Appendix 1

London Borough of Redbridge

Treasury Management Strategy

MRP Strategy

and

Annual Investment Strategy for Treasury Investments

2019/20

1 Introduction

1.1. The council operates a treasury management function which incorporates the management of the council's cashflows, lending and borrowing activities and the management and mitigation of the risks associated with these activities.

1.2. The Local Government Act 2003 and supporting regulations requires the council to have regard the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code for Capital Finance in Local Authorities (Prudential Code) and the CIPFA Code of Practice on Treasury Management in the Public Services (Treasury Code)

1.3 The Council is required to operate a balanced budget. Part of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in accordance with the Council's treasury investment strategy, which provides adequate liquidity initially before considering investment return.

1.4 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.5 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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

CIPFA defines treasury management as:

> *"The management of the local authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

1.7 Revised reporting is required for the 2019/20 reporting cycle because of changes to the Ministry for Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a Capital Investment Strategy, to provide a longer-term focus to the Council's capital plans, and greater reporting requirements surrounding any non-operational/commercial activity. The Capital Investment Strategy is being reported separately.

1.8 Inevitably, certain technical terms have been used in this report. Explanations are provided where possible and a glossary covering main terms is included at Annex F.

2 Treasury Management Reporting

2.1 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. These are:

- **A Treasury Management Strategy Report** (this report) - The first 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 for treasury investments, (the parameters on how investments are to be managed).
- **A Mid-Year Treasury Management Review** – This is primarily a progress report and will update members on treasury management activities, the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- **An Annual Treasury Outturn Report** – This is a backward-looking review and provides information on actual treasury operations and prudential indicators compared to the estimates within the strategy

2.2 Council has nominated the Governance and Assurance Committee to be responsible for ensuring effective scrutiny of the Treasury Management Strategy and policy statements prior to the start of each financial year. Treasury management reports are reviewed by the Strategy and Resources Scrutiny Committee.

2.3 The council has adopted the Treasury Code and subsequent revisions, as part of its Financial Standing Orders since November 1996.

2.4 The Treasury Code also requires the:

- Creation and maintenance of a treasury management policy statement which sets out the policies and objectives of the council's treasury management activities. The Treasury Management Policy Statement is attached as Annex A;
- Creation and maintenance of Treasury Management Practices which set out the way the council will seek to achieve those policies and objectives. These are maintained and kept under review by officers;
- Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administrations of treasury management decisions. Treasury management delegations and responsibilities are set out at Annex E.

2.5 The council's Treasury Management policies and practices comply with the Treasury Code.

Capital Investment Strategy

2.6 The CIPFA revised 2017 Prudential and Treasury Management Codes requires, for 2019/20, that all local authorities to prepare an additional report, a Capital Investment Strategy, which will provide the following:

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

2.7 The aim of the Capital Investment Strategy is to ensure that Elected Members understand the overall long-term policy objectives and resulting Capital Investment requirements, governance procedures and risk appetite.

2.8 The Capital Investment Strategy is reported separately from the Treasury Management Strategy; 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 for non-operational/commercial investments which is usually driven by expenditure on an asset. The Capital Investment Strategy will include information on:

- 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.

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

2.10 Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and any deviation from MHCLG Investment Guidance and CIPFA Prudential Code explained.

2.11 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 Investment Strategy.

2.12 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown in this report as appropriate.

3 Treasury Management Strategy for 2019/20

3.1 The Treasury Management Strategy for 2019/20 covers two main areas:

Capital items

- capital expenditure and the associated prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury management items

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the use of external service providers.

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

3.3 The proposed strategy will assist the council in mitigating risk in the council's treasury management activities and allow the borrowing necessary to finance the capital programme.

3.4 **Training -** The Treasury Code requires Member consideration of treasury management matters, and the need to ensure officers dealing with treasury management and investment are trained and keep their skills up to date. The council addresses this important issue by:

- Providing training sessions, briefings and reports on treasury management and investment issues to those Members responsible for the monitoring and scrutiny of treasury management.
- Requiring all relevant Officers to keep their skills up to date by utilising both external and internal training, workshops and seminars, and by participating in treasury management Forums and other relevant local groups and societies.

3.5 **Treasury Management Consultants -** The council uses Link Asset Services, Treasury solutions as its external treasury management advisers. 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 external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The council will ensure that the terms of their appointment and the methods by which their value will be assessed are agreed and subjected to regular review.

