treasury Management Strategy Statement, Investment Strategy, Capital Strategy and MRP policy for formal approval. Treasury budgeting forms part of the Council's overall monthly budget reporting process.

As part of the reporting regime CIPFA's Prudential Code sets out a number of indicators (Prudential Indicators) which provide information and set limits on treasury activities. These are included within the Annual Strategy documents and are monitored throughout the year to ensure compliance, and include:

- Authorised Limit and Operational Boundary Limit
- Security - Portfolio average credit rating
- Liquidity Risk - Principal sums invested for periods longer than 364 days
- Interest Rate Risk - Upper limit on one-year revenue impact of a 1% rise in interest rates
- Maturity Structure of Borrowing
- Liability Benchmark
- Estimated and Actual Capital Expenditure
- Estimated and Actual Ratio of Financing Costs to Net Revenue Stream
- Capital Financing Requirement
- Actual External Debt

Budget Consideration

The treasury function is one element which feeds into the Councils overall budget monitoring. The financial affordability of capital projects in terms of costs relating to repay debt, interest costs, brokerage, and other associated costs, along with contrasting investment income all feed into the overall monthly budget monitoring process as well as the annual budget setting regime.

Economic Forecasting

Economic forecasting and ultimately the path of interest rates sets the basis for borrowing and investment activities. The Council's Treasury adviser provides interest rate forecasts based on government analysis and market intelligence. This information informs the Council when to borrow, duration and interest rate exposure. However economic forecasts cannot be completely replied upon and so the Council takes a balanced approach and varies its exposure when making borrowing decisions.

FINANCIAL IMPLICATIONS

General implications relating to the Treasury function are noted in the report.

LEGAL IMPLICATIONS

General implications relating to the Treasury function are noted in the report.

BACKGROUND PAPERS

None.