Appendix 8: Treasury Management Strategy and Prudential Indicators 2019/20 to 2021/2022

The Council is recommended to:
- **approve the Treasury Management Strategy for 2019/20**
- **approve the Treasury Management Indicators for 2019/20**
- **approve the Prudential Indicators 2019/20 to 2021/2022**
- **approve the Treasury Management Policy Statement (Annex 1)**

1. Executive Summary

1.1. This appendix sets out the Council's Treasury Management Strategy for 2018/19 and Prudential Indicators for 2019/20 to 2021/2022.

1.2. The Treasury Management Strategy incorporates a debt management strategy that reflects the Council's potential need to borrow to finance its capital expenditure plans as set out in Appendix **4**.

1.3. The Prudential Indicators set out in this report have been formulated on the basis that additional long-term borrowing may be undertaken to fund the capital investment programme in addition to the capital receipt, grants, other contributions and cash balances. One PWLB loan (£6.4m) matured in October 2018.

2. Context

2.1 Introduction

2.1.1 The Council has adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

2.1.2 In addition, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised guidance on local authority investments in February 2018 that requires the Council to approve an investment strategy before the start of each financial year.

2.1.3 This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Prudential Code, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

2.2 Economic context: Treasury Management Adviser's Assessment

2.2.1 The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

2.3 Interest rate forecasts

2.3.1 The Council has appointed Link Asset Services (formerly known as Capita Asset Services) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The interest rate forecasts provided by Link Asset Services are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. The following table gives their central view.

Table 1: Link Central Interest rate Forecast – November 2018					
	Bank Rate	3 month LIBID	12 month LIBID	25-year PWLB rates	50-year PWLB rates
Mar-19	0.75	0.90	1.20	2.90	2.70
Jun-19	1.00	1.00	1.30	3.00	2.80
Sep-19	1.00	1.10	1.40	3.10	2.90
Dec-19	1.00	1.20	1.50	3.10	2.90
Mar-20	1.25	1.30	1.60	3.20	3.00
Jun-20	1.25	1.40	1.70	3.30	3.10
Dec-20	1.50	1.50	1.90	3.40	3.20
Jun-21	1.75	1.70	2.10	3.50	3.30

The table below shows the lowest, average and highest annual medium-term forecasts for the official Bank rate by independent forecasters compiled by HM Treasury.

Table 2:	**HM Treasury Survey of Forecasts – November 2018**				
	Average annual Bank Rate %				
	2018	2019	2020	2021	2022
Highest	0.75	1.25	2.25	3.00	3.00
Average	0.64	0.97	1.37	1.69	1.92
Lowest	0.50	0.75	0.75	1.00	1.00

2.3.2 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.75%, and the base assumption is that new borrowing will be undertaken anytime the need arises to fund the Capital investment programme.

3. Current and Expected Treasury Portfolios

3.1. Current portfolio

The Council's treasury portfolio as at 31 December 2018 was as follows.

Table 3: Current Portfolio	**Principal amount £m**	**Interest rate %**
Call accounts	15.1	0.15
Money market funds	0.0	0.00
Short-term deposits	5.0	0.95
Long-term deposits	0.00	0.00
Total Investments	**20.1**	**0.35**
Short-term loans	0.00	0.00
Long-term PWLB loans	(401.7)	5.43
Long-term market loans (LOBOs)	-	
Total Borrowing	**(401.7)**	**5.43**
Net Borrowing	**(381.6)**	

3.2. Expected changes in portfolio

According to current cash flow forecasts, net borrowing of £381.6 million is expected to increase as a result of capital financing requirements. This forecast increase in net borrowing will be achieved by reducing investment balances and additional borrowing, as discussed in the borrowing strategy below.

3.3. Budget implications

The recent balance sheet review carried out indicates that there is a borrowing requirement of £360m over the next three years ending 2020/21. All of the borrowing will be for the councils Capital Programme and Non-Treasury or Commercially related projects. The exact timing of borrowing will depend on the Council's cashflow position and/or levels of interest rates. Any surplus monies held at any given time will be invested in line with that of the criteria set out within this strategy.

The regular review of the balance sheet confirms that there will be a requirement to borrow £360 million as set out in the capital financing requirement and to finance the proposed Capital Programme. The amounts and timing will depend on the cashflow requirements. Any surplus monies held at any given time will be invested in line with the criteria set out within this strategy.

