Appendix 8

Boston Borough Council

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2019/20

Effective from 31 March 2019

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1. INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget annually, 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 risk appetite, providing adequate security and 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.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

The Chartered Institute of Public Finance and Accountancy (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 reporting cycle due to revisions of the Ministry for Housing, Communities and Local Government (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.

1.2 Reporting Requirements

1.2.1 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 on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

The capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy shows:

- the corporate governance arrangements for these types of activities;
- any service objectives relating to the investments;
- the expected income, costs and resulting contribution;
- the debt related to the activity and the associated interest costs;
- the payback period (MRP policy);
- for non-loan type investments, the cost against the current market value;
- the risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

If any non-treasury investment sustains a loss during the year, implications upon the final accounts and audit process, the strategy and revenue will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between treasury and non-treasury operations, high-level comparators are shown throughout this report.

1.2.2 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 is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision (in addition, this Council receives quarterly update reports).

An annual treasury report – This is a backward looking review document and 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 the Council. This role is undertaken by the Overview and Scrutiny - Corporate and Community Committee and the Audit and Governance Committee.

1.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital issues
- the capital expenditure plans and the associated 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
- the policy on use of external service providers.

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

1.4 Recent Treasury experience

The Council's treasury portfolio position at 30 November 2018 comprised:

Table 1: Current portfolio position

		£m	£m	Average Rate %
External Borrowing	PWLB	-		
	Local Authorities	12.50		0.75%
	Market	1.00		11.13%
Total Debt			**13.50**	
Investments				
Treasury Investments	Banks		10.14	0.61%
Non Treasury	Property Funds		20.81	3.08%
Total Investments			**30.95**	

The Council's portfolio of cash balances held at 30 November 2018 is set out in Table 2 below with the latest valuation of property funds shown in Tables 3 and 4.

Table 2: Counterparty List and Cash Balances at 30 November 2018

Financial Institution	Amount £'000	Length of Investment	Interest Rate	Link colour rating
HSBC	2,375	Call	0.43%	Orange (12 months)
	14	Current a/c	0.00%	
Santander	3,000	95 day notice	0.85%	Red – 6 months
Barclays	2,000	95 day notice	0.95%	Red – 6 months
Bank of Scotland	750	1 year	0.90%	Orange (12 months)
	750	1 year	1.05%	Orange (12 months)
	250	1 year	1.00%	Orange (12 months)
	1,000	1 year	0.85%	Orange (12 months)
	10,139			

Table 3: Property Fund Valuation (Initial £1m Investment) at 30 November 2018

Fund	Initial Investment £'000	Current Valuation £'000	Capital Growth £'000	%
Black Rock	500	574	74	
Schroders	250	295	45	
Threadneedle	250	268	18	
	1,000	**1,137**	**137**	**13.7**

Table 4: Property Fund Valuation (New Holdings) at 30 November 2018

Fund	Initial Investment £'000	Current Valuation £'000	Capital Growth £'000	%
Black Rock	4,000	4,013	13	
Schroders	4,000	4,058	58	
Threadneedle	3,989	3,882	(107)	
M&G	4,000	3,941	(59)	
AEW	4,000	3,777	(223)	
	19,989	**19,671**	**(318)**	**(1.59)**

The difference between initial investment and current valuation for new property fund holdings with Threadneedle, M&G and AEW reflect the premiums payable against the Funds' 'Net Asset Value' price at the settlement date.

1.5 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The Council has addressed this by targeted training courses for relevant members.

In addition, Officer training is identified through the appraisal process and is also supplemented by both targeted training as necessary and technical advice from our treasury management advisors.

1. 6 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 the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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.

The scope of investments within the Council's operations now includes both conventional treasury investments (the placing of residual cash from the Council's functions), and Commercial Property Fund investments. The Council's Property Fund acquisitions required specialist advice, which was provided by Link Asset Services.

2. The Capital Prudential Indicators 2018/19 to 2023/24

2.1 Introduction

The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, reflecting the outcome of the Council's underlying capital appraisal systems. This report updates currently approved indicators.

2.2 The Capital Expenditure Plans

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

- service objectives (e.g. strategic planning);
- stewardship of assets (e.g. asset management planning);
- value for money (e.g. option appraisal);
- prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- affordability (e.g. implications for council tax);
- practicality (e.g. the achievability of the forward plan).

