



TREASURY MANAGEMENT STRATEGY

2019-20

1.0 INTRODUCTION

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council is exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a Treasury Management Strategy (TMS) before the start of each financial year. In addition, the Welsh Government issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an Investment Strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the Welsh Government Guidance.

In 2017 CIPFA also published a new version of the Prudential Code for Capital Finance in Local Authorities (the Prudential Code). The updated Prudential Code includes a new requirement for local authorities to provide a Capital Strategy, which is a summary document approved by full Council covering capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy, complying with CIPFA's requirement, will be approved together with the TMS by full Council in February 2019 and will now include the Prudential Indicators which in previous years were included in the TMS, along with details regarding the Council's non-treasury investments. The CIPFA Code also requires the Council to set a number of Treasury Management Indicators which are forward looking parameters and enable the Council to measure and manage its exposure to treasury management risks and these are included throughout this TMS. The Capital Strategy and TMS should be read in conjunction with each other as they are interlinked as borrowing and investments are directly impacted upon by capital plans.

The Council has an integrated TMS where borrowing and investments are managed in accordance with best professional practice which is assessed either from internal expertise or consultation with our external advisers. The Council borrows money either to meet short term cash flow needs or to fund capital schemes approved within the capital programme. Therefore any actual loans taken are not associated with particular items of expenditure or assets. The Council is exposed to financial risks including the potential loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's TMS. In accordance with Welsh Government Guidance, the Council will be asked to approve a revised TMS should the assumptions on which this is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, the Council's capital programme or the level of its investment balance. There is also a half year review of the TMS which is presented to Council for approval.

The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and

administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's strategy, Treasury Management Practices (TMP) and CIPFA's *Standard of Professional Practice on Treasury Management*. Council will receive reports on its treasury management activities, including as a minimum, an annual strategy in advance of the year, a mid-year review and an annual report after its financial year end. Quarterly reports will also be received by Cabinet. The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2.0 ECONOMIC CONTEXT

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's TMS for 2019-20. Following the Bank of England's decision to increase the Bank Rate from 0.50% to 0.75% in August, no changes to monetary policy has been made. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee (MPC) continues to reiterate that any further increases will be at a gradual pace and limited in extent.

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

The Bank of England released its latest report on bank stress testing, illustrating that all entities included in the analysis were deemed to have passed the test once the levels of capital and potential mitigating actions presumed to be taken by management were factored in, and they did not require any bank to raise additional capital.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading in the UK. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose's most likely scenario is forecasting two more 0.25% hikes during 2019-20 to take official UK interest rates to 1.25% by December 2019. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that

higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Table 1: Arlingclose (Council's TM Advisers) central interest rate forecast December 2018

	Bank Rate	3 month money market rate	1 year money market rate	5 year gilt yield	10 year gilt yield	20 year gilt yield	50 year gilt yield
Dec 2018	0.75	0.90	1.15	1.15	1.50	2.00	1.90
Mar 2019	0.75	0.95	1.25	1.25	1.65	2.10	1.95
June 2019	1.00	1.10	1.35	1.35	1.70	2.20	2.00
Sept 2019	1.00	1.30	1.50	1.50	1.80	2.20	2.00
Dec 2019	1.25	1.40	1.70	1.50	1.80	2.20	2.00
Mar 2020	1.25	1.40	1.60	1.40	1.75	2.20	2.00
Jun 2020	1.25	1.40	1.50	1.35	1.75	2.20	2.00
Sept 2020	1.25	1.35	1.40	1.35	1.70	2.20	2.00
Dec 2020	1.25	1.35	1.35	1.30	1.70	2.20	2.00
Mar 2021	1.25	1.35	1.35	1.30	1.70	2.20	2.00
Jun 2021	1.25	1.35	1.35	1.30	1.70	2.20	2.00
Sept 2021	1.25	1.35	1.35	1.30	1.70	2.20	2.00
Dec 2021	1.25	1.35	1.35	1.30	1.70	2.20	2.00
Average	1.13	1.27	1.40	1.33	1.70	2.18	1.99

3.0 EXTERNAL DEBT AND INVESTMENT POSITION

On the 31st December 2018, the Council held £96.87 million of borrowing and £33.00 million of investments. The external debt and investment position is shown in table 2 below and more detail is provided in section 4.0 Borrowing Strategy and section 5.0 Investment Strategy. Forecast changes in these sums are shown in the balance sheet analysis in table 3 below.

