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|---|
| Wards affected:<br><br>General |

**Strategy Group – 7th February 2019**

**Treasury Management Strategy Statement and Annual Investment Strategy 2019/2020**

**Including Commercial Activities/Non Treasury Investments**

**Resources Issues**

## 1. Purpose of Report

**1.1** To advise Strategy Group of the expected activities and appropriate operational parameters of the treasury management function in 2019/2020. To endorse the "Treasury Management Strategy Statement and Annual Investment Strategy 2019/2020"

## 2. Advice

| | |
|---|---|
| **That it be RECOMMENDED:** | That the Council's Treasury Management Strategy Statement and Annual Investment Strategy 2019/2020 be approved. |

## 3. Introduction

**3.1** The Council is required to set a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that the cash flow is adequately planned, with funds being available when needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity and security of funds 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 flow may involve arranging long or short term loans or using longer term cash flow surpluses.

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 for 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, (often arising from capital expenditure),and are separate from the day to day treasury management activities.

CIPFA defines treasury management as :

“The management of the local authority’s borrowings, 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 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.

## 3.2 Reporting Requirements

### 3.2.1 Capital Strategy

The revised CIPFA 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare a Capital Strategy, 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 this 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.

This Capital Strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former.

The capital strategy will show:

- 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 risks associated with each activity.

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

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level indicators are set.

### 3.2.2 Treasury Management reporting

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

a. **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 ) (see Section 4.7);
   - 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 managed).

b. **A Mid-Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the objectives or whether any policies require revision. In addition, quarterly reports are produced and taken to Resources Working Group and to Portfolios Holders.

c. **An Annual Treasury Management Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by Strategy Group.

## 3.3 Treasury Management Strategy 2019/2020

The strategy for 2019/2020 cover two main areas:

**Capital Issues**

- the capital plans and 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;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code 2017, MHCLG MRP Guidance 2018, the CIPFA Treasury Management Code 2017 and MHCLG Investment Guidance 2018.

## 3.4 Training

The CIPFA Treasury Management Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. Members training was undertaken on the 16th January 2019, with further to be arranged as and when required.

The training needs of treasury management officers are periodically reviewed.

## 3.5 Treasury Management Consultants

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. 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 scopes of investments within the Council’s operations now includes both convential investments (the placing of residual cash from the Council’s functions), and more commercial type investments, such as investment properties. The commercial type investments require specialist advisors, who will be used and when necessary.

## 4. The Capital Prudential Indicators 2019/2020 – 2021/2022 and Minimum Revenue Provision (MRP) Statement

### 4.1 Capital Expenditure

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 member's overview and confirm expenditure plans.

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of the budget cycle.

| **Capital expenditure £m** | **2018/19 Estimate** | **2019/20 Estimate** | **2020/21 Estimate** | **2021/22 Estimate** |
|---|---|---|---|---|
| Total Capital Expenditure | 12.147 | 11.409 | 8.656 | 1.320 |
| **Financed by:** | | | | |
| External Funding | 2.193 | 3.224 | 1.850 | 1.204 |
| Capital reserves | 9.954 | 8.185 | 6.806 | 0.116 |
| Revenue | 0.000 | 0.000 | 0.000 | 0.000 |
| **Net financing need for the year (CFR)** | **0.000** | **0.000** | **0.000** | **0.000** |

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

One of the prudential indicators is the Council's Capital Financing Requirement (CFR). The CFR is simply the 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 underlying borrowing need. Any capital expenditure above, which has not been paid for, will increase the CFR.

The Council, under the current Medium Term Financial Plan and Capital Programme, has no plans to borrow and therefore has a zero CFR.

### 4.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to finance either 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.

| **Year End Resources £m** | **2018/19 Estimate** | **2019/20 Estimate** | **2020/21 Estimate** | **2021/22 Estimate** |
|---|---|---|---|---|
| General Fund balances / reserves | 28.467 | 30.679 | 29.593 | 28.262 |
| Capital receipts reserve | 12.630 | 4.694 | 0.000 | 1.058 |
| **Total core funds** | **41.097** | **35.373** | **29.593** | **29.320** |
| Working capital | -10.398 | -10.398 | -10.398 | -10.398 |
| **Expected investments** | **30.699** | **24.975** | **19.195** | **18.922** |

In addition to the expected investments total from the above table the Council has a cash element which would include the reciepts of Council Tax and NNDR income prior to the payments being made to the government and precepting authorties. This would increase the level of investments held by the council at any one time.

### 4.5 Affordability Prudential Indicators

A number of sections throughout this report cover the prudential indicators for overall capital and control of borrowing and within this framework prudential indicators are also 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.

