



# Treasury Management Strategy 2019-20



Northamptonshire  
County Council

## **1 Introduction**

### **CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes**

- 1.1 CIPFA has defined treasury management as “the management of the organisation’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.”
- 1.2 The Council has adopted CIPFA’s Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (the Treasury Code). The adoption is included in the Council’s Constitution Part 4 at paragraph 7.7 of the Financial Procedure Rules.

### **CIPFA Prudential Code for Capital Finance in Local Authorities**

- 1.3 The CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) is a professional code of practice. Local authorities have a statutory requirement to comply with the Prudential Code when making capital investment decisions and carrying out their duties under Part 1 of the Local Government Act 2003 (Capital Finance etc. and Accounts).
- 1.4 The CIPFA Prudential Code sets out the manner in which capital spending plans should be considered and approved, and in conjunction with this, the requirement for an integrated treasury management strategy.
- 1.5 Councils are required to set and monitor a range of prudential indicators for capital finance, covering affordability, prudence, and a range of treasury indicators.

### **Treasury Management Policy Statement**

- 1.6 The Council’s Treasury Management Policy Statement is included in Appendix I-1. The policy statement follows the wording recommended by the latest edition of the CIPFA Treasury Code.

### **Treasury Management Practices**

- 1.7 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.
- 1.8 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. They are reviewed annually and approved by the Council’s Section 151 (S151) Officer.

### **The Treasury Management Strategy**

- 1.9 It is a requirement under the Treasury Code to produce an annual strategy report on proposed treasury management activities for the year.

1.10 The Council's Treasury Management Strategy is drafted in the context of the key principles of the Treasury Code, as follows:

- Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities.
- Their policies and practices should make clear that the effective management and control of risk are prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and liquidity when investing funds.
- They should acknowledge that the pursuit of value for money in treasury management, and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

1.11 The purpose of the Treasury Management Strategy is to establish the framework for the effective and efficient management of the Council's treasury management activity, including the Council's investment portfolio, within legislative, regulatory, and best practice regimes, and balancing risk against reward in the best interests of stewardship of the public purse.

1.12 The Treasury Management Strategy incorporates:

- The Council's capital financing and borrowing strategy for the coming year;
- The Council's policy on the making of Minimum Revenue Provision (MRP) for the repayment of debt, as required by the Local Authorities (Capital Finance & Accounting) (Amendments) (England) Regulations 2008;
- The Affordable Borrowing Limit as required by the Local Government Act 2003;
- The Annual Investment Strategy for the coming year as required by the MHCLG revised Guidance on Local Government Investments issued in 2018.

1.13 The strategy takes into account the impact of the Council's Medium Term Financial Plan (MTFP), its revenue budget and capital programme, the balance sheet position and the outlook for interest rates.

1.14 The Treasury Management Strategy also includes the Council's:

- Policy on borrowing in advance of need;
- Counterparty creditworthiness policies.

- 1.15 The main changes from the Treasury Management Strategy adopted in 2018-19 are:
- Updates to interest rate forecast; current interest rate position and forecasts across medium term horizon;
  - Updates to debt financing budget forecasts; based on latest assumptions contained within this strategy;
  - Updates and changes to Prudential and Treasury Indicators; CIPFA have streamlined the number of indicators to be presented;
  - Updated MRP Policy; in line with decision approved by full Council on 22nd March 2018.
- 1.16 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. The Treasury Management Scheme of Delegation is shown in Appendix I-2.

## **2 Current Treasury Management Position**

- 2.1 The Council has in the past raised significant sums of short-term borrowing through other local authorities to minimise interest costs. Since the Councils budget position has become clearer, other local authorities have expressed concern about whether these loans will be repaid. This concern is unfounded because whilst the Council may have a budget difficulty, it does have significant capacity to raise cash funds at short notice.
- 2.2 The Councils projected treasury portfolio position at 31<sup>st</sup> March 2019, with forward projections into future years, is summarised below. Table 1 shows the actual external borrowing (the treasury management operations), against the capital borrowing need (the CFR), highlighting any over or under borrowing (also known as internal borrowing).
- 2.3 The Council is currently maintaining an internal/under borrowed cash position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt. The Council could therefore, if it needed to, reverse the internal borrowing position to fund the underlying capital borrowing requirement entirely from external borrowing, so bringing additional cash back into the Council. However raising additional external borrowing brings with it increased interest costs, so the Councils strategic position is to minimise these costs where possible.
- 2.4 The CFR is the total of 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.
- 2.5 Any capital expenditure which has not immediately been paid for will increase the CFR. The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need over each asset's life. The CFR, borrowing and investment figures include sums related to third party loans, but excludes PFI and Finance Lease liabilities.

**Table 1: Forecast Borrowing and Investment Balances**

£m	2018-19 Forecast £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m
<b>External borrowing</b>						
Borrowing at 1 April b/f	600.8	600.0	630.0	645.0	655.0	655.0
Net Borrowing Requirement to fund capital programme (see Table 2 below)	19.4	24.8	3.0	3.5	(2.7)	0.0
MRP <sup>1</sup>	(0.1)	(0.1)	(1.0)	(1.9)	(2.7)	(3.6)
Internal borrowing (increase)/reduction <sup>2</sup>	(20.1)	5.3	13.0	8.4	5.4	3.6
<b>(1) Actual borrowing at 31 March c/f</b>	<b>600.0</b>	<b>630.0</b>	<b>645.0</b>	<b>655.0</b>	<b>655.0</b>	<b>655.0</b>
<b>Capital Borrowing</b>						
<i>Capital Borrowing</i>	<i>578.8</i>	<i>610.1</i>	<i>627.3</i>	<i>638.7</i>	<i>640.2</i>	<i>641.5</i>
<i>Third Party Loans</i>	<i>21.2</i>	<i>19.9</i>	<i>17.7</i>	<i>16.3</i>	<i>14.8</i>	<i>13.5</i>
<b>Actual borrowing at 31 March c/f</b>	<b>600.0</b>	<b>630.0</b>	<b>645.0</b>	<b>655.0</b>	<b>655.0</b>	<b>655.0</b>
<b>(2) CFR – the borrowing need</b>						
<b>(2) CFR – the borrowing need</b>	<b>715.7</b>	<b>740.4</b>	<b>742.4</b>	<b>744.0</b>	<b>738.4</b>	<b>734.8</b>
<b>(3) [2 – 1] Internal Borrowing <sup>2</sup></b>						
<b>(3) [2 – 1] Internal Borrowing <sup>2</sup></b>	<b>115.7</b>	<b>110.4</b>	<b>97.4</b>	<b>89.0</b>	<b>83.4</b>	<b>79.8</b>
<b>Investments</b>						
Funds Available for Investment at 1 April b/f <sup>3</sup>	57.6	27.2	28.5	23.1	23.5	18.1
Change in Funds Available for Investment	(30.4)	1.3	(5.4)	0.4	(5.4)	(1.5)
<b>(4) Investments at 31 March c/f</b>	<b>27.2</b>	<b>28.5</b>	<b>23.1</b>	<b>23.5</b>	<b>18.1</b>	<b>16.6</b>
<b>Investment Balances <sup>3</sup></b>						
<i>Investment Balances <sup>3</sup></i>	<i>5.0</i>	<i>7.6</i>	<i>4.4</i>	<i>6.3</i>	<i>2.3</i>	<i>2.1</i>
<i>Third Party Loans</i>	<i>22.2</i>	<i>20.9</i>	<i>18.7</i>	<i>17.3</i>	<i>15.8</i>	<i>14.5</i>
<b>Investments at 31 March c/f</b>	<b>27.2</b>	<b>28.5</b>	<b>23.1</b>	<b>23.5</b>	<b>18.1</b>	<b>16.6</b>
<b>(5) [1 – 4] Net borrowing</b>						
<b>(5) [1 – 4] Net borrowing</b>	<b>572.8</b>	<b>621.6</b>	<b>642.3</b>	<b>661.8</b>	<b>666.8</b>	<b>673.3</b>