Where a Council finances capital expenditure by debt, it must put aside revenue resources to repay that debt in later years and this amount charged to revenue is called the Minimum Revenue Provision (MRP). The *Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008* requires the Council to produce and approve an Annual Minimum Revenue Provision (MRP) Statement before the start of the financial year that details the methodology for the MRP charge and this is detailed in the Council's Capital Strategy. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high. The Council is forecasting an increased CFR due to the prudential borrowing in the capital programme and the new MRP policy approved by Council in September 2018.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 3 below shows that the Council complied with this in 2017-18 and expects to comply with this recommendation during 2018-19, 2019-20 and the following two years. More detail is provided in the Capital Strategy.

Table 2: Council's external debt and investment position as at 31 December 2018

	Principal as at 31-12-18 £m	Average Rate %
External Long Term Borrowing:		
Public Works Loan Board	77.62	4.70
Lender's Option Borrower's Option	19.25	4.65
Total External Long Term Borrowing	96.87	4.69
Other Long Term Liabilities:		
Private Finance Initiative *	17.16	
Llynfi Loan**	2.40	
Other LTL	0.94	
Total Other Long Term Liabilities	20.50	
Total Gross External Debt	117.37	
Treasury Investments:		
Banks	8.00	0.97
Local Authorities	22.00	0.87
Money Market Funds ***	3.00	0.77
Total Treasury Investments	33.00	0.88
Net Debt	84.37	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 15.25 years remaining term

** Loan from the Welsh Government Central Capital Retained Fund for regeneration works within the Llynfi Valley which has not yet commenced

***the funds provide instant access

Table 3 below has been produced using estimates of capital spend and forecasts on useable reserves for the current financial year and the next three years. The Capital Plans highlight that the Loans CFR, which is the Council's need to borrow to fund capital expenditure, is increasing year on year due to additional prudential borrowing.

Table 3: Balance sheet summary and forecast

	31.3.18 Actual £m *	31.3.19 Estimate £m	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m
CFR	171	172	178	179	182
Less: Other debt liabilities	-18	-18	-17	-16	-16
Loans CFR	153	154	161	163	166
Less: External borrowing	-100	-100	-100	-100	-100
Internal borrowing	53	54	61	63	66
Less: Usable reserves	-80	-67	-55	-50	-46
Less: Working capital	-2	-2	-	-	-

Investments	29	15	10	10	10
New Borrowing - cumulative	-	-	16	23	30

*The accounting practice followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS) so these figures will differ from other figures in the TMS which are based on the actual amounts borrowed and invested

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This assumes the same forecasts as table 3 above, but that cash and investment balances are kept to a minimum level of £10 million at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 4: Liability benchmark

	31.3.18 Actual £m	31.3.19 Estimate £m	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m
Loans CFR	153	154	161	163	166
Less: Usable reserves	-80	-67	-55	-50	-46
Less: Working capital	-2	-2	-	-	-
Plus: Minimum investments	29	15	10	10	10
Liability Benchmark	100	100	116	123	130

4.0 BORROWING STRATEGY

The Council currently holds £96.87 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 3 above shows that the Council will have to borrow £30 million over the next three years as detailed below:-

Table 5: New Borrowing

	31.3.18 Actual £m	31.3.19 Estimate £m	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m
New Borrowing	-	-	16	7	7

The Section 151 will monitor and update the liability benchmark assumptions on an on-going basis and report any significant changes within the treasury management monitoring reports to Cabinet, Audit Committee and Council as appropriate. This could be as a result of changes in the level of useable reserves at year end, slippage within the Capital Programme or changes within the working capital assumptions.

Objectives: The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Therefore the major **objectives** to be followed in 2019-20 are:-

- to minimise the revenue costs of debt

- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy. With short-term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources or borrow short term loans instead.

The Section 151 Officer will take the most appropriate form of borrowing depending on the prevailing interest rates at the time however, with long term rates forecast to rise modestly in future years, any such short term savings will need to be balanced against the potential longer-term costs. The Council's treasury management advisers will assist the Council with this 'cost of carry' and breakeven analysis. The last time the Council took long term borrowing was £5 million from the Public Works Loan Board (PWLB) in March 2012. As detailed above, the liability benchmark is suggesting there will be a requirement for new long term borrowing in 2019-20, 2020-21 and 2021-22. It is anticipated that this would be from PWLB and for estimate purposes it has been assumed that this will be over 30 years.

Alternatively, the Council may arrange forward starting loans during 2019-20 where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow short term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- PWLB and any successor body
- any institution approved for investments (see Investment Strategy below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Council's Pension Fund)
- capital market bond investors
- special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB, but will also investigate other sources of finance, such as Welsh Government and local authority loans and bank loans, that may be available at more favourable rates.