3.6 **Non-Treasury Investments –** 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 property purchases. The commercial type investments require specialist advisers who will be appointed as required in relation to this activity.

3.7 **Pension Fund Cash** - The Local Government Pension Scheme (Management and Investment) Regulations 2016 requires the council to maintain a separate bank account for the Pension Fund. For the management of Pension Fund cash, there is in place an agreement to pool internally held pension fund balances (working cash and those pending external investment) with the investment balances of the council. These balances are invested in accordance with the Council's Treasury Management Strategy.

3.8 The Pension Fund receives interest annually on their cash balances at a rate commensurate with that received by the council. Pension Fund cash balances may be withdrawn anytime. In the event of loss of any investment, this will be borne on a pro rata basis equivalent to the value of each party's contribution to the investment which incurred the loss.

3.9 **East London Waste Authority (ELWA)** – Redbridge is one of the four constituent Councils of the joint waste authority ELWA. The Council carries out treasury management services on behalf of ELWA in accordance with ELWA's approved treasury management strategy. ELWA maintains a separate bank account and all borrowing and investing activities are carried out in ELWA's name.

4 Capital Prudential Indicators

4.1 In accordance with the Prudential Code, the council is required to set prudential indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable.

4.2 Redbridge's capital expenditure and prudential indicators for the period 2018/19 – 2023/24 are set out in Annex C. The prudential indicators are required to be approved by Council.

4.3 The benefit of these indicators will be derived from monitoring them over time rather than from the absolute value of each. The reporting process has been established, with a half yearly report to council to highlight any significant deviations. The prudential indicators can be amended by Council as required.

4.4 The prudential indicators for later years are broad estimates and will be revised as more accurate information becomes available.

5 Minimum Revenue Provision (MRP) Policy Statement

5.1 In accordance with the Local Government Act 2003, the Council is required to pay off an element of the accumulated General Fund capital expenditure which was funded from both internal and external borrowing, through an annual revenue charge known as the Minimum Revenue Provision (MRP).

5.2 Guidance issued by MHCLG, which provides options for calculating MRP was revised in February 2018. The revised guidance and commentary apply primarily from 1 April 2019. Under this guidance the MHCLG provides four options which can be used for the purposes of calculating MRP. These are:

Option 1	Regulatory Method
Option 2	Capital Financing Requirement Method
Option 3	Asset Life Method
Option 4	Depreciation Method

5.3 The council has the discretion to choose from these options if appropriate, or to formulate its own methodology option so long as it represents a prudent provision. Government guidance on MRP states that the broad aim of prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with the period over which the capital expenditure provides benefits, or in the case of borrowing supported by Government Revenue Support Grant (RSG), reasonably commensurate with the period implicit in the determination of that grant.

5.4 Following a thorough review of the MRP provision for pre2008 (supported) debt (Option 1), it was estimated that less than 50% of the required 4% MRP was now provided by RSG. In addition, MRP provision is considered more prudent if broadly aligned to the life of the assets. Therefore, the methodology was changed to provide MRP at 2.5% on a straight line equal instalment basis, thus making annual savings and repaying the debt earlier than under the previous (reducing balance) policy.

5.5 For unsupported borrowing, the Council will use the asset life option as its main method of determining MRP in respect of Service and Commercial assets, making use of both the Equal Instalment Method and the Annuity Method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure. Asset life is deemed to begin once the asset becomes operational. Minimum revenue provision will commence from the financial year following the one in which the asset becomes operational.

5.6 Estimated life periods will be determined under delegated powers to the Corporate Director of Resources. Information provided by the Council's valuer, or other specialist valuation experts will be used to determine asset lives for commercial activities, investment properties and other assets as appropriate.

5.7 The "principal" element included within PFI or finance leases payments are applied as MRP. There is no requirement for the HRA to set aside MRP.

5.8 Expenditure deemed as capital by virtue of a Ministerial direction or regulation, will be provided for in accordance with the guidance.

5.9 During 2017/18 a review of the provision and methodology for calculating MRP was undertaken by the Council Treasury Advisers. The basis of the revised policy, meant that more provision for MRP had been made than was prudently required. A balance of £8.826m (1 April 2018) remains available to off-set future payments.

5.10 The council retains the right to make additional voluntary MRP repayments if considered prudent.

5.11 Regulations require the council to approve an MRP Statement in advance of each year setting out the councils MRP policy. The 2019/20 MRP Policy Statement is set out in Annex B for approval.