### 4.5.1 Ratio of financing costs to revenue streams

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. In other words in 2018/2019 the interest earnings would be approximately 2.23% of the Council's net revenue spend.

| **%** | **2018/19 Estimate** | **2019/20 Estimate** | **2020/21 Estimate** | **2021/22 Estimate** |
|---|---|---|---|---|
| Ratio | -2.23 | -3.47 | -2.79 | -2.81 |

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

### 4.5.2 Incremental impact of capital investment decisions on council tax

In the revised Prudential Code 2017 this indicator is no longer compulsory. However after consideration it has been decided that the indicator provides useful information and will now be included in the report as a local indicator.

The indicator identifies the net revenue effects (expressed in terms of band D council tax) associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. Impacts on the revenue budget may be favourable or adverse as explained in the table below:

| **Favourable Impact<br>Reduces the Incremental Impact on council tax (-)** | **Adverse Impact<br>Increases the Incremental Impact on council tax (+)** |
|---|---|
| Revenue savings | Direct revenue funding of capital |
| Income generation | Revenue running costs |
| | Loss of interest where capital receipts or other earmarked reserves are used to fund capital expenditure |
| | Cost of borrowing (if any) |

The value of the revenue savings and income arising from the proposed capital programme changes exceeds the increase in revenue costs. Therefore the net effect on the revenue budget is beneficial and the incremental impact on council tax is shown as a minus figure.

| **£** | **2018/19<br>Estimate** | **2019/20<br>Estimate** | **2020/21<br>Estimate** | **2021/22<br>Estimate** |
|---|---|---|---|---|
| **Incremental Impact on Council tax - band D** | -3.04 | -0.47 | -2.89 | -3.05 |

### 4.5.3 Proportionality Indicators

There are two new proportionality indicators designed to control the level of debt the Council enters into and restrict the level of commercial income the council generates in order to mitigate the risks associated with debt and reliance on commercial income to fund service delivery. These are recommended in the Annex to the MHCLG Guidance, which says "The Guidance requires local authorities to develop quantitative indicators that allow Councillors and the public to assess a local authority's total risk exposure as a result of its investment decisions". These indicators are:

- Percentage of Debt compared to Net Service Expenditure (NSE). This identifies a maximum limit for the aggregate level of debt the Council holds compared to its net service expenditure (defined as Gross Service Expenditure less Fees and Charges).
- Percentage of Commercial Income compared to NSE. This identifies a limit on the proportion of income the Council earns from commercial activities (such as investment property, The Daventry Estate Company Ltd, and Daventry Norse) compared to its net service expenditure.

This is to mitigate the risks relating over-reliance on commercial income for service delivery.

| | 2019/20 Limit | 2020/21 Limit | 2021/22 Limit |
|---|---|---|---|
| Debt as a Proportion of NSE | 50% | 50% | 50% |
| Commercial Income as a Proportion of NSE | 30% | 30% | 30% |

**4.6 Treasury management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- 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.

| **Upper limit for fixed interest rate exposure** | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|---|
| Net interest re fixed rate borrowing/investments | 100% | 100% | 100% | 100% |
| | | | | |
| **Upper limit for variable rate exposure** | | | | |
| Net interest re variable rate borrowing | 0% | 0% | 0% | 0% |
| Net interest re variable rate investments | 30% | 30% | 30% | 30% |
| **Upper limit for total principal sums invested for over I Year** (per maturity date) | £15m | £15m | £15m | £15m |

| **Maturity structure of fixed rate borrowing during 2019/2020 (if required)** | upper limit % | lower limit % |
|---|---|---|
| under 12 months | 100 | 0 |
| 12 months and within 24 months | 100 | 0 |
| 24 months and within 5 years | 100 | 0 |
| 5 years and within 10 years | 100 | 0 |
| 10 years and above | 100 | 0 |

## 4.7 Minimum Revenue Provision (MRP) Policy Statement

If the Council were to borrow it would be required to pay off an element of the accumulated historic capital spend that has not yet been financed from capital and revenue resources each year (the CFR) through a revenue charge (the Minimum Revenue Provision MRP), although it is allowed to undertake additional voluntary payment if required (Voluntary Revenue Provision VRP).

The MRP is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

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

From 1 April 2019 for all unsupported borrowing (including finance leases) 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);
- 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.

## 5.0 Borrowing

## 5.1 Current Portfolio Position

The capital expenditure plans set out in Section 4 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.

The Council has not previously had to borrow externally and this position is unlikely to change in the near future. However, looking into the future the Council needs to take into consideration that there may be a need to borrow money 'from itself' from other cash holdings that the Council may have. This is known as internal borrowing and means that not all of the reserves would be cash backed. Any borrowing undertaken would be in line with the prudential indicators and borrowing strategy outlined in this report.