<sup>1</sup> Appendix I-4 sets out the Councils MRP policy. Changes to the MRP policy for 2017-18 resulted in identification of an overprovision of MRP when compared against actual MRP charges. This overprovision is being applied prospectively from 2017-18 onwards until fully exhausted, reducing annual MRP charges to a minimal charge of £0.1m. From 2020/21 onwards, MRP will increase by £0.9m per annum in a prudent manner to progressively reinstate the charge to proper levels in the future.

<sup>2</sup> Internal borrowing is effectively the difference between the underlying need to borrow for capital purposes and actual borrowing held. The CFR has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent while investment returns are low and to mitigate against counterparty risk. The Council is therefore maintaining an under borrowed position.

<sup>3</sup> Consequent to maintaining an under borrowed position, the level of funds available for investment (excluding third party loans) will be kept to a minimum. Sufficient liquidity will be maintained during the course of the year to meet expected payments, as projected in the Council's cash flow modelling.

**Table 2: Capital Borrowing Requirement**

Capital Expenditure	2018-19 Forecast £m	2019-20 Estimate £m	2020-21 Estimate £m	2021-22 Estimate £m	2022-23 Estimate £m	2023-24 Estimate £m
Net financing need for the year	19.4	24.8	3.0	3.5	(2.7)	0.0

2.6 Within the set of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. Among these the Council needs to ensure that its gross borrowing does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes except to cover short term cash flows.

2.7 The Executive Director Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, the proposals in this strategy, and the Budget report and Medium Term Financial Plan.

### 3 Prospects for Interest Rates

3.1 The Council has appointed Link Asset Services (LAS) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the LAS central view for short term (Bank Rate) and longer fixed interest rates.

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

3.2 The flow of generally positive economic statistics after the quarter ended 30th June meant that it came as no surprise that the Bank of England's Monetary Policy Committee (MPC) came to a decision on 2nd August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019,

followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

- 3.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. Over the last 25 years, we have been through a period of falling bond yields as inflation subsided to, then stabilised at, much lower levels than before. After the financial crash of 2008, central banks implemented substantial programmes of quantitative easing - the purchases of government and other debt. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.
- 3.4 Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.
- 3.5 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 3.6 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

### **Investment and borrowing rates**

- 3.7 Investment returns in the current economic climate are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- 3.8 Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. The policy of internal borrowing by avoiding new external debt and running down cash balances as a temporary measure has served

the Council well over the last few years. However, this position will be carefully monitored during 2019-20 to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance capital expenditure or the refinancing of maturing debt.

3.9 Cost of carry (the net difference between borrowing costs outweighing investment returns) remains a key factor in assessing any new long-term borrowing decisions.

#### **4 Borrowing Strategy**

4.1 The overarching objectives for the Council's borrowing strategy are as follows:

- To manage the Council's debt maturity profile; this is achieved by monitoring short and long term cash flow forecasts in tandem with balance sheet analysis;
- To maintain a view on current and possible future interest rate movements, and to plan borrowing accordingly; this is achieved by consultation with the Councils treasury advisors and monitoring of other economic commentary to undertake sensitivity analysis;
- To monitor and review the balance between fixed and variable rate loans against the background of interest rates and the Prudential Indicators; this is achieved by consultation with the Councils treasury advisors and monitoring of other economic commentary to undertake sensitivity analysis;
- Challenge reliance on the PWLB as a source of funding and review all alternative options available, including forward loan agreements; this is achieved by regular communication with money market brokers, financial institutions, and other debt issuers and appraised in conjunction with the Councils treasury advisors;
- Provide value for money and savings where possible to meet budgetary pressures; this is achieved by the periodic appraisal of borrowing options, sensitivity analysis of forecast delivery of the approved capital programme and its impact on the overall underlying borrowing requirement, and cashflow analysis.

4.2 The Council is currently maintaining an internal/under borrowed cash position. This means that the capital borrowing need (the Capital Financing Requirement) has not been fully funded with loan debt. Instead cash in hand supporting the Council's reserves, balances, and positive cash inflows has been used as an alternative temporary funding measure. This strategy is prudent in the current economic climate - as returns achievable from the investment of cash are lower than the cost of raising additional loan debt, and counterparty risk remains elevated – but this will need to be reversed over time as and when the original requirement for that cash arrives.

4.3 The under borrowing position has been maximised during 2018-19, which has resulted in net revenue interest savings whilst also minimising credit exposure risk. Looking forward, projections in Section 2, Table 1 above show that the CFR – the Council's underlying capital borrowing requirement - is increasing over the next three years. At the same time, cash backed reserves and balances are projected to

reduce. Therefore additional borrowing, which has been budgeted for within the medium term Debt Financing budgets, will be required to maintain sufficient operational cash resources.