The revenue consequences of capital expenditure need to be paid for from the Council's own resources.

Capital expenditure can be paid for immediately (by applying capital resources such as capital grants and contributions or by use of revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's underlying borrowing need, measured as the Capital Financing Requirement (CFR).

The Council is asked to approve the summary capital expenditure projections below. The current estimate for 2018/19 is subject to change and will be finalised as part of year end accounts process.

Table 1: Estimates of Capital Expenditure and Financing

	'17/18 Actual £'000	'18/19 Est. £'000	'19/20 Est £'000.	20/21 Est. £'000	'21/22 Est. £'000	'22/23 Est. £'000	'23/24 Est. £'000
Capital Expenditure							
Services	2,215	4,007	4,449	761	623	310	310
Property Funds	-	20,000	-	-	-	-	-
Total	**2,215**	**24,007**	**4,449**	**761**	**623**	**310**	**310**
Financed by:							
Capital Grants and Contributions	1,989	2,953	2,685	439	439	280	280
Revenue Resources	226	1,054	1,764	322	184	30	30
Net financing need for the year	**-**	**20,000**	**-**	**-**	**-**	**-**	**-**

The Property Funds were part-financed from PWLB long term borrowing, at fixed rates averaging 2.5% for 50 years.

It should be noted that as in-year changes to the Capital Programme are made, their impact on the prudential indicators will be reported via interim reports to both Cabinet and the Audit and Governance Committee.

2.3 The Council's Borrowing Need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and so charges the economic consumption of capital assets as they are used. The Council's MRP policy is shown at 2.4.

The Council is asked to approve the CFR projections below:

Table 2: Estimates of Capital Financing Requirement

	'17/18 Actual £'000	**'18/19 Est. £'000**	**'19/20 Est. £'000**	**'20/21 Est. £'000**	**'21/22 Est. £'000**	**'22/23 Est. £'000**	**'23/24 Est. £'000**
Capital Financing Requirement							
Total CFR	459	20,459	20,459	20,459	20,459	20,459	20,459
Movement in CFR	-	20,000	-	-	-	-	-

Movement in CFR represented by							
Net financing need for the year	-	20,000	-	-	-	-	-
MRP and other financing movements	-	-	-	-	-	-	-
Movement in CFR	-	20,000	-	-	-	-	-

2.4 Minimum revenue provision (MRP) policy statement

If it has a positive Capital Financing Requirement (CFR) the Council is required to consider paying off an element of the accumulated positive sum through a charge to revenue (known as the Minimum Revenue Provision - MRP). The Council can also undertake additional voluntary payments if it chooses (Voluntary Revenue Provision - VRP).

MHCLG regulations 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 2019/20 -

From 1 April 2008 for all unsupported borrowing the MRP policy will be either:

- asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction); or

- depreciation method – MRP will follow standard depreciation accounting procedures.

These options provide for a reduction in the borrowing need over approximately the asset's life.

Assets held for Investment purposes

Where the Council holds investment assets it will determine the amount of MRP or VRP on the basis of each holding and how any repayment of debt will be made at the time that any borrowing falls due to be repaid.

The Council will monitor the performance of its Property Fund holdings on a regular basis with performance reported to Audit and Governance Committee quarterly. A decision will then be taken at the end of the financial year as to the appropriate level of MRP/VRP required.

MRP Overpayments

A change introduced by the revised MHCLG MRP Guidance was the allowance 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. Up to 31 March 2019 there have been no VRP overpayments.

2.5 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 below are estimates of the year end balances for each resource and anticipated day-to-day cash flow balances (these balances will either be held as cash or cash equivalents or be used to support internal borrowing).