The interest payable for the entire amount (£360m) at "today's i.e. 10 October 2018 Public Works Loan Board rate" would therefore be an estimate of £9.25m per annum at 2.65% on 50yr borrowing; Further the yearly budget for the existing £401.7m borrowing is £21.8m at an average interest rate of 5.43%.

The Council would also need to set aside a Minimum Revenue Provision (MRP). The current provision is set at 1.67% or 60yrs for post 2008 borrowing. Note that MRP is calculated on the Capital Finance Requirement (CFR) (as opposed to actual borrowing) so regardless of which loans are taken out within the CFR, the MRP would only grow with an actual change in the borrowing requirement (i.e. unfinanced capitalised expenditure). The MRP over the next three years to 2021/22 is as follows:

2018/19	2019/20	2020/21	2021/22
(5,749)	(7,692)	(9,621)	(10,413)
5,508	6,431	7,361	502
(241)	(1,261)	(2,260)	(9,911)

However the budget for current loans debt interest payable in 2019/20 is £21.8 million, based on an average debt portfolio of £401.7 million at an average interest rate of 5.43%.

Any variations on actual levels of investments and borrowing, and interest rates and its implications will be reported through the Council's regular revenue monitoring process.

3.4. Investment Strategy

The Council holds surplus funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £5.1 million and £119.6 million, and average balances are expected to be in this same range in the forthcoming year, but if borrowing is undertaken ahead of need to spend then the balances could be slightly higher. Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield.

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

3.4.1 <u>Investment criteria and limits</u>

The Council defines the following as being of "high credit quality" (as per the MHCLG Guidance), subject to the monetary and time limits shown.

Table 4: Investment Criteria and Limits		**Counterparty Rating Cash limit**	**Time limit**
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£25m each of which no more than £20m over 1 year	
	AA+		5 years
	AA		4 years
	AA-		3 years
	A+		2 years
	A	£20m each	1 year 6 months
	A-		
	BBB+	£10m each	1 year
UK building societies whose lowest published long term credit rating is BBB and societies without credit ratings with assets greater than £500m		£10m	1 year 6 months

UK building societies whose lowest published long term credit rating is below BBB and/or societies without credit ratings with assets less than £500m but greater than £250m	£5m	1 year
Money Market Funds and similar pooled vehicles whose lowest published credit rating is AAA	1.0% of the Funds size	Instant Access
Table 4: Investment Criteria and Limits	**Cash limit**	**Time limit**
Other non-credit rated pooled investment vehicles such as bond funds up to £1 million and property funds up to £10 million	£1-10m	notice period
UK Local Authorities (irrespective of credit rating)	£25m each	25 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is [**A-**] or higher	£20m each	10 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is [**BBB-**] or higher and those without credit ratings	£10m each	5 years
UK Central government and its agencies (irrespective of credit rating)	unlimited	unlimited
Organisations funded through the Funding Circle Targeted at local businesses within the Council area.	£100,000	5 years

3.4.2 In order to limit risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and the Council's Bankers - RBS) will be £25 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

3.4.3 <u>Current account banking</u>

The Council's current accounts are held with RBS/National Westminster Bank only. The Council will treat RBS as "high credit quality" for the purpose of making investments as per criteria set out in table 3.4.1 above.

RBS (NatWest) as the Council's provider of banking services, is deemed to meet the Councils minimum criteria in terms of its investment strategy i.e. "high credit quality" for the purpose of making investments.

3.5. Building societies

3.5.1 UK building societies without credit ratings will be considered to be of "high credit quality", but subject to a lower cash limit and shorter time limit than rated societies. The Council takes additional comfort from the building societies' regulatory framework and insolvency regime where, in the unlikely event of a building society liquidation, the Council's deposits would be paid out in preference to retail depositors. When the Government amends the building society insolvency regime the Council will review its use of these counterparties to ensure that it continues to comply with the MHCLG investment guidance that local authorities should have regard to Security first of principal invested, then Liquidity and Yield in that order

3.5.2 However, no investments will be made with building societies with assets less than £250 million or equivalent credit rating due to the increased likelihood of default implied by this rating.