- 4.4 Given that short term interest rates are significantly lower than long term interest rates and this position is set to remain this way for some years to come, it is more cost efficient in the short term to combine the use of internal resources with short term borrowing. However, the decision to raise short dated loans to generate short term savings will be evaluated against the potential for incurring additional long term borrowing costs in future years when long term interest rates are forecast to be higher.
- 4.5 Sources of finance include loans from other local authorities, the PWLB, as well as other financial institutions, banks and building societies. The Council has also agreed to support the UK Municipal Bonds Agency (UKMBA) and will consider drawing down funding from the Agency in line with its overall strategy as appropriate.
- 4.6 Against this background and the risks within the economic forecast, caution will be adopted with the 2019-20 treasury operations. The LGSS Treasury Team will monitor interest rates in financial markets to brief the Executive Director Finance and adopt a pragmatic approach to changing circumstances. For example:
- 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 a relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered;
  - if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

### **Prudential & Treasury Indicators**

- 4.7 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators. The Prudential Code for Capital Finance in Local Authorities was updated in 2018.
- 4.8 A full set of Prudential Indicators and borrowing limits are shown in Appendix I-3.

### **Policy on Borrowing in Advance of Need**

- 4.9 Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for

money can be demonstrated and that the Council can ensure the security of such funds. Borrowing in advance will be made within the following constraints:

Year	Max. Borrowing in advance	Notes
2019-20	100%	Borrowing in advance will be limited to no more than the expected increase in borrowing need (CFR) over the period of the approved Medium Term Capital Programme, a maximum of 3 years in advance.
2020-21	50%	
2021-22	25%	

- 4.10 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the Council's reporting mechanism for treasury management and capital financing matters.
- 4.11 As mentioned within 4.2 above, the Council is currently maintaining an internally borrowed cash position and, although new funding will be required to meet the net capital financing need for 2019/20, it is not anticipated that borrowing in advance of future years financing needs will take place.
- 4.12 The Council will not borrow more than or in advance of its needs to purely profit from the investment of the extra sums borrowed.

### **Debt Rescheduling**

- 4.13 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term borrowing to short term borrowing.
- 4.14 Consideration will also be given to identifying whether there is any potential for making interest savings by running down investment balances to repay debt prematurely, as short term rates on investments are likely to remain lower than rates paid on current debt.
- 4.15 However, any potential savings will need to be considered in the light of the Councils current treasury position and, in the current economic climate, the substantial exit costs associated of any early debt repayment.
- 4.16 The reasons for any rescheduling to take place will include:
- the generation of cash savings and/or discounted cash flow savings;
  - helping to fulfil the treasury strategy; and
  - enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 4.17 The LGSS Treasury Team maintain open dialogue with its lenders and consider any early repayment proposals on a case by case basis, taking advice from the Councils treasury advisors where appropriate.

- 4.18 Any rescheduling activity decision will be made by the Executive Director Finance, and reported to Cabinet at the next scheduled Treasury Management quarterly report following its action.

## **5 Minimum Revenue Provision**

- 5.1 The Council is required to repay annually an element of its total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources (the CFR). This is achieved through a revenue charge known as the minimum revenue provision – MRP. It is also allowed to undertake additional voluntary payments (voluntary revenue provision - VRP).
- 5.2 MHCLG Regulations have been issued which require full Council, upon the recommendation of Cabinet or equivalent committee, to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the MRP Policy in Appendix I-4 which sets out how MRP will be charged against particular asset types or other forms of capital expenditure.
- 5.3 The Council last updated its MRP Policy on 22<sup>nd</sup> March 2018. This included backdating annuity method calculation methodology to apply from 2007/08 onwards for historic and unsupported debt liability (excluding PFI and Finance Leases). This recalculation, when compared to actual MRP charges incurred in prior years under the previous calculation basis, identified a cumulative amount of overprovision had the Council adopted the annuity method. This sum will be applied prospectively from 2017-18 onwards to reduce future years MRP charges. Under statutory guidance, an MRP charge for any given year cannot be zero, therefore at least a minimal charge must be made. For 2018-19 and 2019-20, this element of MRP charge will be reduced to £0.1m. From 2020-21, MRP charges will be prudently increased on a stepped basis to eventually reinstate this charge and budget provision over time, as the overprovision sum is consumed.
- 5.4 The Council, in conjunction with its Treasury Management advisors, considers the MRP policy to be prudent.

## **6 Investment Strategy**

- 6.1 Government guidance on Local Government Investments in England requires that an Annual Investment Strategy (AIS) be set. The Guidance permits the Treasury Management Strategy Statement (TMSS) and the AIS to be combined into one document.
- 6.2 The Council's general policy objective is to invest its surplus funds prudently. As such the Council's investment priorities, in priority order, are:
- security of the invested capital;
  - liquidity of the invested capital; and
  - the yield received from the investment.
- 6.3 A copy of the Council's Investment Strategy is shown in Appendix I-5.

## **7 Risk Analysis and Forecast Sensitivity**

### **Risk Management**

7.1 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. Treasury management risks are identified in the Council's approved Treasury Management Practices. The main risks to the treasury activities are:

- Credit and counterparty risk (security of investments);
- Liquidity risk (adequacy of cash resources);
- Interest rate risk (fluctuations in interest rate levels);
- Exchange rate risk (fluctuations in exchange rates);
- Refinancing risks (impact of debt maturing in future years);
- Legal and regulatory risk (non-compliance with statutory and regulatory requirements);
- Fraud, error and corruption, and contingency management (in normal and business continuity situations);
- Market risk (fluctuations in the value of principal sums).

7.2 The TMP Schedules set out the ways in which the Council seeks to mitigate these risks. Examples are the segregation of duties (to counter fraud, error and corruption), and the use of creditworthiness criteria and counterparty limits (to minimise credit and counterparty risk). Council officers, in conjunction with the treasury advisors, will monitor these risks closely.

### **Sensitivity of the Forecast**

7.3 The sensitivity of the forecast is linked primarily to movements in interest rates and in cash balances, both of which can be volatile. Interest rates in particular are subject to global external influences over which the Council has no control.

7.4 Both interest rates and cash balances will be monitored closely throughout the year and potential impacts on the Council's debt financing budget will be assessed. Action will be taken as appropriate, within the limits of the TMP Schedules and the treasury strategy, and in line with the Council's risk appetite, to keep negative variations to a minimum. Any significant variations will be reported to Cabinet as part of the Council's regular budget monitoring arrangements.

## **8 Reporting Arrangements**

### ***Capital Strategy***

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

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

8.2 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.

8.3 This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The Capital Strategy 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 payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

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

8.5 Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

8.6 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.

8.7 The Capital Strategy will also consider the proportionality between the treasury investments shown throughout this report and non-treasury investments.