Table 3: Expected Investment Position

	'17/18 Act. £'000	'18/19 Est. £'000	'19/20 Est. £'000	'20/21 Est. £'000	'21/22 Est. £'000	'22/23 Est. £'000	'23/24 Est. £'000
General Fund	2,000	2,000	2,000	2,000	2,000	2,000	2,000
Earmarked Reserves	8,741	9,509	8,607	9,720	10,928	12,191	13,311
BTAC	286	286	286	286	286	286	286
Capital Receipts	239	239	239	239	239	239	239
Capital Grants	768	598	329	329	329	329	329
Provisions	1,254	1,254	1,254	1,254	1,254	1,254	1,254
Collection Fund	(308)	(308)	-	-	-	-	-
Total Core Funds	**12,980**	**13,578**	**12,715**	**13,828**	**15,036**	**16,299**	**17,419**
Working Capital	(209)	(209)	(209)	(209)	(209)	(209)	(209)
Surplus Capital Resources	541	-	-	-	-	-	-
Internal Borrowing	**-**	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)	(4,000)
Expected Investments	**13,312**	**9,369**	**8,506**	**9,619**	**10,827**	**12,090**	**13,210**
Increase/(decrease) in expected investments	**-**	**(3,943)**	**(863)**	**1,113**	**1,208**	**1,263**	**1,120**

*balances shown are estimated year end figures and will fluctuate throughout the year

2.6. Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, 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 finances. The Council is asked to approve the following indicators:

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.

Table 4: Ratio of Financing Costs to Net Revenue Stream

%	'17/18 Act.	'18/19 Est.	'19/20 Est.	'20/21 Est.	'21/22 Est.	'22/23 Est.	'23/24 Est.
Services	0.40	0.21	0.32	(0.06)	(0.35)	(0.48)	(0.83)
Property Funds	(0.43)	(3.57)	(6.65)	(6.71)	(6.78)	(6.84)	(6.91)
Total	**(0.03)**	**(3.36)**	**(6.33)**	**(6.77)**	**(7.13)**	**(7.32)**	**(7.74)**

The estimates of financing costs include current commitments and the proposals in this budget report.

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 and the Council's capital strategy. 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 Council's treasury portfolio position at 31 March 2018, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 1: Current Portfolio Position

£'000	'17/18 Act. £'000	'18/19 Est. £'000	'19/20 Est. £'000	'20/21 Est. £'000	'21/22 Est. £'000	'22/23 Est. £'000	'23/24 Est. £'000
External Debt							
Debt at 1 April	1,000	1,000	16,459	16,459	16,459	16,459	16,459
Anticipated change in debt	**-**	15,459	-	-	-	-	-
Actual gross debt at 31 March	1,000	16,459	16,459	16,459	16,459	16,459	16,459
The Capital Financing Requirement	459	20,459	20,459	20,459	20,459	20,459	20,459
(Under)/ over borrowing	**541**	**(4,000)**	**(4,000)**	**(4,000)**	**(4,000)**	**(4,000)**	**(4,000)**

Within the above figures the level of debt relating to Property Fund acquisition investment is:

	'17/18 Act.	'18/19 Est.	'19/20 Est.	'20/21 Est.	'21/22 Est.	'22/23 Est.	'23/24 Est.
Actual Debt at 31 March £'000	1,000	16,459	16,459	16,459	16,459	16,459	16,459
Percentage of total external debt %	-	93.92%	93.92%	93.92%	93.92%	93.92%	93.92%

Within the range of 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 or speculative purposes.

The Chief Finance Officer reports 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 this budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond 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 and the ability to fund under-borrowing by other cash resources.

Table 2: Operational Boundary for External Debt

	'18/19 Est. £'m	'19/20 Est. £'m	'20/21 Est. £'m	'21/22 Est. £'m	'22/23 Est. £'m	'23/24 Est. £'m
Debt	22	22	22	22	22	22
Other long term liabilities	-	-	-	-	-	-
Total	**22**	**22**	**22**	**22**	**22**	**22**

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal 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.

a. 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.

b. The Council is asked to approve the following authorised limit:

Table 3: Authorised Limit for External Debt

	'18/19 Est. £'m	'19/20 Est. £'m	'20/21 Est. £'m	'21/22 Est. £'m	'22/23 Est. £'m	'23/24 Est. £'m
Debt	25	25	25	25	25	25
Other long term liabilities	-	-	-	-	-	-
Total	**25**	**25**	**25**	**25**	**25**	**25**

3.3 Maturity structure of borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. The Council is asked to approve the following treasury indicators and limits:

Maturity structure of fixed interest rate borrowing 2019/20		
	Lower	**Upper**
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%
Maturity structure of variable interest rate		

borrowing 2019/20		
Under 12 months	0%	100%
12 months to 2 years	0%	100%

3.4 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.