6 Borrowing

6.1 The capital expenditure plans in this report are contained in the Council's Capital Investment Strategy which is appended to the Budget Report.

6.2 The treasury management function adheres to the relevant treasury codes as well as organising the council's cash flow and borrowing needs to fund the requirements of the approved Capital Investment Strategy. Regulations requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional capital expenditure; and
- any increases in running costs from new capital projects are limited to a level which is affordable, prudent and sustainable within the projected income of the council for the foreseeable future.

6.3 **Current portfolio position -** The overall treasury management portfolio as at the 31 March 2018 and the position as at 31 December 2018 is shown below.

Table 1

	Actual	**Actual**	**Current**	**Current**
	31/03/18	**31/03/18**	**31/12/18**	**31/12/18**
Treasury Investments	**£m**	**%**	**£m**	**%**
Banks Deposits	30.000	27	53.000	45
Building Society Deposits	5.000	5	5.000	4
Local Authorities	5.000	5	13.000	11
Money Market Funds	40.000	36	18.020	15
Certificates of deposit	20.000	18	20.000	17
Total managed in-house	**100.000**	**91**	**109.020**	**92**
CCLA Property Fund	10.000	9	10.000	8
Total managed externally	**10.000**	**9**	**10.000**	**8**
Total treasury investments	**110.000**	**100**	**119.02**	**100**
Treasury External Borrowing				
Long Term				
PWLB	173.271	80	177.765	85
LOBO's	25.000	12	20.000	10
Market	10.000	5	10.000	5
Total long-term borrowing	**208.271**	**97**	**207.765**	**100**
Short Term				
Market	7.500	3	-	-
Total External Borrowing	**215.771**	**100**	**-**	**100**
Net investments/(borrowing)	(104.771)		(88.745)	

6.4 The council's external debt portfolio position, with forward projections are summarised overleaf. The table shows external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement):

6.5 **Table 2 Debt Requirement**

	2018/19 Revised Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
External Debt						
Debt at 1 April	215.771	243.665	250.027	255.314	261.975	267.959
Estimated change in debt +/(-)	16.488	(4.513)	(5.013)	(3.013)	(3.013)	(1.013)
Other Long-Term Liabilities (OLTL)	11.919	11.406	10.875	10.299	9.674	8.997
Estimated change in OLTL +/(-)	(0.513)	(0.531)	(0.576)	(0.625)	(0.677)	(0.735)
Gross Debt 31 March	**243.665**	**250.027**	**255.313**	**261.975**	**267.959**	**275.208**
The Capital Financing Requirement	**363.089**	**492.015**	**600.017**	**679.408**	**701.893**	**682.662**
(Under) / over borrowing	(119.424)	(241.988)	(344.704)	(417.433)	(433.934)	(407.454)

Table 2 clearly defines the impact of not externally borrowing i.e. using the council's balances to internally fund the councils underlying capital borrowing requirements over the next five years.

Within the Capital Financing Requirement (CFR) the level of debt relating to non-operational activities / non-financial investments is:

Table 3

	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
External Debt for non-operational activities / non-financial investments						
Debt at 31 March	30.444	75.444	119.739	159.739	179.739	179.739

7 Treasury Limits 2018/19 to 2021/22 and indicative limits for 2022/23 - 2023/24

7.1 It is a statutory duty under Section 3 of the Act and supporting regulations for the council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales, the Authorised Limit represents the legislative limit specified in the Act.

7.2 The council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits.

7.3 Whilst termed an Affordable Borrowing Limit, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised limit is to be set on a rolling basis, for the forthcoming financial year and two successive financial years. Details of the Authorised Limit is set out in Annex C

8 Economic Background and Interest Rate Forecasts

8.1 Link Treasury Services (Link) are treasury adviser to the council and part of its service is to assist the council to formulate a view on interest rates. The following table and commentary outlines Link's central view. The Public Works Loans Board (PWLB) offers a certainty rate discount of 0.20% to local authorities who provide specified information on their capital spending plans and associated long term borrowing. The council qualifies to borrow at the certainty rate.