### ***Treasury Management Reporting***

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

a) **Prudential and treasury indicators and treasury strategy (this report)** - The first and most important report is forward looking and covers:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);

- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b) **A mid-year treasury management report** – This is primarily a progress report to Cabinet and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, Cabinet will receive quarterly update reports.

c) **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

8.9 In line with Code, Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are:

a) **Annual Treasury Management Strategy**; this provides Council with details of capital plans and impact upon prudential indicators, the MRP Policy setting out how residual capital debt liability is charged to revenue over time, the Treasury Management Strategy setting out how the investments and borrowings are to be organised (including treasury indicators), and an Investment Strategy setting out the parameters on how investments are to be managed.

b) **Treasury Management Mid-Year Report**; this will update the Cabinet with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the agreed treasury strategy is meeting the Council's stated capital financing objectives, or whether any policies require revision.

c) **Treasury Management Outturn Report**; this provides Cabinet with details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

## 9 Treasury Management Budget

9.1 The table below provides a breakdown of the treasury management budget.

Description	2019-20	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m	£m
Interest payable on borrowing	21.0	20.8	21.7	23.3	24.3
Interest receivable from investments	-0.8	-0.8	-0.8	-0.8	-0.9
Debt management expenses	0.4	0.4	0.4	0.4	0.4
MRP (inc PFI bullet)	0.8	1.7	2.6	3.5	4.3
Service contributions <sup>1</sup>	-0.2	-0.2	-0.2	-0.2	-0.2
Capitalised borrowing interest costs	-0.1	-0.1	-0.1	0.0	0.0
Premium on debt rescheduling	0.1	0.1	0.1	0.1	0.1
<b>Total</b>	<b>21.2</b>	<b>21.9</b>	<b>23.7</b>	<b>26.3</b>	<b>28.0</b>

<sup>1</sup> - inc PFI & Property contributions offsetting borrowing interest payable on specific capital assets.

9.2 Key assumptions underpinning the 2019-20 Budget are:

- New and replacement borrowing to fund the capital programme will be predominantly financed by short term loans at a rate 1.9%;
- Average rates achievable on investments will be between 0.75-1.00%;
- The MRP charges in line with the Council's MRP policy (Appendix I-4).

## **10 Policy on the use of External Service Providers**

10.1 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.

10.2 However, there is value in employing an external provider of treasury management services in order to acquire access to independent specialist skills and advice to support the in-house treasury management team.

10.3 The Council's treasury management advisor is Link Asset Services (LAS). LAS were awarded a 2 year contract following a formal joint procurement exercise with other LGSS authorities during 2016-17. The Council has extended this contract by a further 2 years during 2018-19.

10.4 The scope of investments within the Council's operations now includes both conventional treasury investments (the placing of residual cash from the Council's functions) and more commercial type investments, such as investment properties. Commercial type investments may require specialist advice, and therefore the Council will undertake appropriate due-diligence on a case-by-case basis.

## **11 Future Developments**

11.1 Local Authorities are having to consider innovative strategies towards improving service provision to their communities. This approach to innovation also applies to councils' treasury management activities. The Government has already introduced new statutory powers and regulatory agencies such as CIPFA are introducing policy changes which will have an impact on treasury management approaches in the future. Examples of such changes are:

### **Localism Act**

11.2 A key element of the Act is the "General Power of Competence": "A local authority has power to do anything that individuals generally may do." The Act opens up the possibility that a local authority can use derivatives as part of their treasury management operations. However the legality of this has not yet been tested in the courts even though CIPFA have set out a framework of principles for the use of derivatives in the Treasury Management Code and guidance notes. The Council has no plans at this point to use financial derivatives under the powers contained within this Act.

### **Loans to Third Parties**

11.3 The Council may borrow to make grants or loans to third parties for the purpose of capital expenditure, as allowable under paragraph 25 (1) (b) of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 (Statutory Instrument No. 3146). This will usually be to support local economic development, and may be funded by external borrowing.

11.4 The following key projects in this respect are under way:

- University of Northampton Energy Centre Loan (£20.4m) – Fully guaranteed by the UK Government to facilitate the construction of an Energy Centre to provide services to the Waterside Campus.
- LGSS Law (£0.950m) - loan at commercial rates to aid the cash flow of the company;
- Northamptonshire County Cricket Club (£0.9m) – loan to facilitate build of a permanent stand at the cricket ground site. Loan terms stipulate that principal repayments are to be made early as first-call upon the Cricket Clubs receipt of funding from England and Wales Cricket Board (ECB);

### **UK Municipal Bonds Agency (MBA)**

11.5 The MBA raised £6m share capital from 56 local authorities, including £0.2m from Northamptonshire County Council, plus the Local Government Association to launch an agency to issue bonds in the capital markets on behalf of local authorities across the country and at lower rates than available from the PWLB.

11.6 Council approved entry into the Framework Agreement, which allows the Council to borrow through the MBA at lower rates than from the Public Works Loan Board. To date the MBA has not issued any bonds. The Council may make use of this new source of borrowing as and when appropriate.

### **Proposals to amend the CIPFA Treasury Management and Prudential Codes**

11.7 CIPFA conducted a review of the Treasury Management Code of Practice and the Prudential Code. This review particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management. A separate report is required on non-treasury investments to deal with such purchases, their objectives, how they have been appraised, how they have been financed, and what powers were used to undertake these purchases.

11.8 CIPFA has withdrawn the following prudential indicator which has caused confusion and added little value to interpretation of capital information:

- Incremental impact of capital investment decisions on council tax.

11.9 CIPFA have also made a minor change the requirement to report on investments for longer than 364 days to longer than 365 days.

## **Impact of IFRS 9**

- 11.10 An important consideration when assessing current and future investment policy is the implementation of accounting standard IFRS 9 in the 2018-19 Local Authority Code of Practice. A key element of the new standard is the move from incurred losses on financial assets (i.e. an event that has happened) to expected loss (i.e. the likelihood of loss across the asset lifetime). Whilst this will not have a material impact upon traditional treasury investments, the standard also encompasses other investment areas including: loans to third parties, subsidiaries, or longer dated service investments.
- 11.11 The expected credit loss model requires local authorities to make provision for these potential losses having assessed the asset with regard to the due diligence undertaken prior to investment, the nature of any guarantees, and subsequent regular updates. As set out in paragraphs 11.3 and 11.4 above, the Council has advanced a number of third party loans and may be required to set aside provision for credit loss.
- 11.12 In addition to the above, the new standard requires changes to the recognition and subsequent valuation treatment of certain investment products. These instruments include property and equity, but also service investments that give rise to cashflows that are not solely payments of principal and interest (SPPI) on the principal outstanding.
- 11.13 MHCLG has now introduced a five year statutory override allowing Councils to reverse any revenue impact of pooled fund valuation gains and losses. MHCLG were not minded to make this statutory override permanent, and will keep it under review.