LOBOs: The £19.25 million shown in table 2 above, relates to Lender’s Option Borrower’s Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. There are two trigger points in 2019-20 and although the Council understands that the lender is unlikely to exercise this option in the current low interest rate environment, an element of refinancing risk remains and the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future.

Short term and variable rate loans: These loans expose the Council to the risk of short term interest rate rises and are therefore subject to the treasury management indicator to manage interest rate exposure as shown below in tables 6 and 12 below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

Maturity structure of borrowing indicator: This indicator is set for the forthcoming financial year to control the Council’s exposure to refinancing risk with respect to the maturity of the Council’s external borrowing and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk. It is the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The upper and lower limits on the maturity structure of borrowing will be:

Table 6: Treasury Management Indicator Maturity Structure of Borrowing 2019-20

Refinancing rate risk indicator Maturity structure of borrowing 2019-20	Upper limit	lower limit
Under 12 months	50%	0%
12 months and within 24 months	25%	0%
24 months and within 5 years	25%	0%

5 years and within 10 years	40%	0%
10 years and within 20 years	50%	0%
20 years and above	60%	25%

5.0 INVESTMENT STRATEGY

The preparation each year of an Investment Strategy is central to the Welsh Government guidance on Local Authority Investments. It encourages the formulation of policies for the prudent investment of the surplus funds that authorities hold on behalf of their communities. In addition, the need for the Strategy to be approved by the full Council ensures that these policies are subject to the scrutiny of elected Members: this is particularly important as since 2004 central Government no longer closely regulates local government investment.

The Council holds surplus funds representing income received in advance of expenditure plus balances and reserves and as shown in table 2 above in section 3, the balance at 31 December 2018 was £33.00 million. Investments are estimated to drop to between £15 and £20 million by the 31 March 2019. As in previous years this is due partly to increased expenditure expected to be incurred for the capital programme and the reduction in income collected from Council Tax in February and March 2019 and Based on its cash flow forecasts, the Council anticipates its investment balances in 2019-20 to range between £10 million to £55 million with an average investment rate of between 0.75% to 1.00% depending on the Bank Rate and investment types, which will be reviewed at half year and reported to Council. The actual balance varies because of the cash flow during the year as to when income is received (such as specific grant income, housing benefits subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments).

Objectives: Both the CIPFA Code and the Welsh Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments while seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

The major **objectives** to be followed in 2019-20 are:

- to maintain capital **security**
- to maintain portfolio **liquidity** so funds are available when expenditure is needed
- to achieve the **yield** on investments commensurate with the proper levels of security and liquidity

Negative interest rates: If the UK enters into a recession in 2019-20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in some other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: The Council's investments have historically been placed in mainly short term bank and building society unsecured deposits and local and central government, however, investments may be made with any public or private sector organisations that meet the credit criteria detailed below. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will further diversify into more secure and/or higher yielding asset classes during 2019-20 as appropriate in consultation with the Council's treasury management advisers. The majority of the Council's surplus cash is currently invested in money market funds and with other local authorities but the Council will continue to look at investment options in line with the limits detailed below.

With short term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long term borrowing if appropriate options become available as referred to in section 4.0 Borrowing Strategy.

International Financial Reporting Standard (IFRS) 9: Under the new IFRS 9 Standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types shown in table 7 below, subject to the cash limits and the time limits shown. **These cash/time limits are per counterparty and relate to principal only and exclude any accrued interest.**

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies to ensure that this lies within our agreed minimum credit rating. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account. **Schedule A** shows the equivalence table for credit ratings for three of the main rating agencies Fitch, Moody's and Standard & Poor's and explains the different investment grades.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Where additional amounts received into our accounts with our own bankers are received too late in the day to make an investment the same day, the limit in the above table will not apply as this does not count as an investment.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment and consultation with the Council's treasury management advisers.

Registered providers: Loans and bonds issued by, guaranteed by, or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Welsh Government and as providers of public services, they retain the likelihood of receiving government support if needed.

