APPENDIX A

1. INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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."

Revised reporting is required for the 2019/20 budget cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately, alongside the 5 Year Capital Programme.

This authority has not engaged in any commercial investments and currently has no non-treasury investments.

1.2 Reporting Requirements

Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability

The aim of the capital strategy is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

Treasury Management Reporting

The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) – The first, and most important, report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed)

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to Council. This role is undertaken by Scrutiny Committee and the Cabinet Executive.

1.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues
- The capital plans and the prudential indicators;
- The minimum revenue provision (MRP) policy.

Treasury Management issues
- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy
- Creditworthiness policy; and
- Policy on the use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Minister of Housing, Communities and Local Government (MHCLG) MRP Guidance, the CIPFA Treasury Management Code, and MHCLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Cabinet members received refresher training from our treasury consultants, Link Asset Services, in October 2018.

The training needs of treasury management officers are periodically reviewed to ensure that they are kept up to date with changes to best practice and legislation.

1.5 Treasury Management Consultants

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members to overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those previously agreed, and those forming part of this budget cycle. This indicator also covers how those plans are to be financed by capital or revenue resources. Members are asked to approve the estimated capital expenditure and resources in the table below. Any shortfall in resources results in a need to borrow.

	2017/18 Actual £000	2018/19 Revised £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Capital Expenditure	**2,213**	**7,481**	**7,062**	**2,601**	**1,185**
Financed by: Capital Receipts	(118)	(299)	(250)	(250)	(250)
Capital Grants & Contributions	(867)	(1,830)	(500)	(500)	(500)
Capital Reserves	(22)	(532)	(266)	0	0
Revenue Contributions	(203)	(783)	0	0	0
Net financing need for the year	**1,003**	**4,037**	**6,046**	**1,851**	**435**

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It represents a measure of the Council's underlying need to borrow. Any capital expenditure above, which has not immediately been paid for, will increase the CFR. The CFR does not increase indefinitely, as the MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The CFR includes any other long term liabilities such as finance leases. Whilst this increases the CFR and, therefore, the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has just under £0.5m of finance lease liabilities within the CFR.

The Council is asked to approve the following CFR projections:

	2017/18 Actual £000	**2018/19 Revised £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Total CFR	10,299	10,279	15,460	16,156	15,278
Movement in CFR	234	(20)	(5,181)	696	(878)

Movement in CFR Represented By:					
Net financing need for the year (above)	1,003	4,037	6,046	1,851	435
MRP and other financing movements	(769)	(4,057)	(865)	(1,155)	(1,313)
Movement in CFR	234	(20)	(5,181)	696	(878)

2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed in the following table are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

	2017/18 Actual £000	**2018/19 Revised £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Fund Balances & Reserves	(10,617)	(7,302)	(6,521)	(6,505)	(6,394)
Capital Receipts	(1,159)	(986)	(876)	(766)	(656)
Provisions	(2,113)	(2,377)	(2,673)	(3,544)	(4,238)
Other	(487)	(437)	(387)	(337)	(287)
Total Core Funds	**(14,376)**	**(11,102)**	**(10,457)**	**(11,152)**	**(11,575)**
Working Capital*	(6,535)	(9,971)	(7,995)	(4,199)	(2,606)
(Over)/Under Borrowing	6,898	7,073	6,452	5,351	4,181
Expected Investments	**(14,013)**	**(14,000)**	**(12,000)**	**(10,000)**	**(10,000)**

* Working capital balances shown are estimated year end; these may be higher mid year.

2.4 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full Council to approve an **MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1st April 2008 or which in the future will be Supported Capital Expenditure, the policy will be that MRP will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance (the Regulatory Method).

The remaining expenditure reflected within the debt liability will be subject to MRP under option 3 of the guidance (Asset Life Method), which will be charged over a period which is reasonably commensurate with the estimated useful life applicable to the nature of the expenditure, using the equal instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from such expenditure. Whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The following table gives an indication of the useful asset lives of different categories of assets/capital expenditure type, and hence the period over which MRP will be charged.

Capital Expenditure incurred on:	Estimated Asset Life for MRP purposes
Construction of new buildings	40 – 60 years
Disabled Facilities Grants – Stairlifts	5 years
Disabled Facilities Grants – Bathrooms/Major Adaptations	20 years
Enhancement and refurbishment of land and buildings	10 years
Refuse vehicles	10 years
Other vehicles, plant and equipment	5 – 10 years
Other capital grants	5 years
IT Systems	5 years

MRP in respect of assets acquired under Finance Lease will be charged at a rate equal to the principal element of the annual lease rental for the year in question.

