Borough of Pendle

REPORT OF:	**FINANCIAL SERVICES MANAGER**
TO:	**EXECUTIVE**
DATE:	**15th MARCH 2018**

Contact Details: Vince Green
Tel. No: 01282 661867
E-mail: vince.green@pendle.gov.uk

TREASURY MANAGEMENT STRATEGY STATEMENT 2018/19

PURPOSE OF REPORT

1. The purpose of the report is to present for approval the Annual Treasury Management Strategy Statement for 2018/19.

RECOMMENDATIONS

2. The Executive is recommended to submit the following to Council for approval:

   a) The Treasury Management Strategy Statement (TMSS), Minimum Revenue Provision Policy Statement the Annual Investment Strategy (AIS) for 2018/19 at **Appendix A** and in particular:-

      i) The prudential Indicators and limits referred to in Sections 2 and 3 of the Strategy document;

      ii) The statement by the Financial Services Manager, shown below at paragraph 9 of this report indicating compliance with the requirement to keep borrowing below the Council's Capital Financing requirement over the medium-term;

      iii) The revised policy on the Minimum Revenue Provision for 2018/19 (Section 5.1.2 page 19 of the Strategy) including the circumstances in which MRP may not be required.

REASONS FOR RECOMMENDATION

3. To comply with the CIPFA Treasury Management Code of Practice (recently updated), the Council's Treasury Management Policy and good practice generally.

ISSUE

4. Attached at **Appendix A** is the Council's Treasury Strategy for Statement for 2018/19. The Strategy document sets out how the investment and borrowing operations of the Council are to be managed within the framework established by the Treasury Management Policy Statement.

5. The document also reflects the requirements of the Local Government Act 2003 which places a duty on Local Authorities to:-

   a) determine affordable borrowing limits which are calculated in accordance with the Prudential Code for Capital Finance in Local Authorities. Section 2 and 3 of the Strategy provides more detail of the Prudential Code and the relevant limits proposed for the Council, for 2018/19 and over the medium term period to 2020/21.

   b) comply with Section 15 of the Act which requires local authorities to have regard to such guidance as may be issued by the Secretary of State for Housing, Communities and Local Government. The statutory guidance on local government investments (3rd edition) is relevant in this respect and effective for financial years commencing on or after 1st April 2018. The Annual Treasury Management Strategy Statement incorporates the Council's Annual Investment Strategy in Section 4 of **Appendix A.**

<u>Annual Minimum Revenue Provision Policy Statement</u>

6. The Strategy document also includes, in section 5.1.2 on page 19 of **Appendix A**, a statement on the Minimum Revenue Provision which is a requirement arising out of the Local Authorities (Capital Finance and Accounting) (England) Regulations.

7. The Minimum Revenue Provision (MRP) is the annual charge to the Council's revenue accounts for the repayment of debt. Prior to the new regulations, the annual MRP was the result of complex calculation based on notional amounts of debt. The regulations simplified and introduced a degree of flexibility to the calculations and also attempted, in the case of unsupported borrowing, to link the MRP charge to the estimated life of the borrowing for specific assets.

8. Since 2008, the calculation of the annual MRP charge has consisted of 2 elements as follows:

   - Pre-2008 legacy debt – calculated at 4% on a reducing balance basis;
   - Post-2008 debt – calculated on an annuity basis such that the debt is repaid over the life of the capital expenditure financed by borrowing.

9. For 2018/19 no change is proposed in respect of the post-2008 debt. However, the current methodology for the pre-2008 debt does not result in the debt being fully discharged. The applicable amount of debt subject to this part of the calculation as at 1/4/18 is estimated at £3.16m. Applying repayments at 4% per annum on a reducing balance basis it takes 84 years before the debt falls below £100k.

10. Given the financial pressures facing the Council over the medium-term consideration has been given to the scope to adopt a variant methodology for MRP in relation to the pre-2008 debt. The objective being to deliver savings over the medium term whilst ensuring the debt is fully repaid in a way that can still be considered 'prudent'.

11. One way of achieving the above objectives is to charge MRP on a straight line basis over a defined number of years. The suggested duration is 40 years.

12. The rationale for this term being that the maximum period for charging MRP on the basis of an assets useful life is normally 50 years. However, 10 years has elapsed since the 2008 regulations came in to force leaving a residual period of 40 years to stay within the maximum period expected under the regulations.

13. Adopting a term of 40 years equates to an annual charge from 1/4/18 of 2.5% per annum. This is below the current charge of 4% per annum and hence results in savings on MRP for the pre-2008 debt. These savings span a period to 2030 but thereafter the MRP charge increases under this revised method. The annual savings span the range £47k in 2018/19 falling to £2k in 2029/30. Thereafter the charge gradually increases until the final payment is made in 2057/58. This option does, however, result in the debt being fully discharged whereas under the current approach debt of £617k will still be outstanding by 2058.

14. The Council must have regard to the guidance issued by the MHCLG. This guidance has recently been updated albeit that this latest guidance only takes effect for financial years commencing on or after 1st April 2019.

15. Neither the current, nor the forthcoming guidance, include the variant option now being proposed for 2018/19. The guidance does state that '*local authorities can vary the methodologies that they use to make prudent provision during the year'.* It is for the Council to consider what is prudent although it is clear from the guidance that MRP cannot be nil or negative.