Link Asset Services Interest Rate View	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.10%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

Growth has been healthy since the August MPC meeting which raised the Bank Rate to 0.75%, but is expected to weaken somewhat during the last quarter of 2018. At their November 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. 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.

Rising bond yields in the US have caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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 have increased modestly since the summer. The initial approach of deferring new long term borrowing to finance Property Fund acquisitions by running down spare cash balances served well during the third quarter of 2018/19, but with reductions in December the decision was taken to borrow;

- 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.

3.5 Borrowing Strategy

In recent years, the Council maintained a slightly over-borrowed position, and up to 2017/18 borrowing consisted of a single market loan of £1m repayable in 2051.

During 2018/19, to take advantage of the historically low borrowing rates available, the Council increased the amount it borrowed by £15.459m, purchasing holdings in Capital Commercial Property Funds. This was undertaken carefully and the rationale is set out in the Capital Strategy approved by Council on 30 April 2018, in accordance with the Prudential Code and government guidance. At this stage the TMSS creates no capacity for further borrowing during the period to 2023/24. Should any opportunities arise for potential further borrowing during this time, detailed reports will be brought to members for consideration and approval prior to any new borrowing being undertaken.

3.6 Policy of 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 Capital Financing Requirement 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.

4. Annual Investment Strategy

4.1 Investment Policy – Management of Risk

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy (included in a separate report).

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

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

The guidance from the MHCLG and CIPFA places 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 section 7 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 has determined that it will limit the maximum total exposure to non-specified investments as being 90% of the total investment portfolio, (see paragraph 4.3).

6. **Lending limits,** Counterparty limits and duration are set out in paragraph 4.2.

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

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

9. 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.

10. All investments will be denominated in **sterling.**

11. 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. This change will, in the future, affect the accounting treatment in relation to the gain or loss on the value of the Council's Property Fund Holdings. MHCLG guidance allows for a Mandatory Statutory Override to apply for a five year period to 2023/24 which will see gains/losses taken to an unusable reserve with no resultant impact on the General Balance over this period.

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.

These 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 & 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 ratings;
- 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 as a guide:

- **Yellow** **5 years**
- **Blue*** **1 year**
- **Orange** **1 year**
- **Red** **6 months**
- **Green** **100 days**
- No Colour not to be used

***only applies to nationalised or semi-nationalised UK banks**

Counterparty limits are no more than £3m per counterparty and the counterparty group limit is £5m, with UK registered/domiciled banks, and for a period of no more than one year. The only exception to the £3m individual limit is if due to cash flow reasons all counterparties are being used to their maximum limit then any residual balances will be deposited in the Council's Call Account with HSBC. The balance on the call account should not exceed £5m.

Paragraph 1.4 of this Strategy document gives the currently used Counterparties. Changes to the investment policy can be authorised by the Section 151 Officer or the Deputy Section 151 Officer and thereafter will be reported to the Audit and Governance Committee. This is to cover exceptional circumstances so that instant decisions can be made in an environment which is both fluid and subject to high risk.

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 a daily 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 credit default swap 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, this Council will also use market data and market information to help support its decision making process.

UK banks – ring fencing

The largest UK banks (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

Due care will be taken to consider the exposure of the Council’s total investment portfolio to non-specified investments, countries, groups and sectors.

1. **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 90% of the total investment portfolio.
2. **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-.** The list of countries that qualify using this credit criteria as at the date of this report are shown below. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
3. **Other limits.** In addition:
    - no more than 20% will be placed with any non-UK country at any time;
    - limits in place above will apply to a group of companies;
    - sector limits will be monitored regularly for appropriateness.

Approved Countries for Investment

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

AA-

- Belgium
- Qatar

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. For its cash flow generated balances, the Council will seek to utilise its instant access call account and notice accounts (30 day and 95 day) in order to benefit from the compounding of interest. The Council's core funds available for investment are detailed in Table 3, paragraph 2.5 of this strategy.

- 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.