## **Training**

- 11.14 A key outcome of investigations into local authority investments following the credit crisis has been an emphasis on the need to ensure appropriate training and knowledge in relation to treasury management activities, for officers employed by the Council, in particular treasury management staff, and for members charged with governance of the treasury management function.
- 11.15 The Councils treasury advisors run training events regularly which are attended by the LGSS Treasury Team. In addition members of the team attend national forums and practitioner user groups where possible.
- 11.16 Treasury management training for relevant officers and councillors will be delivered as required to facilitate informed decision making and challenge processes.

## **12 List of Appendices**

- Appendix I-1: Treasury Management Policy Statement  
Appendix I-2: Treasury Management Scheme of Delegation and Role of Section 151 (S151) Officer  
Appendix I-3: Prudential & Treasury Indicators  
Appendix I-4: Minimum Revenue Provision (MRP) Policy Statement  
Appendix I-5: Annual Investment Strategy

## **Treasury Management Policy Statement**

Northamptonshire County Council defines its treasury management activities as:

“The management of the organisation’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.”

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.

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.

## **Treasury Management Scheme of Delegation and Role of Section 151 (S151) Officer**

### **The Scheme of Delegation**

#### **Full Council**

- Approval of annual strategy and mid year update to the Strategy.
- Approval of the annual Treasury Management report.
- Approval of the Treasury Management budget.

#### **Cabinet**

- Approval of the Treasury Management quarterly update reports.
- Approval of the Treasury Management outturn report.

#### **Scrutiny Committee**

- Scrutiny of performance against the Strategy.

### **The Treasury Management Role of the S151 Officer**

#### **The Treasury Management role of the S151 Officer**

The Council's Executive Director Finance is the officer designated for the purposes of Section 151 of the Local Government Act 1972 as the Responsible Officer for treasury management at the Council.

The Council's Financial Regulations delegates responsibility for the execution and administration of treasury management decisions to the Executive Director Finance, who will act in accordance with the Council's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

The Executive Director Finance has delegated powers through this policy to take the most appropriate form of borrowing from the approved sources, and to make the most appropriate form of investments in approved instruments.

Prior to entering into any capital financing, lending or investment transaction, it is the responsibility of the responsible officer to be satisfied, by reference to the Council's legal department and external advisors as appropriate, that the proposed transaction does not breach any statute, external regulation or the Council's Financial Regulations.

The Executive Director Finance may delegate his power to borrow and invest to members of his staff.

The Executive Director Finance is responsible for:

- Ensuring that the schedules to the Treasury Management Practices (TMPs) are fully reviewed and updated annually and monitoring compliance to the Treasury Management in the Public Services: Code of Practice and Guidance Notes;
- Submitting regular treasury management reports to Cabinet and Council;
- Submitting debt financing revenue budgets and budget variations in line with the Council's budgetary policies;
- Receiving and reviewing treasury management information reports;

- Reviewing the performance of the treasury management function and promoting value for money;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- Recommending the appointment of external service providers (e.g. treasury management advisors) in line with the approval limits set out in the Council's procurement rules;
- Ensuring that the Council's Treasury Management Policy is adhered to, and if not, bringing the matter to the attention of elected members as soon as possible.
- Preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe.
- Ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money.
- Ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority.
- Ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing.
- Ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources.
- Ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities.
- Provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees.
- Ensuring that members are adequately informed and understand the risk exposures taken on by an authority.
- Ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above.
- Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed.

## Prudential and Treasury Indicators

### 1 The Capital Prudential Indicators

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

#### Capital Expenditure

- 1.2 This prudential indicator shows the Council's capital expenditure plans; both those agreed previously, and those forming part of this budget cycle. Capital expenditure figures below excludes spend on PFI and Leasing arrangements, which are now shown on the balance sheet.
- 1.3 The table below summarises the net borrowing funding need of the capital expenditure plans for the Council. Detailed capital expenditure plans are set out in the Capital Strategy.

Capital Expenditure	2018-19 Forecast	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate	2022-23 Estimate	2023-24 Estimate
	£m	£m	£m	£m	£m	£m
Net financing need for the year	19.4	24.8	3.0	3.5	(2.7)	0.0

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

- 1.4 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historical outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 1.5 Following accounting changes the CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The CFR below is shown net of these liabilities.

	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	Projected	Estimate	Estimate	Estimate	Estimate	Estimate
	£m	£m	£m	£m	£m	£m
<b>Capital Financing Requirement <sup>(1)</sup></b>						
<b>CFR (net of LT Liabilities)</b>	715.7	740.4	742.4	744.0	738.4	734.8
<b>Movement in CFR</b>	19.3	24.7	2.0	1.6	(5.6)	(3.6)

<b>Movement in CFR represented by</b>						
Net financing need for the year (above)	19.4	24.8	3.0	3.5	(2.7)	0.0
Less: MRP and other financing movements	(0.1)	(0.1)	(1.0)	(1.9)	(2.9)	(3.6)
<b>Movement in CFR</b>	<b>19.3</b>	<b>24.7</b>	<b>2.0</b>	<b>1.6</b>	<b>(5.6)</b>	<b>(3.6)</b>

### The Operational Boundary

- 1.6 This is the limit beyond which external borrowing is not normally expected to exceed. All things being equal, this could be a similar figure to the CFR, but may be lower or higher depending on the levels of actual borrowing undertaken as impacted by the level of current and future cash resources and the shape of the interest rate yield curve.

Operational Boundary	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m	£m	£m
<b>Total Borrowing</b>	750.0	775.0	780.0	780.0	775.0	770.0

- 1.7 The rising trend of the Operational Boundary reflects that of the CFR above. The level set is at a margin above the CFR so that if borrowing was taken to this level, sufficient headroom exists for further short-term borrowing should it be required for in year cashflow purposes.

### The Authorised Limit for external borrowing

- 1.8 A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.
- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

- Council is asked to approve the following Authorised Limit (excluding PFI and Finance Lease Financing arrangements):

Authorised Limit	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24
	£m	£m	£m	£m	£m	£m
<b>Total Borrowing</b>	780.0	805.0	815.0	815.0	810.0	805.0

1.9 The rising trend of the Authorised Limit reflects that of the CFR and subsequently the Operational Boundary. The level set is at a margin above the Operational Boundary, providing additional headroom for further short-term borrowing should it be required for cashflow purposes, before the legal limit is reached.