3.6. Money market funds

3.6.1 Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council. As part of its shadow banking regulatory proposals, the European Commission implemented a new European framework for Money Market Funds ("MMFs") that came into force in July 2018 that require these funds to segregated as below;

- Public Debt Constant Net Asset Value ("CNAV") MMFs
- Low Volatility NAV ("LVNAV") MMFs or
- Variable NAV ("VNAV") MMFs

It is assumed from the description of the LVNAV that these will mimic CNAV and in order to manage liquidity, the Council will be inclined to invest in any of these funds as they offer same-day liquidity and as an alternative to instant access call accounts which now offer a yield of as low as 0.01%

3.7 Other Pooled Funds:

The Council will also consider using other pooled funds such as pooled property and bond funds that offer enhanced returns over the longer term, but as these are longer term commitments, the Council would undertake due diligence and a selection process before entering into such longer term investments.

3.8 Funding Circle

As part of the 2019/20 investment criteria a small amount of funds will be invested with local companies through the peer to peer lending scheme, The Funding Circle. The inclusion of this option is part treasury management, to test whether investment returns can be boosted, and part policy to support local businesses. These investments will be classified as non-treasury investments in compliance with the new CIPFA & MHCLG guidance. The initial investment pool is small to assess the performance of this option. The Council's finance staff will mainly undertake appropriate due diligence on the Funding Circle counterparties commensurate with the size of any loan but may seek the assistance of the Council's external treasury advisors. As with any loans of this nature there is a possibility of partial or full loss of some of the investments, although overall the Council would expect a better performance than cash investments. The performance of this option will be reported to Members in the annual treasury management report to assess whether to continue or expand the scheme.

3.9 Foreign countries

3.9.1 Investments in foreign countries will be limited to those that hold an AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of £25 million per foreign country. Investments in countries whose lowest sovereign rating is not AAA will be limited to one year's duration. No country limit will apply to investments in the UK, irrespective of the sovereign credit rating.

3.9.2 Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will be classed as UK banks and given the arms-length nature of the parent-subsidiary relationships.

3.9.3 Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

3.10 Risk assessment and credit ratings

3.10.1 The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc. and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

3.10.2 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 (except for rated building societies whose Balance Sheet size is taken into consideration). The Council will not hold speculative grade investments.

3.10.3 Credit ratings are obtained via a live feed from the rating agencies and monitored in conjunction with the Council's treasury advisers. 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 sold, and full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

3.10.4 Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks.

3.10.5 The Council's investments are normally senior unsecured liabilities of the borrower, and the credit rating of the investment is therefore normally identical to the credit rating of the counterparty. However, where a credit rating agency awards a different rating to a particular class of investment instruments, the Council will base its investment decisions on the instrument credit rating rather than the counterparty credit rating.

3.11 Other information on the security of investments

3.11.1 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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

3.11.2 When deteriorating financial market conditions affect the creditworthiness of all organisations this 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.

3.11.3 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 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.

3.12 Non-specified investments

3.12.1 The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- investment is not a long term investment and is due to be repaid within 12 months of arrangement,
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - A body or investment scheme of "high credit quality".

3.12.2 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation, such as company shares. 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. Limits on non-specified investments are shown on Table 5 below;

Table 5

Limits on non-specified investments	Cash Limit
Total Long-Term Investments	£50m
Total Investments with Building Societies without credit rating or rated below [BBB]	£180m
Total of other non-credit rated Pooled Funds	£15m
Total of Funding Circle Loans (non-credit rated)	£0.1m
Total non-specified investments	**£245.1m**

3.12.3 The total cash limit on Money Market Funds has been increased to £50m to diversify away from Debt Management Account Deposit Facility (DMADF) and other local authorities owing to the fixed nature of investments with these institutions which limits the Council's ability to respond to unexpected cash out-flow requirements.

4. Liquidity management

4.1. The Council uses purpose-built cash flow forecasting software (Logotech) to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

4.2. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

4.3. In addition to the above, a new Daily Cash Flow excel workbook is in place. This cash flow is updated, line by line, on a daily basis and compared to the forecast and this is providing further comfort to the Council's cash position. The liquidity position of the Council is reported weekly to the S151 officer

5. Planned investment strategy for 2019/20

5.1. The cash flow forecast will be used to divide surplus funds into three categories:

- Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.

- Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

The investment strategy will be different for each period based on the need to access these funds as outlined in 4 above.

6. Borrowing Strategy

6.1. The Council currently holds £401.7 million of long-term loans, having repaid a loan of £6.4 million that matured in-year. The Council's capital financing requirement (CFR, or underlying need to borrow for capital purposes) as at 31st March 2019 is expected to be £970 million, and is forecast to go up by £ 121 million by March 2020 as capital expenditure is incurred. This will be funded from the current cash balances held and new borrowing.