Investment return expectations

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

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

The Council is budgeting for investment returns over its Medium Term Financial Strategy as shown below:

Year	Cash Balances %	Property Funds %
2018/19	0.70	3.50
2019/20	1.00	3.00
2020/21	1.30	3.00
2021/22	1.40	3.00
2022/23	1.40	3.00
2023/24	1.50	3.00

The overall balance of risks to these forecasts is currently skewed to the upside and is dependent on how strong GDP growth turns out, how quickly inflation pressures rise 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 funds after each year-end. They relate at this stage to the capital investment in Property Funds.

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

Maximum principal sums invested > 365 days					
	'19/20	**'20/21**	**'21/22**	**'22/23**	**'23/24**
Principal sums invested > 365 days	£21m	£21m	£21m	£21m	£21m

4.5 Investment reporting

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report and a mid-year update report will also be presented to the Audit and Governance Committee. Any significant issues on a quarterly basis will be reported as part of the quarterly Finance and Performance report to Cabinet and any issues of concern regarding governance (for example risks concerning counterparties) will be reported to the next meeting of the Audit and Governance Committee.

5. Treasury Management Scheme of Delegation

The table below shows in terms of governance arrangements the various levels of responsibility with regards to the treasury function.

Table 1: Treasury Management Governance Arrangements

Area of Organisation	Responsibilities
1.Full Council	1.1 Approval of the annual Treasury Management Strategy Statement (TMSS) and any changes recommended by the Audit and Governance Committee
2.Cabinet	2.1 Budget consideration and approval 2.2 Updates on service and financial performance
3.Overview and Scrutiny - Corporate and Community Committee	3.1 Scrutiny of service and financial performance
4. Audit and Governance Committee	4.1 Approval of/amendments to the adopted clauses, TMSS and treasury management practices 4.2 Reviewing the TMSS and procedures and making recommendations to the responsible body 4.3 Approval of the division of responsibilities 4.4 Receiving and reviewing regular monitoring reports and ensuring recommendations are followed-up 4.5 Approving the selection of external service providers and agreeing terms of appointment

6. The Treasury Management Role of the Chief Finance Officer (Section 151 Officer)

The S151 Officer's main functions with regards to treasury are to:

- recommend clauses, treasury management policy/practices for approval, review them regularly, and monitor compliance
- submit regular treasury management policy reports
- submit budgets and budget variations
- receive and review management information reports
- review the performance of the treasury management function
- ensure the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensure the adequacy of internal audit, and liaise with external audit; and recommend the appointment of external service providers
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:

    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

- *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

7 Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' quality criteria where applicable.

		Minimum 'High Credit' Criteria
1	Debt Management Agency Deposit Facility	Government Secure
2	Term deposits with credit rated banks and building societies with maturities up to one year • UK nationalised banks • UK part nationalised banks • Non-UK domiciled banks*	Minimum Green colour rating – up to 100 days
3	Local Authorities with maturities up to one year	High Security, although Local Authorities are not credit rated.
4	Money Market Funds (CCLA)	Minimum AAA rated by one of the rating agencies
5	Business Reserve Accounts and Deposit Accounts with credit rated banks and building societies	Minimum Green colour rating – up to 100 days

* A maximum of 20% of the total portfolio will be invested in non-UK domiciled banks operating in countries with a minimum sovereign rating of AA+.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria. A maximum of 90% will be held in aggregate in non-specified investments.

	Minimum Credit Criteria
Term Deposits with credit rated deposit takers (UK banks and building societies).	Minimum Orange or blue colour rating –in excess of 1 year.
Callable Deposits with credit rated deposit takers (UK banks and building societies) with maturities greater than one year.	Minimum Orange or blue colour rating –in excess of 1 year.
Forward deals with credit rated deposit takers (UK banks and building societies)	Minimum Orange or blue colour rating –in excess of 1 year.
Property funds – in excess of one year*	N/a – see comment below

*The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources.

Interest Rate Forecasts 2018 – 2021

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Bank Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**0.75%**	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%
Capital Economics	**0.75%**	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%	1.75%	1.75%	2.00%	-
5yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**1.76%**	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%
Capital Economics	**1.76%**	1.95%	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-
10yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.18%**	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%
Capital Economics	**2.18%**	2.30%	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-
25yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.80%**	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	**2.80%**	2.83%	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-
50yr PWLB Rate											
	Now	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Link Asset Services	**2.68%**	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	**2.68%**	2.65%	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-