## 2 Treasury Management Limits on Activity

2.1 There are four debt and investment related treasury activity limits. The purpose of these are to contain 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 or improve performance. The indicators for debt 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.

2.2 The interest rate exposure is calculated as a percentage of net debt. Due to the mathematical calculation exposures could be greater than 100% or below zero (i.e. negative) depending on the component parts of the formula. The formula is shown below:

$$\frac{\text{Total Fixed (or Variable) rate exposure}}{\text{Total borrowing} - \text{total investments}}$$

Fixed rate calculation:

$$\frac{(\text{Fixed rate borrowing} - \text{Fixed rate investments}^*)}{\text{Total borrowing} - \text{Total investments}}$$

\*defined as greater than 1 year to run

Variable rate calculation:

$$\frac{(\text{Variable rate borrowing}^{**} - \text{variable rate investments}^{**})}{\text{Total borrowing} - \text{Total investments}}$$

\*\* Defined as less than 1 year to run to maturity, or in the case of LOBO borrowing, the call date falling within the next 12 months.

£m	2018-19	2019-20	2021-22	2022-23	2023-24
<b>Interest rate Exposures</b>					
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	150%	150%	150%	150%	150%
<b>Limits on variable interest rates based on net debt</b>	65%	65%	65%	65%	65%

2.3 The maturity structure of borrowing indicator represents the borrowing falling due in each period expressed as a percentage of total borrowing. These gross limits are set to manage the Council's exposure to sums falling due for refinancing or repayment.

<b>Maturity Structure of borrowing</b>				
	<b>Lower</b>	<b>Upper</b>	<b>Dec 2018</b>	
Under 12 months	0%	80%	34.4%	
12 months to 2 years	0%	50%	5.9%	
2 years to 5 years	0%	50%	9.2%	
5 years to 10 years	0%	50%	1.3%	
10 years to 20 years	0%	100%	49.2%	5.7%
20 years to 30 years	0%		0.7%	
30 years to 40 years	0%		26.0%	
40 years to 50 years	0%		15.9%	
50 years and above	0%		0.9%	

2.4 The Treasury Management Code of Practice Guidance notes requires that maturity date is determined by the earliest date on which the lender *may* require repayment, which in the case of LOBO loans is technically the next break point. This indicator represents the borrowing falling due in each period expressed as a percentage of total borrowing.

2.5 The Council is asked to approve the following treasury indicator and limits for total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. This indicator is calculated by adding together all investments which have greater than 365 days to run to maturity at a single point in time.

	<b>Maximum principal sums invested &gt; 365 days</b>				
£m	2018-19	2019-20	2020-21	2021-22	2022-23
Principal sums invested > 365 days	20.0	20.0	20.0	20.0	20.0

2.6 The Councils current strategic approach is to utilise internal borrowing to finance cash demands, avoiding new external debt and running down cash balances as a temporary measure where possible. The Council does not expect to hold any investments that exceed 365 days, but may do so in the future if it holds sufficient cash balances and such investments assist in the prudent management of the Councils financial affairs.

### 3 Affordability Prudential Indicator

- 3.1 The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework is an indicator required to assess the affordability of the capital investment plans. This provides an indication of the impact of the capital investment plans on the Council's overall finances.
- 3.2 The Council is asked to approve the actual and estimates of financing costs to net revenue stream. This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.
- 3.3 This is calculated as the estimated net financing costs for the year divided by the amounts to be met from government grants and local taxpayers.

	Actual and estimates of financing costs to net revenue stream				
£m	2019-20 %	2020-21 %	2021-22 %	2022-23 %	2023-24 %
Financing costs to net revenue stream	5.1	5.0	5.2	5.6	5.8

## Minimum Revenue Provision Policy Statement

### 1 Policy Statement

- 1.1 The Council is required to repay an element of the accumulated General Fund capital spend each year (Capital Financing Requirement - CFR) through a revenue charge (Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required.
- 1.2 The Ministry for Housing, Communities and Local Government (MHCLG) have issued regulations that require full Council to approve an MRP Statement in advance of each year. A variety of options are provided to Councils in the guidance with the underlying principle that a prudent provision is made.

#### **Historic Debt Liability accumulated to 31<sup>st</sup> March 2007**

- 1.3 Up until 2014-15, this element of the annual provision was calculated using Option 1 of the Guidance, the "Regulatory Method", which based the calculation on 4% of the Capital Financing Requirement on a reducing balance basis.
- 1.4 A change in this policy was introduced in and applied from 2015-16 onwards for historic debt liability, whereby provision calculation was changed to an annuity calculation methodology, allowable under the Guidance.
- 1.5 A further change in this policy was introduced in and applied from 2017-18, whereby the annuity method calculation methodology was backdated to apply from 2007/08 onwards. This recalculation when compared against actual MRP charges identified an amount of overprovision, which will be applied prospectively from 2017-18 onwards until fully exhausted. Again, this approach is allowable under the Guidance.

#### **Debt Liability accumulated from 1<sup>st</sup> April 2007**

- 1.6 For unsupported capital expenditure incurred from 1st April 2007 onwards, MRP will be charged from the year after the assets funded have become operational.
- 1.7 Up until 2016-17, capital expenditure incurred from 1st April 2007 onwards MRP was provided for under Option 3 of the Guidance, based on the estimated useful life of the assets and using an equal annual instalment method.
- 1.8 A change in this policy was introduced in and applied from 2017-18, whereby MRP calculation was changed to an annuity calculation methodology backdated to apply from 2007/08. This recalculation when compared against actual MRP charges identified an amount of overprovision, which will be applied prospectively from 2017-18 onwards until fully exhausted. Again, this approach is allowable under the Guidance.
- 1.9 Estimated useful life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods

will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

- 1.10 As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure with substantially different useful economic lives.

### **Non-operational assets**

- 1.11 The Council will not charge MRP on its non-operational assets. MRP will only be charged in the financial year following the asset becoming operational. This policy will be reviewed annually.

### **Use of Capital Receipts**

- 1.12 The Council may use capital receipts in the year in which they are received to reduce the CFR and to offset the MRP charge for that year. Any unapplied capital receipts will be available in future years and will be applied in a prudent manner.

### **Private Finance Initiatives (PFI) and Finance Leases**

- 1.13 Any PFI or finance lease that comes onto the balance sheet via the introduction of the new International Financial Report Standards will already have taken capital financing into account as part of their revenue charges.
- 1.14 MRP charges for PFI will provide MRP on an asset life basis to match the life of the associated assets.