Table 4

Average	Bank Rate	PWLB Rates (includes certainty rate adjustment) %		
	%	5 yr	25 yr	50 yr
March 2019	0.75	2.10	2.90	2.70
June 2019	1.00	2.20	3.00	2.80
Sept 2019	1.00	2.20	3.10	2.80
Dec 2019	1.00	2.30	3.10	2.90
March 2020	1.25	2.30	3.20	3.00
June 2020	1.25	2.40	3.30	3.10
Sept 2020	1.25	2.50	3.30	3.10
Dec 2020	1.50	2.50	3.40	3.20
March 2021	1.50	2.60	3.40	3.20
June 2021	1.75	2.60	3.50	3.30
Sept 2021	1.75	2.70	3.50	3.30
Dec 2021	1.75	2.80	3.60	3.40
March 2022	2.00	2.80	3.60	3.40

8.2 The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. 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. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

8.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over last 25 years or so, there has been a period of falling bond yields as inflation subsided to, and then stabilised at much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. 2016 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. 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 2.25 – 2.50% in December 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. October 201/8 saw US 10-year bond Treasury yields rise above 3.2% and a sharp fall in equity prices as investors disinvested from holding riskier assets. However, by early January 2019, US 10year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

8.4 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.

8.5 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 year. Geopolitical developments, especially in the EU, could also have a major impact.

8.6 **Investment and borrowing rates**

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018/19 and while they were on a rising trend during the first half of the year, they have back-tracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

9 Borrowing Strategy 2019/20

9.1 The council is currently maintaining an under-borrowed position as a result of utilising internal resources to financing capital expenditure. This means that the capital borrowing need (the Capital financing Requirement – CFR) has not been fully funded with loan debt as cash supporting the council's balances and cashflow has been used as a temporary measure. This strategy is prudent, whilst balances remain available, as investment returns are low and counterparty risk still needs to be considered.

9.2 Against this background and mindful of the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Corporate Director of Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

New Borrowing

9.3 The council's borrowing strategy will consider the following forms of borrowing to finance capital requirements:

- ***Internal borrowing***: The need to undertake external borrowing can be reduced by the temporary use of internal balances held for provisions and reserves within the Council’s accounts and cashflow movements on a day-to-day basis. The option of postponing borrowing and running down investment balances may provide short term revenue savings and reduce investment risk. The use of internal balances, however, must be monitored in order to mitigate the risks arising from the need to externally refinance when rates are unfavourable;

- ***Temporary Borrowing***: from the money market or other local authorities;
- ***Shorter Term Borrowing (1 – 5 years)***: from money market institutions or other local authorities;
- ***Long Term Market Debt***: where rates are significantly below those offered by the PWLB for an equivalent maturity period, and to provide diversity within the debt portfolio;
- ***PWLB:*** borrowing for periods across all durations where rates offer best value;
- ***Other borrowing arrangements***: such as the use of leasing may be more cost efficient for some types of capital expenditure such as for vehicles and equipment.

9.4 When undertaking borrowing, no more than 30% of total borrowing should fall due for renewal in any one year.

9.5 The council will continue to borrow in respect of the following:

- Maturing debt;
- Approved (prudential) capital expenditure / capital investment;
- To finance short-term cashflow fluctuations.

9.6 The type, period, rate and timing of new borrowing will be determined by the Corporate Director of Resources under delegated powers, taking into account the following factors:

- Expected movements in interest rates as outlined above;
- Maturity profile of the debt portfolio;
- The impact on the medium term financial strategy;
- Prudential indicators and limits.

Treasury Management Limits on borrowing activity

9.7 There are three debt related treasury activity limits. The purpose of these are to manage the activity of the treasury function within a flexibly set remit for risk management, yet not impose undue restraints that constrict opportunities for cost reduction or performance improvement. The indicators are:

- Upper limits for fixed and variable interest rate exposure on borrowing;
- Upper limits on fixed and variable interest rate exposure on investments;
- Maturity structure of borrowings.

9.8 The proposed indicators are set out in Annex C.

Policy on borrowing in advance of need

9.9 The council will not borrow more than or in advance of its needs purely to profit from its treasury management financial investment activities. Any decision to borrow in advance will be within the 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.

9.10 In determining whether borrowing will be undertaken in advance of need the council will:

- Ensure that the ongoing revenue liabilities created, and the implications for future capital plans and budgets have been considered;
- Evaluate economic and market factors that might influence the manner and timing of the decision to borrow;
- Consider the pros and cons of alternative forms of funding, interest rate structures and repayment profiles;
- Consider the positive and negative impacts of borrowing in advance of need on the council's cash balances, in particular the increased exposure to credit risk that will arise as a result of investing this additional cash in advance of need.