## 5.2 Treasury Indicators: limits to borrowing activity

**The operational boundary.** This is the limit beyond which external debt is not normally expected to exceed. Whilst the council has no plans to borrow an operational boundary is set for occasions where very short term borrowing is required for cash flow purposes only.

| Operational boundary £m | 2018/19 Estimate | 2019/20 Estimate | 2020/21 Estimate | 2021/22 Estimate |
|---|---|---|---|---|
| Debt | 3.000 | 3.000 | 4.000 | 4.000 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| **Total** | **3.000** | **3.000** | **4.000** | **4.000** |

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

1. It is a statutory requirement to set an authorised 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.
2. The Council is asked to approve the following authorised limit:

| Authorised limit £m | 2018/19 Estimate | 2019/20 Estimate | 2020/21 Estimate | 2021/22 Estimate |
|---|---|---|---|---|
| Debt | 5.000 | 5.000 | 6.270 | 6.475 |
| Other long term liabilities | 0 | 0 | 0 | 0 |
| Total | 5.000 | 5.000 | 6.270 | 6.475 |

## 5.3 Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed in treasury investments. Therefore gross external debt will not (except in the short term) exceed the estimates of any capital financing (borrowing) requirements for the current and next two financial year's capital programme. Any decision to borrow in advance will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Subject to affordability, the Council is willing to consider borrowing for any capital project that generates an asset where the freehold is owned by DDC and all external funding sources have been exhausted, but only within the prudential limits set. This may include investment property.

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

## 6. Prospects for Interest Rates

Link Asset Services as part of their service assist the Council to formulate a view on interest rates. The following table gives their central view.

| Annual Average % | Bank Rate % | PWLB Borrowing Rates % (including certainty rate adjustment) | | | |
|---|---|---|---|---|---|
| | | 5 year | 10 year | 25 year | 50 year |
| Mar 2019 | 0.75 | 2.10 | 2.50 | 2.90 | 2.70 |
| Jun 2019 | 1.00 | 2.20 | 2.60 | 3.00 | 2.80 |
| Sep 2019 | 1.00 | 2.20 | 2.60 | 3.10 | 2.90 |
| Dec 2019 | 1.00 | 2.30 | 2.70 | 3.10 | 2.90 |
| Mar 2020 | 1.25 | 2.30 | 2.80 | 3.20 | 3.00 |
| Jun 2020 | 1.25 | 2.40 | 2.90 | 3.30 | 3.10 |
| Sep 2020 | 1.25 | 2.50 | 2.90 | 3.30 | 3.10 |
| Dec 2020 | 1.50 | 2.50 | 3.00 | 3.40 | 3.20 |
| Mar 2021 | 1.50 | 2.60 | 3.00 | 3.40 | 3.20 |
| Jun 2021 | 1.75 | 2.60 | 3.10 | 3.50 | 3.30 |
| Sep 2021 | 1.75 | 2.70 | 3.10 | 3.50 | 3.30 |
| Dec 2021 | 1.75 | 2.80 | 3.20 | 3.60 | 3.40 |
| Mar 2022 | 2.00 | 2.80 | 3.20 | 3.60 | 3.40 |

The flow of generally positive economic statistics after quarter ending June 2018 meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision to make the first increase in Bank Rate above 0.50% since the financial crash from 0.50% to 0.75%. Growth became increasingly stronger throughout 2018 until slowing significantly during the last quarter. At the November quarterly Inflation Report meeting, the MPC left the Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlike that there will be a change in the Bank Rate until the situation with regards to Brexit has been resolved. On an assumption that a Brexit deal has been reached in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

## 7. Annual Investment Strategy

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

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

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

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

4. This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in section 7.4 under the categories of 'specified' and 'non-specified' investments.

    - Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.

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

5. All investments will be denominated in sterling.

6. As a result of the change in accounting standards for 2018/19 under IFRS 9 – Financial Instruments, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1 April 2018.)

However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against the apporpriate benchmarks for investment performance.

## 7.2 Creditworthiness Policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The Council criteria are set on the Fitch credit rating and in the absence of this Moody's ratings will be taken. However, it does not rely solely on the current credit ratings of counterparties but also uses the following overlays:-

- credit watches and credit outlooks from credit rating agencies;
- 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 Credit Default Swaps (CDS) spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:-

- Yellow 5 years
- Dark Pink 5 years for Enhanced money market funds with a credit score of 1.25
- Light Pink 5 years for Enhanced money market funds with a credit score of 1.5

- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

The Link Asset Services creditworthiness service uses a wider array of information other than just primary ratings and by using a scoring system does not give undue weight to just one agency's ratings.

All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three rating agencies though the use of the Link Asset Services' creditworthiness service.