### **Third party loans**

- 1.15 The only exception to these MRP rules are loans classified as capital expenditure and raised by the Council for the purposes of funding third party loans. No MRP will be charged on this debt liability as the loans will be repaid in full in later years. The loan repayment will be treated as a capital receipt.
- 1.16 This approach will be reviewed on a loan by loan basis annually to ensure this remains a prudent approach, otherwise MRP charge may be introduced.

### **Capitalisation of Interest**

- 1.17 MRP will be charged on capitalised interest in line with the Councils Interest Capitalisation policy as set out in the Capital Strategy.

### **Borrowing to Fund Assets with Guaranteed Future Income Streams**

- 1.18 One new potential funding source for capital projects identified by central government is tax increment financing (TIF), in effect mortgaging future business rate tax streams from new developments to initially fund those new developments.

- 1.19 As type of capital expenditure will be financed from future income streams, MRP will not be charged on any cash flow borrowing required to fund the initial expenditure up front, where TIF provides a guaranteed future income stream.

**Revenue Funded from Capital Under Statute (REFCUS)**

- 1.20 REFCUS will be treated in the same way as other capital expenditure for the purposes of charging MRP, and will be charged based on the estimated useful life of the asset.

**Investment Properties**

- 1.21 For property investment activities funded through unsupported borrowing, MRP will be charged in the same way as other capital expenditure, based on the following estimated useful lives:
1. Freehold property - over 60 years;
  2. Leasehold property - over the term of the lease.
- 1.22 These estimated lives were calculated following due diligence in assessing the investment business cases and with an appreciation of the risks associated.

## **Annual Investment Strategy**

### **1 Investment Policy**

- 1.1 MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments managed by the treasury management team. Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy.
- 1.2 The Council's appetite for risk must be clearly identified in its strategy report. The Council affirms that its investment policies are underpinned by a strategy of prudent investment of funds held on behalf of the local community. The objectives of the investment policy are firstly the security of funds (protecting the capital sum from loss) and then liquidity (keeping money readily available for expenditure when needed). Once approved levels of security and liquidity are met, the Council will seek to maximise yield from its investments, consistent with the applying of the agreed parameters. These principles are carried out by strict adherence to the risk management and control strategies set out in the TMP Schedules and the Treasury Management Strategy.
- 1.3 Responsibility for risk management and control lies within the Council and cannot be delegated to an outside organisation.
- 1.4 Investment instruments identified for use in the financial year are listed in sections 6 and 7 under the 'Specified' and 'Non-Specified' Investments categories.

### **2 Creditworthiness Policy**

- 2.1 The Council's counterparty and credit risk management policies and its approved instruments for investments are set out below. These, taken together, form the fundamental parameters of the Council's Investment Strategy.
- 2.2 The Council defines high credit quality in terms of investment counterparties as those organisations that:
  - Meet the requirements of the creditworthiness service provided by the Council's external treasury advisors and;
  - UK banking or other financial institutions, or are;
  - UK national or local government bodies, or are;
  - Countries with a sovereign ratings of -AA or above, or are;
  - Triple-A rated Money Market funds.
- 2.3 The creditworthiness service provided by the Council's external treasury advisors applies a modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard & Poor's. The credit ratings of counterparties are supplemented with the following overlays:
  - credit watches and credit outlooks from credit rating agencies;

- Credit Default Swaps (CDS – a traded insurance policy market against default risk) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

- 2.4 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted calculation with an overlay of CDS spreads, to determine suggested duration for investment. The Council will apply these suggested duration limits to its investments at all times, unless otherwise approved by the S151 officer.
- 2.5 All credit ratings are monitored daily. The Council is alerted to changes to ratings of all three agencies through its external treasury advisors. If a rating downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council is advised of information in movements in CDS spreads against benchmark data and other market information on a daily basis and extreme market movements (which may be an early indicator of financial distress) may result in downgrade of an institution or removal from recommended investment.
- 2.6 Sole reliance will not be placed on the use of the Council's external treasury advisors creditworthiness service. In addition the Council will also use market data, financial press and information on any external support for banks to help support its decision making process.
- 2.7 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times, and as such the Executive Director Finance shall have the discretion during the year to lift or increase the restrictions on the counterparty list and or to adjust the associated lending limits on values and durations should it become necessary, to enable the effective management of risk in relation to its investments.

### **3 Sovereign Limits**

- 3.1 Expectation of implicit sovereign support for banks and financial institutions in extraordinary situations has lessened considerably in the last couple of years, and alongside that, changes to banking regulations have focussed on improving the banking sectors resilience to financial and economic stress.
- 3.2 The Council has determined that for 2019-20 it will only use approved counterparties from overseas countries with a sovereign credit rating from the three main ratings agencies that is equal to or above AA-. Banks domiciled in the UK are exempt from this minimum sovereign credit rating, so may be used if the sovereign rating of the UK falls below AA-.
- 3.3 The list of countries that qualify using these credit criteria as at November 2018 are shown below. This list will be amended by officers should ratings change in accordance with this policy.

<b>AAA</b> Australia Canada Denmark Germany Luxembourg Netherlands Norway Singapore Sweden Switzerland	<b>AA+</b> Finland USA	<b>AA</b> Abu Dhabi (UAE) France Hong Kong UK  <b>AA-</b> Belgium Qatar
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#### 4 Banking Services

- 4.1 Barclays Bank currently provides banking services for the Council. The Council may continue to use its own bankers for short term liquidity requirements if the credit rating of the institution falls below the minimum credit criteria set out in this report, monitored daily. A pragmatic approach will be adopted and rating changes monitored closely.

#### 5 Investment Position and Use of Council's Resources

- 5.1 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).
- 5.2 Investments will be made with reference to the core balances and cash flow requirements and the outlook for interest rates.
- 5.3 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts, notice accounts, money market funds (CNAV and LVNAV) and short-dated deposits in order to benefit from the compounding of interest.

#### 6 Specified Investments

- 6.1 The Council assesses that an investment is a specified investment if all of the following criteria apply:
- The investment is **denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.**
  - The investment is **not a long term investment (i.e. up to 1 year).**
  - The making of the investment is **not defined as capital expenditure** by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended].
  - The investment is **made with a body or in an investment scheme of high credit quality** (see below) or with one of the following public-sector bodies:
    - The United Kingdom Government.
    - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland.

- High credit quality is defined as a minimum credit rating as outlined in this strategy.