MRP Overpayments - A revision to the MHCLG MRP Guidance allows that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. This situation does not currently apply to Blaby.

2.5 Affordability prudential indicators

The previous sections deal with the prudential indicators relating to overall capital expenditure and control of borrowing, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall financial position. The Council is asked to approve the following indicators:

2.6 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in the budget report.

	2017/18 Actual	**2018/19 Revised**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
General Fund	7.79%	8.68%	8.84%	11.31%	12.28%

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The overall treasury management portfolio as at 31st March 2018 is shown below compared with the position as at 31st January 2019.

	Actual 31/03/18 £000	Actual 31/03/18 %	Actual 31/01/19 £000	Actual 31/01/19 %
Treasury Investments				
Banks	3,680	26%	13,221	45%
Building Societies (Rated)	0	0%	2,000	7%
Local Authorities	9,000	65%	4,000	14%
Money Market Funds	1,250	9%	10,000	34%
Total Treasury Investments	**13,930**	**100%**	**29,221**	**100%**
External Borrowing				
Public Works Loans Board	2,945	100%	2,848	100%
Total External Borrowing	**2,945**	**100%**	**2,848**	**100%**
Net Treasury Investments/(Borrowing)	**10,985**		**26,373**	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

	2017/18 Actual £000	2018/19 Revised £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
External Debt					
Debt at 1st April	3,135	2,945	2,750	8,552	10,349
Expected change in debt	(190)	(195)	5,802	1,797	293
Other long term liabilities (OLTL)	456	456	456	456	456
Expected change in OLTL	0	0	0	0	(1)
Actual Gross Debt at 31st March	**3,401**	**3,206**	**9,008**	**10,805**	**11,097**
Capital Financing Requirement	**10,299**	**10,279**	**15,460**	**16,156**	**15,278**
Under/(over) borrowing	**6,898**	**7,073**	**6,452**	**5,351**	**4,181**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross 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 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Strategic Director (Section 151) is pleased to report that the Council complied with this prudential indicator in the current year, and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

3.2 Treasury Indicators – limits to borrowing activity

The operational boundary – This is the limit which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary	2018/19 Revised £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Borrowing	5,980	11,380	13,180	13,630
Other long-term liabilities	500	500	500	500
Total	6,480	11,880	13,680	14,130

The authorised limit for external debt - A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

- The Council is asked to approve the following authorised limit:

Authorised limit	2018/19 Revised £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Borrowing	6,644	12,644	14,644	15,144
Other long-term liabilities	556	556	556	556
Total	7,200	13,200	15,200	15,700

3.3 Prospects for interest rates

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

	Bank Rate	LIBID Rates		PWLB Borrowing Rates (including certainty rate adjustment)			
		3 Mth	12 Mth	5 year	10 year	25 year	50 year
Mar 2019	0.75%	0.90%	1.20%	2.10%	2.50%	2.90%	2.70%
Jun 2019	1.00%	1.00%	1.30%	2.20%	2.60%	3.00%	2.80%
Sep 2019	1.00%	1.10%	1.40%	2.20%	2.60%	3.10%	2.90%
Dec 2019	1.00%	1.20%	1.50%	2.30%	2.70%	3.10%	2.90%
Mar 2020	1.25%	1.30%	1.60%	2.30%	2.80%	3.20%	3.00%
Jun 2020	1.25%	1.40%	1.70%	2.40%	2.90%	3.30%	3.10%
Sep 2020	1.25%	1.50%	1.80%	2.50%	2.90%	3.30%	3.10%
Dec 2020	1.50%	1.50%	1.90%	2.50%	3.00%	3.40%	3.20%
Mar 2021	1.50%	1.60%	2.00%	2.60%	3.00%	3.40%	3.20%
Jun 2021	1.75%	1.70%	2.10%	2.60%	3.10%	3.50%	3.30%
Sep 2021	1.75%	1.80%	2.20%	2.70%	3.10%	3.50%	3.30%
Dec 2021	1.75%	1.90%	2.30%	2.80%	3.20%	3.60%	3.40%
Mar 2022	2.00%	2.00%	2.40%	2.80%	3.20%	3.60%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor’s fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.
- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

3.4 Borrowing Strategy

The Council's capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary borrowing measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

It is not considered necessary to fully close the gap between borrowing and the CFR given the situation that the Council currently holds relatively healthy balances and reserves. However, it is recognised that, in the longer term, it is not sustainable to use internal balances to support capital expenditure in lieu of borrowing.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Strategic Director (S151) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp **fall** in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper **rise** in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

The Council is, however, in a strong position to respond to market changes as the majority of its existing debt is relatively short-dated and will mature within a few years. This also reduces any immediate underlying need to reschedule debt.