16. Officers consider the change proposed for 2018/19 to be prudent and will ensure that the debt is fully discharged in a shorter period than the existing arrangement. It will also deliver savings over a period which is critical to the council as it seeks to balance its financial position in the period to 2020/21. Subject to the agreement of Council the revised methodology will be applied from 1/4/18.

17. If this change is agreed, officers will consult with Grant Thornton, as the appointed auditor to the Council to establish if they have any concerns or objections to the revised methodology and update Councillors as appropriate following this.

Statement of Prudential Limits

18. Members should note that the Chief Finance Officer, as the Council's s151 Officer, is required to provide a statement indicating the Council's external borrowing will not exceed the capital financing requirement over the medium term. The Strategy statement provides details that show this limit should not be breached (refer to Table in Section 3.1 on page 8 of the Strategy document for details) and as a result the Financial Services Manager provides the following statement for approval by the Council:-

"The Financial Services Manager reports that in 2016/17 the Council complied with the requirement to ensure that its gross external debt did not exceed the total of the CFR as projected over the medium-term and that this position is expected to be maintained for both 2017/18 and the forthcoming financial year. This view takes into account current commitments, existing plans, and the schemes proposed as part of the Council's capital programme as approved by the Council on 22nd February 2018".

Treasury Management Code of Practice (2017) – "The Code"

19. In December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance

these purchases, or the use of existing cash balances. Both actions would affect treasury management.

20. The codes require all local authorities to produce detailed Capital Strategies, though CIPFA accepts that authorities may not be able to implement this in the 2018-19 budget cycle. The Capital Strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability. The development of a Capital Strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members. A draft Capital Strategy was presented to the Council in February 2018.

21. The Code revision follows developments in the marketplace and a more 'commercialised' approach being adopted by the sector. It acknowledges that non-financial assets may not be managed as part of normal treasury management activity but expects *all* investments to be subjected to appropriate investment management and risk management frameworks covered by the Code. The acquisition of No1 Market Street and the recent loan advance to Pendle Leisure Trust could be considered non-treasury investments, although the primary objective of these decisions to support service delivery outcomes may outweigh the Code's reference to such activity being *primarily* for financial return.

22. The role of the Chief Finance Officer has been extended within the attached TMSS to cover additional functions such as preparation of a Capital Strategy and provision of information to members of all material non-financial investments (examples as above).

23. Treasury Management Practices (TMPs) will be reviewed and submitted to the Accounts and Audit Committee for approval in March 2018.

Annual Investment Strategy (AIS) – "Ring-Fencing"

24. The largest UK banks are required by UK law to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing".

25. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and other designated deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure.

26. In general, simpler activities offered from within a ring fenced bank (RFB) will be focussed on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity – a non-ring fenced bank (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

27. The Council's Treasury Advisors, Link Asset Services (LAS), anticipate the impact on Local Authorities to be minimal. In most cases, the expectation is that Local Authority activity will sit in the RFB structure but with the ability to access products that are not allowed to be conducted within an RFB should they so desire – and that are covered by the approved AIS and TMSS.

28. It is important to note that the change in structures and creation of separate entities will attract their own assessments from the ratings agencies. Any entity being considered for a potential investment will continue to be subject to scrutiny, as outlined in the attached TMSS document. The quality and suitability of the counterparty will override the RFB or NRFB status.

IMPLICATIONS

Policy

29. The Annual Treasury Management Strategy has been produced in compliance with the requirements of the Councils' Treasury Management Policy which the Council has previously approved and formally adopted specific clauses as per recommendations in the CIPFA Code of Practice on Treasury Management.

30. CIPFA has changed their definition of Treasury Management as per the 2017 Code, adding 'borrowing' to the previous definition, in addition to the management of a Local Authority's investments and cash-flows.

Financial

31. The financial implications associated with the Annual Treasury Strategy are incorporated in the Council's General Fund Revenue Budget for 2018/19 as approved by Council on 22nd February 2018.

32. The financial implications for 2018/19 primarily reflect the external interest cost of £872k (including premia/discounts) associated with the Council's outstanding long-term debt and the Minimum Revenue Provision (a mechanism to provide for the repayment of loan principal) of £586k. Investment income for the year has been budgeted at £60k.

Legal

33. In accordance with the Local Government Act 2003, Councillors are required to approve the Annual Treasury Management Strategy incorporating the Annual Investment Strategy, the prudential indicators, and the authorised limit for external debt, which are provided in the Annual Treasury Strategy attached at **Appendix A.**

34. With effect from 1 January 2019, the largest UK banks will be required by law to separate their core retail banking services from their investment and international banking activities. This "ring-fencing" requirement is referred to in the main body of the report.

Risk Management

35. There are no direct risk management implications arising from the contents of this report. Treasury activities are undertaken within the Council's Treasury Management Policy and risk is managed through the application of the requirements of Treasury Management Practice notes (an update of the Council's TMPs will be reported to the Accounts and Audit Committee at its March 2018 meeting). The Strategy includes details of some of the risks associated with the Council's treasury management operations and how these will be manged.

Health and Safety

36. There are no health and safety implications arising directly from the contents of this report.

Sustainability Implications

37. There are no sustainability implications arising directly form this report.

Community Safety:

38. There are no community safety issues arising directly from the contents of this report.

Equality and Diversity:

39. There are no equality and diversity implications arising from the contents of this report.

APPENDICES

Appendix A – Treasury Management Strategy Statement including MRP Policy and Annual Investment Strategy 2018/19.

LIST OF BACKGROUND PAPERS

None