Table 7: Approved investment counterparties and limits

These limits must be read in conjunction with the notes immediately below the table. The combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments:

Credit Rating	Banks (including building societies) Unsecured	Banks (including building societies) Secured	Government	Corporates	Registered Providers
UK Central Government	n/a	n/a	£ Unlimited	n/a	n/a
			50 Years		
UK Local Authorities	n/a	n/a	£12,000,000	n/a	n/a
			10 Years		
AAA	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	5 Years	20 Years	50 Years	20 Years	20 Years
AA+	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	5 Years	10 Years	25 Years	10 Years	10 Years
AA	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	4 Years	5 Years	15 Years	5 Years	10 Years
AA-	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	3 Years	4 Years	10 Years	4 Years	10 Years
A+	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	2 Years	3 Years	5 Years	3 Years	5 Years
A	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	13 Months	2 Years	5 Years	2 Years	5 Years
A-	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	6 Months	13 Months	5 Years	13 Months	5 Years
None	£1,000,000	n/a	see above central government and local authority limit	n/a	£3,000,000
	6 Months				
Pooled Funds	£6,000,000 per fund				

Pooled funds: Shares or units in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money

Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period can be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Operational bank accounts: The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes as they occur.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made
- any existing investments that can be recalled or sold at no cost will be
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations as happened in 2008 and 2011, it is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified investments: The *Welsh Government Investment Guidance* defines specified investments as those:

- denominated in pound sterling
- due to be repaid within 12 months of arrangement (364 days)
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government
 - a UK local authority
 - a UK parish or community council or
 - body or investment scheme of "high credit quality"

The Council defines "**high credit quality**" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified investments: Any investment that does not fall into the criteria detailed above under the Specified investments definition. The Council does not intend to make any investments denominated in foreign currencies nor any defined as capital expenditure. Non-specified investments will therefore be limited to:

- long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement
- investments with bodies and schemes not meeting the definition on high credit quality

The *Welsh Government Investment Guidance* requires the Council's Investment Strategy to set an overall limit for non-specified investments which is currently set at £20 million. Table 9 below shows the non-specified categories and the relevant limits and although the total of the individual limits exceed £20 million, at any one point in time a **maximum of £20 million** could be invested in these non-specified investments.

Principal sums invested for periods longer than a year: All investments longer than 365 days (non-specified) will be made with a cautious approach to cash flow requirements and advice from the Council's treasury management advisers will be sought as necessary.

Where the Council invests, or plans to invest, for periods longer than a year, an upper limit is set for each forward financial year period for the maturing of such investments. The purpose of this indicator is to control the Council's exposure to the

risk of incurring losses by seeking early repayment of long term investments. The limits on the long term principal sum invested to final maturities beyond the period end will be as shown in table 8 below.

Table 8: Treasury Management Indicator Principal sums invested for periods longer than a year

Price risk indicator	2019-20 £m	2020-21 £m	2021-22 £m
Limit on principal invested beyond financial year end	15	10	8

Investment Limits: The combined values of specified and non-specified investments with any one organisation are subject to the approved counterparties and limits shown in table 7 above and also the non-specified limits in table 9 and the investment limits detailed in table 10 below.

A group of banks under the same ownership will be treated as a single organisation for limit purposes. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

The combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments.

Table 9: Non-specified investment limits

	Category Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below the Council's definition of "high credit quality" (A-) (except the UK Government and UK local authorities)	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries with a sovereign rating below AA+	£3m
Total Non-Specified Investments Outstanding	£20m

Table 10: Investments limits

	Category Cash limit
Any single organisation, except the UK Central and Local Government	£6m
UK Central Government	unlimited
UK Local Authorities (per Authority)	£12m
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£6m per country
Registered providers and registered social landlords	£5m in total
Unsecured investments with Building Societies	£6m in total

Money market funds (MMF)	£20m in total
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Liquidity Management: The Council forecasts on a prudent basis the maximum period for which funds may be committed therefore minimising the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. A limit of £15 million (table 9 above) has been set for 2019-20 for long term investments and this has been set with reference to the Medium Term Financial Strategy and cash flow forecast as shown in the principal sums invested for periods longer than a year indicator in table 8 above. This represents just under 30% of the maximum amount of investments that the Council anticipates to have at any one point in time in 2019-20.

6.0 INTEREST RATE EXPOSURES BORROWING AND INVESTMENTS

The Council is exposed to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council, depending on how variable and fixed interest rates move across differing financial instrument periods. For instance, a rise in variable and fixed interest rates would have the following effects:

- borrowings at variable rates – the interest charged to revenue within the Comprehensive Income and Expenditure Statement will rise;
- borrowings at fixed rates – the fixed rate protects the Council from increased interest charges as an equivalent loan would now cost more. The fair value of the borrowing (liability) will fall;
- investments at variable rates – the interest income credited to the Comprehensive Income and Expenditure Statement will rise;
- investments at fixed rates – the fixed rate prevents the Council from receiving higher investment income from the same principal invested. The fair value of the investment (asset) will fall.