6.2. The cumulative capital financing requirement (CFR) as at 31st March 2018 was £ 859.1 million. This amount comprises of 408.1 million of external borrowings and 451.0 million of other internal resourcing which negated the requirement to borrow.

6.3. The maximum expected borrowing requirement for 2019/20 is:

Table 6: Maximum Expected borrowing Requirement for 2019/ 20	£m
Change in underlying need to borrow	120.8
Less: Minimum Revenue Provision (MRP)	(0.2)
Less: Finance Lease Repayments and PFI's	(5.5)
Equals: Forecast increase in Capital Financing Requirement (CFR)	**115.1**
Plus: Loans matured in 2018/19	6.4
Equals: Total borrowing requirement 2019/20	**121.5**

6.4. However, depending on the pattern of interest rates during the year, it may be more cost effective to defer borrowing until later years, and to temporarily reduce the size of the Council's investment balance instead.

6.5. In addition, the Council may borrow for short periods of time (normally for up to two weeks) to cover unexpected cash flow shortages.

6.6. **Sources of borrowing**

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board

- any institution approved for investments above
- any other bank or building society approved by the Financial Services Authority
- capital market bond investors
- Special purpose companies created to enable joint local authority bond issues.
- Institutional investors such as pension funds

6.7. **Planned borrowing strategy for 2019/20**

6.6.1 The base assumption is that the Council will consider new borrowing to finance its capital investment programme and any other capitalised expenditure. 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 borrow short-term loans, variable rate loans or to not borrow and reduce the level of investments held instead. However, with long-term rates forecast to rise in the coming years, any such short-term savings will need to be balanced against the potential longer-term costs.

6.6.2 Loans that present additional risk to the authority, such as lender's option borrower's option (LOBO) loans will be limited to £10m. Variable rate loans will be subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

6.6.3 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. 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. However, debt rescheduling opportunities have been limited in the current economic climate and following the increase in the margin added to gilt yields which has impacted PWLB new borrowing rates since October 2010.

6.6.4 The Balance Sheet review and three year forecast to 2020/21 shows that based on the Statement of Accounts for 2017/18 LBL has an underlying borrowing requirement (CFR less Other Long Term Liabilities (OLTL)) of £754m. The Council has Public Works Loan Board (PWLB) borrowing of £408m and the Council is therefore internally borrowed by £346m. This means cash backing up reserves and balances and working capital has been used in lieu of external borrowing. This is both cost effective and low risk.

6.6.5 Usable reserves (£295m) and working capital (£142m) total £437m, which are cash backed by £91m. This under-investment of £204m (£295m reserves - £91m cash) plus the working capital surplus of £142m represents the cash used in lieu of borrowing (the under-borrowed position).

6.6.6 The current forecast for the next three years to 2020/21 shows that:

- The Underlying Long Term Borrowing requirement (ULTBR) will rise by £346m to £1.1bn. A £6.4m PWLB loan will mature in 2018/19.
- Reserves falling by £102m to £192m.
- Working Capital is assumed to stay static at £142m.

6.6.7 Therefore, investments are forecast to fall by £447m to an overdraft position of £356m. This is because the Council has a very ambitious capital programme planned over the next three years, coupled with the Redress scheme (Capital Investment Programme August 2018).

6.6.8 On 12 September 2018 the "need to borrow" was discussed between the Council's s151 officer, deputy s151 officer, Treasury Manager and the Council's advisors Link Asset Services.

6.6.9 The level of internal borrowing and interest rate risk being taken was also covered, looking at the percentage of internal borrowing as part of the Authority's underlying borrowing requirement. This indicated the Council may want to reduce this via external borrowing.

6.6.10 The current maturity profile of the Council's borrowing portfolio aligned to the shape of the yield curve (and expected future increases in CFR) suggests that 50 year maturity loan(s) would initially be the most suitable option to take.