Debt Rescheduling

9.11 As short-term borrowing rates are generally expected to be cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. The Council also has two LOBO loans which could be considered for early repayment. Any rescheduling activities would need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

9.12 All rescheduling will be reported to Strategy and Resources Scrutiny Committee and Council as appropriate.

10 Housing Revenue Account (HRA)

10.1 The Government introduced the new "Self Financing" system in 2012 and as a result of its introduction the complex system of subsidies from Government has ended. Instead, the Council now retains housing rental income to use to maintain the housing stock.

10.2 Redbridge was required to pay a one-off sum of £60.1m to the Government on the 28 March 2012, funded by increased debt to the HRA. To facilitate this, loans were provided by the PWLB at a discounted rate.

10.3 HRA loans are separately identified and all financing charges are ring fenced within the HRA so there is no impact on the General Fund.

TREASURY MANAGEMENT POLICY STATEMENT

1. The 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.

2. 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.

3. 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 performance measurement techniques, within the context of effective risk management.

4. When setting borrowing and lending policies, the Council adheres to the principles contained within the CIPFA Treasury Management Code of Practice, The Prudential Code and other statutory guidance. These policies are contained within the Council's Treasury Management Strategy which is approved annually.

Annex B

2019/20 Minimum Revenue Provision Policy Statement

Guidance issued by the Secretary of State requires that before the start of each financial year the Council prepares a statement of its policy on making MRP in respect of the forthcoming financial year and submits it to full Council for approval.

- For capital expenditure incurred before 1 April 2008, or for any new capital expenditure incurred in the future up to the limit of the Council's supported borrowing, minimum revenue provision will be provided on a 2.5% straight line equal instalments charge, i.e. provision for the full repayment of debt over 40 years.
- Service Assets - Minimum revenue provision for new capital expenditure incurred wholly or partly by unsupported (Prudential) borrowing or credit arrangements is to be determined by reference to the expected life of the asset, using either the Equal Instalment method or Annuity method. Asset life is deemed to begin once the asset becomes operational. Minimum revenue provision will commence from the financial year following the one in which the asset becomes operational.
- Commercial / Investment Assets - The Council will use the asset life option as its main method of determining MRP in respect of Commercial assets and Investment Properties, making use of both the Equal Instalment Method and the Annuity Method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure. Asset life is deemed to begin once the asset becomes operational. Minimum revenue provision will commence from the financial year following the one in which the asset becomes operational.
- Estimated life periods will be determined under delegated powers to the Corporate Director of Resources. Information provided by the Council's valuer, or other specialist valuation experts will be used to determine asset lives for commercial activities, investment properties and other assets as appropriate.
- Minimum revenue provision in respect of Finance Leases and on balance sheet Private Finance Initiative (PFI) contracts will be regarded as being met by a charge equal to the element of the rent/charges that goes to write down the balance sheet liability. Where a lease (or part of a lease) or PFI contract is brought onto the balance sheet, having previously been accounted for off balance sheet, the minimum revenue provision requirement would be regarded as having been met by the inclusion in the charge for the year in which the restatement occurs, of an amount equal to the write down for that year plus retrospective writing down of the balance sheet liability that arises from the restatement.
- Minimum revenue provision in respect of unsupported (Prudential) borrowing taken to meet expenditure, which is treated as capital expenditure or loans by virtue of either a capitalisation direction or regulations, will be determined in accordance with the asset life method as recommended by the statutory guidance.
- The Council retains the right to make additional voluntary payments to reduce debt if deemed prudent.

Prudential Indicators

1. Capital Prudential Indicators

1.1. The council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure

1.2. This prudential indicator is a summary of the council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

1.3. **Table 5: Capital Expenditure Forecast**

	2018/19 Revised Budget £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
General Fund (GF) Operational	55.255	106.891	51.933	23.823	21.363	-
***GF Non-operational / non-financial**	23.098	45.000	44.295	40.000	20.000	-
HRA	17.191	52.492	66.384	60.102	9.312	9.500
Total	**95.544**	**204.383**	**162.612**	**123.925**	**50.675**	**9.500**

*Non-Operational / Non-Financial investments relates to areas such as capital expenditure on Investment Properties and loans to third parties

1.4. **Other long-term liabilities**: The above capital expenditure forecast excludes other long-term liabilities such as PFI and leasing arrangements which are classified as borrowing instruments.

1.5. Table 6 overleaf provides information on how capital expenditure plans are proposed to be financed by capital or revenue resources. Any shortfall of resources results in a funding need i.e. borrowing.