Instrument	Minimum 'High' Credit Criteria	Maximum Amount
Debt Management Agency Deposit Facility (DMADF)	N/a	No maximum
UK Government Gilts / Treasury Bills	UK sovereign rating	
Certificate of Deposits	Per Treasury Advisors creditworthiness service	£10m per individual/group in total
Term Deposits - Banks and Building Societies	Per Treasury Advisors creditworthiness service	
Term Deposits - Local Authorities and Housing Associations	Considered on an individual basis	
Collateralised Deposit / Covered Bonds	AAA	£20m per individual/group in total
Bonds issued by multilateral development banks	AAA / UK sovereign rating	
Bond issuance issued by a financial institution which is explicitly guaranteed by UK Government (e.g. National Rail)	UK sovereign rating	
Sovereign bond issues (other than the UK govt)	AAA / UK sovereign rating	
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</b>		
1. Money Market Funds (CNAV, LVNAV or VNAV)	AAA MMF rating	£20m per individual/group in total
2. Bond Funds	Considered on an individual basis	
3. Gilt Funds	Considered on an individual basis	

- 6.2 The Council may enter into forward agreements up to 3 months in advance of the investment commencing. If forward agreements are made, the forward period plus the deal period should not exceed the 1 year to be classified as a specified investment.
- 6.3 Maximum counterparty limits may be temporarily exceeded by small amounts and for very short periods where interest is compounded by the counterparty to the principal investment amount. In such instances the interest amounts will be withdrawn as soon as reasonably practicable.
- 6.4 The counterparty limit with the Council's corporate bank (Barclays) may be utilised over and above the set counterparty limit on an overnight basis if cash surpluses are identified as a result of unexpected receipts of income after the day's dealing position is closed. This occurs when the timing for receipt of funds is uncertain, for example the sale of a property. In such instances, funds will be withdrawn to bring the Councils exposure back in line with the approved counterparty limit as soon as reasonably practicable and invested elsewhere in line with this strategy.

## 7 Non-specified investments

- 7.1 Non-specified investments are defined as those not meeting the specified investment criteria above (including investments exceeding 1 year).
- 7.2 Given the additional risk profile associated with non-specified investment, the Council may consult with its external treasury advisors before undertaking such investments where appropriate.

Instrument	Minimum 'High' Credit Criteria	Maximum Amount
UK Government	Government backed	No maximum
Certificate of Deposits	Per Treasury Advisors creditworthiness service	£10m per individual/group in total
Term Deposits - Banks and Building Societies	Per Treasury Advisors creditworthiness service	
Term Deposits - Local Authorities and Housing Associations	Considered on an individual basis	
Collateralised Deposit / Covered Bonds	AAA	£20m per individual/group in total
Bonds issued by multilateral development banks	AAA / UK sovereign rating	
Bond issuance issued by a financial institution which is explicitly guaranteed by UK Government (e.g. National Rail)	UK sovereign rating	
Sovereign bond issues (other than the UK govt)	AAA / UK sovereign rating	
Corporate Bond / Equity Holdings	Considered on an individual basis	£10m per individual/group in total
<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</b>		
Property Funds	Considered on an individual basis	£20m per individual/group in total
Enhanced Money Market Funds	AAA VNAV mmf rating	
Corporate Bond / Equity Funds / Share Capital	Considered on an individual basis	

- 7.3 Maximum counterparty limits may be temporarily exceeded by small amounts and for very short periods where interest is compounded by the counterparty to the principal investment amount. In such instances the interest amounts will be withdrawn as soon as reasonably practicable.

## 8 Lending to third parties for treasury management purposes

- 8.1 The Council has the power to lend monies to third parties subject to a number of criteria. Any loans to or investments in third parties will be made under the Well Being powers of the Council conferred by section 2 of the Local Government Act 2000 or permitted under any other act.

- 8.2 The Well Being power can be exercised for the benefit of some or all of the residents or visitors to a local authority's area. The power may also be used to benefit organisations and even an individual.
- 8.3 Loans of this nature will be under exceptional circumstances. Loans above £2m will require Cabinet approval. The S151 Officer in conjunction with the lead member responsible for finance may approve loans to third parties below this £2m threshold.
- 8.4 The primary aims of this Investment Strategy, in order of priority, are the security of its capital, liquidity of its capital and to obtain a return on its capital commensurate with proper levels of security and liquidity. These aims are crucial in determining whether to proceed with a potential loan for the purposes of managing the Council's treasury management investments.
- 8.5 Recipients of this type of investment are unlikely to be a financial institution and therefore unlikely to be subject hold a credit rating. In order to ensure security of the Council's capital, extensive financial due diligence must be completed prior to any loan or investment being agreed. The Council will, where appropriate, use specialist advisors to complete financial strength of the entity to ascertain the creditworthiness of the third party. Where necessary, additional guarantees will be sought. This will take the form of security against assets and/or through guarantees from parent companies.

## **9 Investments Defined as Capital Expenditure**

- 9.1 The acquisition of share capital or loan capital in any corporate body is defined as capital expenditure under Regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded from capital or revenue resources and will be classified as 'non-specified investments'.
- 9.2 Investments in "money market funds" which are collective investment schemes and bonds issued by "multilateral development banks" – both defined in SI 2004 No 534 – will not be treated as capital expenditure.
- 9.3 A loan, grant or financial assistance provided by this Council to another body will be treated as capital expenditure if the Council would define the other bodies use of those funds as capital had it undertaken the expenditure itself.

## **10 Provisions for Credit Related Losses**

- 10.1 If any of the Council's investments appear at risk of loss due to default (i.e. this is a credit-related loss and not one resulting from a fall in price due to movements in interest rates) the Council will make revenue provision of an appropriate amount.

## **11 End of Year Investment Report**

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

## **12 Pension Fund Cash**

- 12.1 The Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st January 2010. The Council will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with this local authority will comply with the requirements of SI 2009 No 39.

### **13 Governance Arrangements**

- 13.1 By approving this strategy, Council is setting the framework from which treasury activity will be conducted, recorded and reported.
- 13.2 The Executive Director Finance has delegated powers through this strategy to take the most appropriate form of borrowing from approved sources, and to make the most appropriate form of investments in approved instruments. Paragraph 2.7 above delegates powers to the Executive Director Finance giving discretion during the year to lift or increase the restrictions on the counterparty lending list and or to adjust the associated lending limits on values and durations should it become necessary, to enable the effective management of risk in relation to its investments.
- 13.3 The Executive Director Finance may delegate his powers to borrow and invest within the confines of this strategy to members of his staff and the LGSS Treasury team, who will provide regular updates on treasury activity.
- 13.4 Any other amendments to this strategy deemed necessary will be taken to Council for prior approval.