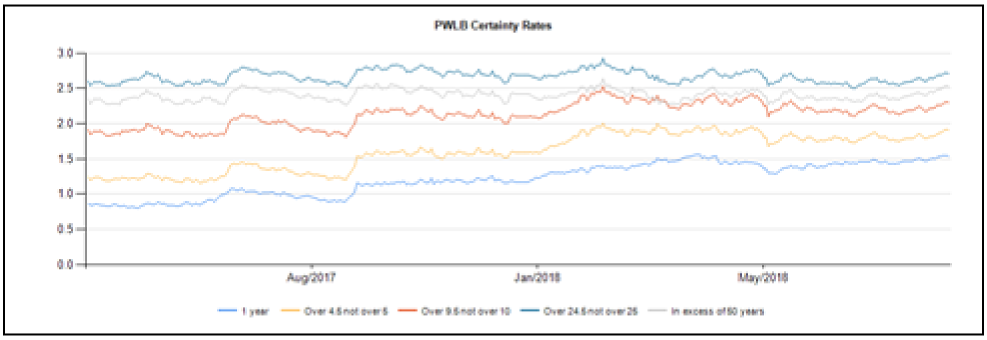
6.6.11 The future movement in CFR was discussed, related to the Council's MRP Policy and expected future capital receipts as a return from some of the elements of capital expenditure being undertaken.

6.6.12 The Council's cash had fallen during 2018/2019 to approximately £60m at September 2018 indicating that the CFR was continuing to increase and/or reserves were being spent.

6.6.13 An estimated borrowing need is forecasted at a maximum of £130m for 2018/19, £100m for 2019/20 and £130m for 2020/21. Borrowing will take place in tranches throughout the three year period, rather than taking this in one lump sum. This would:

- spread the risk in respect of the movement in interest rates and allow gilt yields to be monitored so that the Council could be kept informed of market movements
- It would also allow further analysis of the individual projections internally by the capital and major projects teams.
- The Interest Rate Forecast was reviewed, with interest rates expected to increase gradually over the next few years.

6.6.14 The graph below illustrates the historical movement of PWLB rates in 2017/18 and 2018/19 indicating periods of volatility but an overall trend of 50 year maturity borrowing just under the 2.5% level.



6.6.15 Therefore 50yr PWLB borrowing will be undertaken for 2018/19, 2019/20 and 2020/21.

The Borrowing Process

6.6.16 A request for up-to-date information from key officers (Housing Revenue Account (HRA), Schools, Reporting, Strategy and budgets, Major Projects, Pensions and Treasury) will be sought and obtained on a quarterly basis.

6.6.17 Once obtained that the Council will work with its advisor Link Asset Services with regards to the timing and amount of borrowing moving forward over the next three to five years.

6.6.18 The borrowing will be assessed on mainly a quarterly basis and if more efficient on a monthly basis – this will be dependent on market activity.

6.6.19 The final decision i.e. type, amounts, rates and duration will always be made by the S151 Officer.

6.7 Policy on Use of Financial Derivatives

6.7.1 Local authorities (including this Council) have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

6.7.2 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

	Agreed Performance or target			
Indicator Description	**2018/19**	**2019/2020**	**2020/21**	**2021/22**
Borrowing Limits				
Authorised Limit	£934m	£1,041m	£1,162m	£1,252m
Authorised limit – other long-term liabilities	101m	96m	91m	86m
Operational Limit	859m	966m	1,087m	1,177m
Operational limit – other long-term liabilities	101m	96m	91m	86m
Security: average credit rating				
Portfolio average credit rating	A-	A-	A-	A-
MHCLG Non-specified investments Limits				
Total Long-Term Investments	£50m	£50m	£50m	£50m
Total Investments with Building Societies without credit rating or rated below [BBB]	£180m	£180m	£180m	£180m
Total of other non-credit rated Pooled Funds	£15m	£15m	£15m	£15m
Total of Funding Circle Loans (non-credit rated)	£0.1m	£0.1m	£0.1m	£0.1m
MHCLG Specified investments Limits				
Total investments in MMF*	£50m	£50m	£50m	£50m
Budgeted Investment Return				
Return on Investments	0.75%			
Liquidity: cash available within three months				
Total cash available without borrowing	£10m	£10m	£10m	£10m
Total cash available including borrowing	£20m	£20m	£20m	£20m
Maturity structure of borrowing				
Under 12 months	0-100%	0-100%	0-100%	0-100%
12 months and within 24 months	0-100%	0-100%	0-100%	0-100%
24 months and within five years	0-100%	0-100%	0-100%	0-100%
Five years and within 10 years	0-100%	0-100%	0-100%	0-100%
10 to 20 years	0-100%	0-100%	0-100%	0-100%
20 to 30 years	0-100%	0-100%	0-100%	0-100%
30 to 40 years	0-100%	0-100%	0-100%	0-100%
40 to 50 years	0-100%	0-100%	0-100%	0-100%
Principal sums invested for periods longer than 365 days				
Investments longer than 365 but less than 2 years	£50m	£50m	£50m	£50m

7.0 Treasury Management Indicators

7.1 The Council measures and manages its exposures to treasury management risks using the following indicators. The Council is asked to approve the following indicators summarised in the below table with details below:

7.1.1 Security: average credit rating

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the weighted average credit rating of its investment portfolio.