- If a downgrade in rating 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.
- If a body is placed on negative rating watch with Fitch or Moody's in the absence of a Fitch rating (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near the floor of the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body. Alternatively if the result of a negative rating watch keeps the counterparty within the credit ratings set out by the Council, the counterparty can be considered for investment.
- The Council uses Fitch ratings to derive its counterparty criteria. Where counterparty does not have a Fitch rating, the equivalent Moody's rating will be used. All credit ratings will be monitored daily.
- The Council is alerted to changes in Fitch ratings through its use of the Link Asset Services credit worthiness service.
- Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

**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.

## 7.3 Country Limits

With the exception of the UK, the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them).

## 7.4 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 up to 12 months). Greater returns are usually obtainable by investing for longer periods. Whilst most cash balances are required in order to manage day to day cash flow where funds can be identified that the funds could be invested for longer periods, the value of the longer term will be carefully assessed.

### Investments returns expectations

Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 in 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 will use an investment benchmark to assess the investment performance of its investment portfolio of the 3 and 6 month LIBID rates, it is expected that an interest rate return above these levels will be achieved.

### Investment instruments

Investment instruments identified for use in the financial year are listed below under the ‘Specified’ and ‘Non-Specified’ Investments categories.

**Specified Investments:** All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum high rating criteria where applicable.

| | **Minimum 'High' Credit Criteria** | **Use** |
|---|---|---|
| Debt Management Account Deposit Facility | --- | In-house |
| Term Deposits – Other Local Authorities | --- | In-house |
| UK Nationalised and Semi Nationalised Banks | Semi Nationalised | In-house |
| Term Deposits – Bank and Building Societies | Sovereignty AA<br>Short Term F1<br>Long-term A, | In-house and Fund Managers |
| Certificates of deposits issued by banks building societies covered by UK government | Sovereignty AA<br>Short-term F1<br>Long-term A | In-house buy and hold and fund managers |
| UK Government Gilts | Sovereignty Rating AA | In-house and fund managers |
| Treasury Bills | Sovereignty Rating AA | In-house and fund managers |
| Money Market Funds | AA | In-house and fund managers |

**Non-Specified Investments:** A maximum of 60% or £15m, whichever is the lower of the total portfolio, will be held in aggregate in non-specified investment (i.e. over 1 year)

| | **Minimum Credit Criteria** | **Use** | **Max. maturity period** |
|---|---|---|---|
| Term deposits – local authorities | -- | In-house | 5 Years |
| UK Nationalised and Semi Nationalised Banks | Semi Nationalised | In-house | 5 Years |
| Term deposits – banks and building societies | Sovereignty AA<br>Short-term F1+<br>Long-term AA- | In-house | 5 Years |
| Certificates of deposits issued by banks and building societies | Sovereignty AA<br>Short-term F1+<br>Long-term AA- | In-house and Fund managers | 2 Years |
| UK Government Gilts | Sovereignty Rating AA | In-house and Fund Managers | 5 Years |
| Sovereign bond issues (i.e. other than the UK gov't) | Sovereignty Rating AA | In-house and Fund Managers | 5 Years |

For both specified and non-specified investments the UK is an exception to the stated criteria in that we will continue to deal with UK institutions in the event of a downgrading in the UK sovereign rate.

**Use of additional information other than credit ratings**

Additional requirements under the Treasury Management Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

**7.5 Treasury Management Practices**

The Council's Treasury Management Practices (TMPs) set out the manner in which the Council will seek to achieve its treasury management policies and objectives, and how it will manage and control those activities.

The Council's TMPs schedules cover the detail of how the Council will apply the TMP Main Principles in carrying out its operational treasury activities. The schedule will be updated to take account of any relevant changes to the treasury management code and will be reviewed and approved annually by the Council's Chief Financial Officer.

**7.6 End of year investment report**

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

**8. Implications**

**8.1 Financial** – This report is wholly concerned with financial issues.

**8.2 Personnel** - None, other than those mentioned in the report above.

**8.3 Legal/Constitutional** – No implications.

**8.4 Environmental** – No implications.

**8.5 Policy** – No implications.

**8.6 ICT** – No implications.

**8.7 Crime and Disorder** – No implications.

**8.8 Human Rights** – No implications.

**8.9 Equalities** – No implications.

**9. Conclusions**

**9.1** Volatility within the current economic climate continues as a result of Brexit, amongst other things, and, if appropriate, the Section 151 Officer will not hesitate to restrict investments, in line with the approved strategy, should there be a need to do so. Returns on investments will continue at a low level for the foreseeable future, albeit with slight increases following the increase in the base rate, with security being the overriding factor.

**Audra Statham**
**Chief Financial Officer**

**Background papers:**

CIPFA Treasury Management Code of Practice 2017 (the Code)
CIPFA Prudential Code 2017
MHCLG Investment Guidance 2018
MHCLG Guidance on the Minimum Revenue Provision 2018

**Previous minutes:**

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