An indicator has been set in table 11 below to measure the net impact over one year on the revenue account of both a 1% rise and a 1% fall in all interest rates for borrowing net of treasury investments. This is calculated on the assumption that maturing loans and investments will be replaced at rates 1% higher or lower than they would otherwise have been on their maturity dates and that the treasury investment and borrowing portfolios remain unchanged over the coming year. Interest rates can move by more than 1% over the course of a year, although such instances are rare.

Table 11: Treasury Management Indicator Interest Rate Exposures

Interest rate risk indicator	Indicator £'000
One year revenue impact of a 1% rise in interest rates	(140)
One year revenue impact of a 1% fall in interest rates	315

The figures for the 1% fall in interest rates indicator is not the same figures as the 1% increase (but reversed) as the borrowing relates to variable LOBO loans where it is assumed that the lender would not exercise their option if there was a fall in

interest rates. All other borrowing does not have a rate reset in the next year and is with the PWLB at fixed rates.

6.0 PERFORMANCE INDICATORS

Performance indicators are set to assess the adequacy of the treasury function over the year. These are distinct historic indicators as opposed to the treasury management and prudential indicators which are predominantly forward looking.

One debt performance indicator is where the average portfolio rate of interest is compared to an appropriate average available such as the average PWLB Debt for Welsh and UK local authorities. The rate of return on investments can be monitored against the average rate of return on investments against the Bank Rate and the average rate of return on investments as compared to the average rate of Arlingclose's Welsh local authority clients at each relevant quarter/year-end.

7.0 OTHER ITEMS

In line with the CIPFA Code and Welsh Government guidance the following also forms part of the Council's TMS.

Financial Derivatives: In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives such as swaps, forwards, futures and options. Derivatives embedded into loans and investments including pooled funds and forward starting transactions may be used and the risks they present will be managed in line with the overall treasury risk management strategy.

Markets in Financial Instruments Directive II (MIFID II): From January 2018, MIFID II changed the classification of local authority investors. It reclassified local and public authorities as retail investors. The Council has opted up to professional client status with its providers of financial services, including treasury management advisers, banks, building societies and brokers, allowing it access to a greater range of services but without the greater regulatory protection afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Section 151 Officer believed this to be the most appropriate status.

Investment training: The needs of the Council's treasury management staff for training in investment management are assessed every six months as part of the staff appraisal process and also if the responsibilities of individual members of staff change.

Training is received from the Council's treasury management advisers, CIPFA and other bodies in the form of training courses and seminars. The Council also supports personal development so individuals enhance their own knowledge through reading CIPFA guidance, publications and research on the internet.

Investment advisers: The Council appointed Arlingclose Limited as treasury management advisers following a tender exercise in August 2016. They were awarded a four year contract, to provide advice and information relating to its borrowing and investment activities and capital finance issues. The contract will be reviewed annually and either party may at any time terminate this agreement on 3

months prior written notice. The quality of this service is controlled by having regular meetings with the advisers and regularly reviewing the service provided.

Investment of money borrowed in advance of need: The Welsh Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and the Council will not engage in such activity, however, the Council could potentially borrow in advance of need where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

As the Council has an integrated TMS, borrowing is not linked to the financing of specific items of expenditure. The Council's Capital Financing Requirement (CFR) as at 1 January 2019 was in excess of the actual debt of the Council as shown in table 3 above indicating there was no borrowing in advance of need. More detail is provided in the Prudential Indicators in the Council's Capital Strategy.

Schedule A

Credit Rating Equivalence Table

	Description	Fitch		Moody's		Standard & Poor's	
		Long	Short	Long	Short	Long	Short
INVESTMENT GRADE	Extremely strong	AAA		Aaa		AAA	
	Very strong	AA+	F1+	Aa1	P-1	AA+	A-1+
		AA		Aa2		AA	
		AA-		Aa3		AA-	
	Strong	A+	F1	A1	P-2	A+	A-1
		A		A2		A	
		A-		A3		A-	
	Adequate	BBB+	F2	Baa1	P-3	BBB+	A-2
		BBB		Baa2		BBB	
BBB-		Baa3		BBB-			
SPECULATIVE GRADE	Speculative	BB+	B	Ba1	Not Prime (NP)	BB+	B
		BB		Ba2		BB	
		BB-		Ba3		BB-	
	Very speculative	B+	B	B1	Not Prime (NP)	B+	B
		B		B2		B	
		B-		B3		B-	
	Vulnerable	CCC+	C	Caa1	Not Prime (NP)	CCC+	C
		CCC		Caa2		CCC	
		CCC-		Caa3		CCC-	
CC		Ca		CC			
	C				C		
Defaulting	D	D	C		D	D	