	Target
Portfolio average credit rating	A-

For the purpose of this indicator, unrated building societies are assigned an indicative rating of BBB, and unrated local authorities are assumed to hold an AA+ rating.

7.1.2 Liquidity: cash available within three months

The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period.

	Target
Total cash available without borrowing	£10m
Total cash available including borrowing	£20m

7.1.3 Interest rate exposures

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt but by use of internal resources (reserves and other cash balances). This strategy is prudent as investment returns are low.
Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
• if it was felt that there was a significant risk of a sharp FALL in long and short term rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
• if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
Any decisions will be reported to the appropriate decision making body at the next available opportunity.

7.1.4 Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

Maturity structure of fixed interest rate borrowing 2019/20	Upper	Lower
Under 12 months	0-100%	0%
12 months and within 24 months	0-100%	0%
24 months and within five years	0-100%	0%
Five years and within 10 years	0-100%	0%

10 years and within 20 years	0-100%	0%
20 years and within 30 years	0-100%	0%
30 years and above	0-100%	0%
Mat**urity structure of variable interest rate borrowing 2019/20**	Upper	Lower
Under 12 months	0-100%	0%
12 months to 2 years	0-100%	0%
2 years to 5 years	0-100%	0%
5 years to 10 years	0-100%	0%
10 years to 20 years	0-100%	0%
20 years to 30 years	0-100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

7.1.5 <u>Principal sums invested for periods longer than 365 days</u>

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£50m	£50m	£50m

8. Brokers

A broker is a completely independent player in over-the-counter (OTC) financial or non-financial markets. They primarily act as agent between the Council and deposit takers, when there is no direct access for the Council

Borrowings;
The Council has not used and does not plan to use the services of brokers for the purposes of borrowing as it only borrows from the Public Works Loan Board with whom it has direct contact.

Investments
The Council deals with most of its counterparties directly (as has been the case over the past five or so years) but from time to time the Council will use the services of brokers to act as agents between the Council and its counterparties when lending.

However no one broker will be favoured by the Council neither will the Council choose a broker who has secured less favourable terms for the Council just to be fair to them. The Council will ensure that sufficient quotes are obtained before investment decisions are made via brokers.

Charges
Brokers charge the borrower and not the lender; to this end the Council will not incur any broker fees.

Reporting
The Deputy Head of Treasury and Pensions will flag the use of brokers to the Head of Treasury and Pensions prior to their use. Subsequently all due diligence checks will be carried out before the broker is used. This wil then be reported to the S151 as part of the weekly Treasury Management Briefings.

9. Prudential Indicators 2019/20 to 2021/22

9.1 CIPFA's Prudential Code for Capital Finance in Local Authorities requires Council to use a set of indicators and limits to provide a control framework for capital investment and treasury management decisions. The Council is being asked to approve these Prudential Indicators as part of the Revenue & Capital Budget report.

9.2 Setting the Borrowing Limits.

9.2.1 The Council is required to set the Operational Boundary and the Authorised Limit to its external debt. External debt refers to borrowing and other long-term liabilities e.g. Leasing arrangements.

9.2.2 Both the limits need to be consistent with the Council's plans for capital expenditure and financing and with its treasury management policy statement and practices.

9.2.3 The operational boundary is to directly link into the Council's plans for capital expenditure, the estimates of the capital financing requirement and the estimate of the cash flow requirements for all other purposes, including revenue.

9.2.4 Table 7 below sets out the Borrowing Limits for the years 2019/20 to 2021/22.

Table 7: Borrowing Limits	2019/20 £m	2020/21 £m	2021/22 £m
Operational boundary – borrowing	966	1,087	1,177
Operational boundary – other long-term liabilities	96	91	86
Operational boundary – TOTAL	1,062	1,178	1,263
Authorised limit – borrowing	1,041	1,162	1,183
Authorised limit – other long-term liabilities	96	91	86
Authorised limit – TOTAL	1,137	1,253	1,338

9.3 Capital Expenditure and Affordability

9.3.1 The purpose of the affordability indicators is to show whether capital investment decisions are affordable and sustainable in the medium term. The key information that indicates both the affordability and sustainability of the programme is shown in the table below:-