3.5 Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than the sum of the expected increase in borrowing need (CFR) over the three year planning period; and
- The Council would not look to borrow more than 24 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (i.e. premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Cabinet Executive at the earliest meeting following its action.

3.7 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the near future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing if it is deemed appropriate.

4. ANNUAL INVESTMENT STRATEGY

4.1 Investment policy – management of risk

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance"), the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"), and the CIPFA Treasury Management Guidance Notes 2018.

The Council's investment priorities will be security first, portfolio liquidity second, then return.

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

2. Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

3. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4. This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix D under the categories of 'specified' and 'non-specified' investments.

    - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
    - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified investments limit.** The Council does not currently place a limit on the maximum total exposure to non-specified investments as a percentage of the total investment portfolio.

6. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2.

7. **Transaction limits** are set for each type of investment in Appendix D.

8. This authority will set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 4.4).

9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 4.3).

10. This authority has engaged external consultants, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

11. All investments will be denominated in sterling.

12. As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1st April 2018. The Council currently holds no investments of the type that might be subject to a movement in valuation. However, in December 2018 Council gave approval to the investment of a maximum of £1m in a Property Fund to be identified.

However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year

The above criteria are unchanged from last year.

4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's, and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ranges;
- sovereign ratings to select counterparties from only the most creditworthy countries.

This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will, therefore, use counterparties within the following durational bands:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (nationalised/or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used (NB: except building societies)

	Colour/long term rating	Money and/or % limit	Time Limit
UK Banks/Non-UK Banks	Yellow	£5m/£3m	5 years
UK Banks/Non-UK Banks	Purple	£5m/£3m	2 years
UK Bank – LA Mortgage Scheme	Blue	£2m	5 years
UK Banks/Non-UK Banks	Orange	£5m/£3m	1 year
Banks – part nationalised • RBS	Blue	£8m	1 year
UK Banks/Non-UK Banks	Red	£8m/£5m/£3m	6 months
UK Banks/Non-UK Banks	Green	£5m/£3m	100 days
UK Banks/Non-UK Banks	No colour	n/a	n/a
Building Societies	No colour/P-2	£5m	100 days
Council's own banker (not meeting usual criteria)	No colour	£5m	Overnight
DMADF	AAA	unlimited	6 months
Local authorities	n/a	£5m	5 years
Money Market Funds			
• CNAV	AAA	£5m	Liquid
• LVNAV	AAA	£5m	Liquid
• VNAV	AAA	£5m	Liquid

In respect of building societies, the Council will use those societies that have assets in excess of £1 billion, subject to them having a minimum credit rating of P-2 (Moody's).

The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not place undue emphasis on just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1, and a long term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
All credit ratings will be monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in CDS spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support for banks to help to underpin its decision making process.

UK banks – ring fencing

The largest UK banks, i.e. those with more than £25bn of retail/Small and Medium-sized Enterprise (SME) deposits, 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". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused 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.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Country limits

Whilst the Council has determined that it will not limit investments to UK banks, it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent counterparty rating). Furthermore the maximum amount which may be invested with non-UK banks will be limited to £3m per institution. The list of countries that qualify using the sovereign credit rating criteria as at the date of this report are shown in Appendix F. This list will be maintained by officers in accordance with this policy if ratings change.

4.4 Investment strategy

In-house funds - investments will be made with reference to the core balance and cash flow requirements and the outlook for short term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The internally managed funds are now budgeted to realise net investment interest of £150,000 during 2018/19 against an original estimate of £80,000. It is envisaged that the Council will continue to operate with a cash flow surplus throughout 2019/20. Investment rates will remain relatively low. Accordingly, in-house investments are also estimated to generate interest income of around £150,000 in 2019/20.

The Council’s proposed Approved Counterparty List appears at Appendix E.

Investment returns expectations - Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.50%

The overall balance of risks to economic growth in the UK is probably neutral. The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Investment treasury indicator and limit - Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of investments after each year-end.

The Council is asked to approve the following treasury indicator and limit:

Maximum principal sums invested for more than 365 days	**2018/19**	**2019/20**	**2020/21**
Principal sums invested> 365 days	£6.0m	£6.0m	£6.0m
Current investments as at 31/01/19 in excess of 1 year maturing in each year	£0.0m	£0.0m	£0.0m

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

4.5 Performance indicators

The Council will use the uncompounded 7 day LIBID rate as a benchmark against which it will assess the performance of its investment portfolio.

4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.