Table 8: General Fund Prudential Indicators - Affordability	2018/19 Budget (£'000)	2019/20 Budget (£'000)	2020/21 Budget (£'000)	2021/22 Budget (£'000)
Estimates of capital expenditure	240,556	128,068	108,863	107,000
Estimates of capital financing requirement ("CFR" incl. PFI's)	408,135	516,640	634,138	718,567
GF ratio of financing costs to revenue (%)	1.09%	1.06%	1.66%	1.66%
Incremental impact on band D council tax levels (£)	0.00	0.00	0.01	0.01

Table 9: HRA Prudential Indicators - Affordability	2018/19 Budget (£'000)	2019/20 Budget (£'000)	2020/21 Budget (£'000	2021/22 Budget (£'000)
Estimates of capital expenditure	44,100	45,344	45,459	39,004
Estimates of capital financing requirement ("CFR" incl. PFI's)	450,999	449,829	453,159	458,160

HRA ratio of financing costs to revenue (%)	11.94%	11.83%	11.61%	11.39%
Incremental impact on housing rents (£)	-0.03	-0.01	0.01	0.01

Table 10: Combined Capital Financing Requirement	**2018/19 Budget (£'000)**	**2019/20 Budget (£'000)**	**2020/21 Budget (£'000**	**2021/22 Budget (£'000)**
Estimates of capital financing requirement (CFR)	859,134	966,469	1,087,297	1,176,727

9.3.2 The table above sets out the following indicators for capital expenditure and affordability:

- Actual and estimated capital expenditure;
- Actual and estimated capital financing requirement;
- Actual and estimated ratio of financing costs to net revenue stream; and
- Estimated incremental impact on council tax and housing rents.

9.3.3 The estimates of capital expenditure indicator reflects the capital expenditure and funding plans set out in Appendices 4 and 5, plus the capitalised value and funding of relevant long term liabilities (such as PFI arrangements).

9.3.4 Estimates of Capital Financing Requirement ("CFR"): there is considerable change on the General Fund CFR for the period 2019/20 to 2021/22, this is largely due to substantial capital projects such as Lambeth Redress Scheme and Homes for Lambeth. The HRA indicator Estimates of Capital Financing Requirement increase over the period as the HRA implements its capital investment plans following recommendations set out by the Lambeth Housing Commission

9.3.5 It should be noted that the CFR does not reflect the actual level of external debt. Neither does it reflect the actual capital expenditure to be incurred in these years. They are indications of the level of capital expenditure the authority plans to finance from borrowing (that is, its underlying need to borrow). The Director of Finance, as Chief Finance officer, determines how capital expenditure is actually financed once a year, after year-end.

9.3.6 The authority has a number of significant capital investment schemes in the early stages of development. The potential borrowing requirements of these schemes have now been incorporated within the CFR.

9.3.7 **Ratio of Financing Costs to Net Revenue %:** The estimated General Fund and HRA ratios are forecast to increase as the council implements its ambitious Capital Investment plans.

9.3.8 **Incremental Impact on Council tax/Housing rents:** this is a key indicator of affordability since any decision to borrow to finance capital expenditure creates incremental costs to the authority, which may impact on council tax and/or housing rents. The indicators express the cost of proposed changes in the three year capital programme recommended in this budget report, in comparison with the council's existing commitments and current plans. It is essential to note that this indicator is not a projection of increases in council tax/housing rents over the three years. It is simply an additional tool to aid medium term financial planning.

9.4 Prudence

9.4.1 Gross Debt and the CFR indicator is a key control over the council's borrowing activity in relation to its capital expenditure and ensures that over the medium term net borrowing is only for capital purposes.

9.4.2 No difficulty is anticipated in meeting this requirement for the current or future years having taken into account current commitments, existing plans, and the proposals in the budget report. Borrowing is anticipated for now.

Gross Debt and the CFR Indicator	**2019/20 (£m)**
Opening Borrowing	401.70
Opening Finance Leases	90.74
Opening Gross Debt	**492.44**
CFR March 2019	**966**

10. Other Matters

10.1 The MHCLG Investment Guidance requires the Council to note the following matters each year as part of the investment strategy:

10.2 Treasury management advisers

10.2.1 The Council uses Link Asset Services (formerly known as Capita Asset Services) as its external treasury management advisors, having reappointed them through a tender process. The contract started on 10 May 2017.

The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources.

Link Asset Services now therefore provides advice and information on the Council's investment and borrowing activities, although responsibility for final decision making remains with the Council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates, and
- Training courses.

10.2.2 The quality of this service is controlled by monitoring its relevance to the requirements of the authority, the speed at which requests for information are responded to and how accurate the advice is when evaluated against other independent but similar institutions.

10.3 Investment training

10.3.1 The needs of the Council's treasury management staff for training in investment management are assessed quarterly as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

10.3.2 Staff regularly attend training courses, seminars and conferences provided by Link Asset Services (formerly known as Capita Asset Services) and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations. The Council has therefore made a commitment to support staff in their pursuit to obtaining and maintaining the relevant skills, qualifications and membership needed as recommended by the CIPFA code TMP10 "*The Council recognises that relevant individuals will need appropriate levels of training in treasury management due to its increasing complexity. There are two categories of relevant individuals: - Treasury management staff employed by the Council and Members charged with governance of the treasury management function. All treasury management staff shall receive appropriate training relevant to the requirements of their duties at the appropriate time. The Council operates a Professional Development Review system which identifies the training requirements of individual members of staff engaged on treasury related activities."*

10.4 Investment of money borrowed in advance of need

10.4.1 The Council may, from time to time, borrow in advance of spending 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.

10.4.2 The total amount borrowed will not exceed the authorised borrowing limit of £1,041 million in 2019/20. The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

10.5 Policy on charging interest to the Housing Revenue Account

10.5.1 Following the reform of housing finance as set out in the report to Cabinet on 12th September 2011 the Council is free to adopt its own policy on sharing interest costs and income between the General Fund and Housing Revenue Account (HRA). The CIPFA Code recommends that authorities state their policy on this matter each year in their treasury management strategy.

10.5.2 The report agreed the separation of its external loans into GF and HRA pools and the mechanism for charging interest to each revenue account based on the weighted average cost of those loans. Following ratification of the localism bill on the 28 March 2012 the remaining loans were split into a GF pool (£169.6m) and an HRA pool (£243.1m). The split at the beginning of 2018/19 was GF pool (£31.9m) and HRA pool (£376.1m).

10.5.3 Interest costs chargeable to the HRA per 2018/19 will be determined once the financing of the Capital Investment Programme has been completed at year end.

10.5.4 Under self-financing the government has set a cap for each local authority. The Housing Commission recommended that the council should borrow up to this amount to fund capital expenditure for the Housing Revenue Account over a 3 to 5 year period starting in 2012/13.

When measuring the HRA capital financing requirement (HRA CFR) against the government's debt cap for the Council, credit arrangements in connection with PFI schemes that have been approved by the Secretary of State for Communities and Local Government are excluded. This is in tandem with the CLG Limits on Indebtedness Determination 2012 - Amending Determination 2013 (No.2).

	2019/20	**2020/21**	**2021/22**
HRA Limit on indebtedness	**£m**	**£m**	**£m**
HRA Borrowing Limit	**408.078**	**408.078**	**408.078**
HRA Capital Financing Requirement	450,999	449,829	453,159
Less Myatt's Field North PFI	(76,037)	(72,907)	(72,907)
HCFR	**374,962**	**376,923**	**380,253**
Additional HRA borrowing allowable	33,116	31,155	27,825

10.6 Other Options Considered

The CLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted the Deputy Leader (Finance), believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Adopt a narrower definition of "high credit quality" and/or shorter time limits	Interest income will be lower	Reduced risk of losses from credit related defaults
Adopt a wider definition of "high credit quality" and/or longer time limits	Interest income will be higher	Increased risk of losses from credit related defaults
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income in the short/medium term depending on changes in interest rate. Repaying	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain

	debt would currently include significant premium costs, which make it unattractive.	

10.7 Management Practices for Non-Treasury Investments

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity, includes loans supporting service outcomes, investments in subsidiaries and investment property portfolios.

The Council will ensure that all the Council's investments are covered in the capital strategy or equivalent, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

The Council will maintain a schedule, setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the Council's risk exposure.

Annex 1

Treasury Management Policy Statement

The Council's financial regulations require it to create and maintain a treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

Definition

The Council defines its treasury management activities as: the management of the Council's 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.

Risk management

The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

Value for money

The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

Borrowing policy

The Council greatly values revenue budget stability and will therefore borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the *Local Government Act 2003*, and will have regard to the *CIPFA Prudential Code for Capital Finance in*

Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment policy

The Council’s primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.