1.6. **Table 6: Capital Programme Funding Summary**

Capital Expenditure	2018/19 Revised Budget £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
GF	78.353	151.891	96.228	63.823	41.363	-
HRA	17.191	52.492	66.384	60.102	9.312	9.500
Total	**95.544**	**204.383**	**162.612**	**123.925**	**50.675**	**9.500**
GF Capital Grants	31.453	38.686	6.606	-	-	-
GF Capital Receipts	-	1.250	1.200	-	-	-
GF CIL / S106	1.037	3.784	4.300	-	-	-
GF Revenue Contributions	-	0.480	-	-	-	-
HRA Resources	17.1291	21.955	28.905	27.942	9.312	9.500
Total Resources	**49.681**	**66.155**	**41.011**	**27.942**	**9.312**	**9.500**
Financing Requirement	45.863	138.228	121.601	95.983	41.363	-
Split GF	*45.863*	*107.691*	*84.122*	*63.823*	*41.363*	-
HRA	-	*30.537*	*37.479*	*32.160*	-	-
Total Financing Requirement	**45.863**	**138.228**	**121.601**	**95.983**	**41.363**	**-**
Total Funding	**95.544**	**204.383**	**162.612**	**123.925**	**50.675**	**9.500**

The net financing need for non-operational activities / non- financial investments included in the above table against expenditure is shown in the table below.

Table 7: Non-Operational / Non-Financial Investment

Non-Operational / Non-Financial Investment	2018/19 Revised Budget £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Capital Expenditure	23.098	45.000	44.295	40.000	20.000	-
Net Financing requirement	23.098	45.000	44.295	40.000	20.000	-
% of GF financing requirement	50.4	41.8	52.7	62.7	48.4	-

Capital Financing Requirement (CFR)

1.7. This prudential indicator represents the total of historic unfinanced capital expenditure, and therefore a measure of the council's underlying borrowing need. Any capital expenditure not immediately paid for (e.g. by capital grants), will increase the CFR. The requirement to set aside the minimum revenue provision (MRP) reduces the council's underlying borrowing need and therefore CFR.

1.8. The CFR includes other long term liabilities (OLTL) which relate to the PFI scheme and finance leases brought onto the balance sheet. Whist these OLTL's increase the CFR, and therefore the council's borrowing requirement, they also include a financing arrangement and so the council is not required to separately borrow for them. The Council currently has £11.406m in such schemes within the CFR

1.9. The Council is asked to approve the CFR projections below:

Table 8: CFR Projections

CFR	**2018/19 Revised Budget £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**	**2023/24 Estimate £m**
Operational Services	265.134	319.129	346.851	356.432	362.020	346.230
Non-Operational/ Non-Financial	30.297	74.691	117.492	155.542	172.039	168.598
HRA	67.658	98.195	135.674	167.834	167.834	167.834
Total CFR	**363.089**	**492.015**	**600.017**	**679.408**	**701.893**	**682.662**

Movement in CFR represented by

	2018/19 £m	**2019/20 £m**	**2020/21 £m**	**2021/22 £m**	**2022/23 £m**	**2023/24 £m**
Net financing need for the year	45.863	138.228	121.601	95.983	41.363	-
Less MRP	(7.611)	(9.301	(13.599)	(16.592)	(18.878)	(19.231)
Movement in CFR	**38.252**	**128.927**	**108.002**	**79.391**	**22.485**	**(19.231)**

1.10. Under the capital finance regulations, local authorities are permitted to borrow up to three years in advance of need. The council will only consider borrowing in advance of need if market conditions indicate that it is the best course of action. One reason to borrow in advance of need would be to take advantage of low interest rates if the consensus view was that long term rates were likely to rise when significant borrowing may need to be taken. Any borrowing in advance of need will incur short term cost of carry until used to fund capital expenditure. This is because investment returns are lower than long term borrowing rates. However the ability to lock into low borrowing rates should provide better value over the life of the loan. Any advanced borrowing will also increase investment balances and thus exposure to credit risk. The council has in place a robust Investment Strategy to minimise this risk.

2. Affordability Prudential Indicators

2.1. **Ratio of financing cost to net revenue stream:** This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs net of investment income) against the net revenue stream.

Table 9: Ratio of financing cost to net revenue stream

	2018/19 Revised Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %	2023/24 Estimate %
General Fund	3.25	8.20	12.67	15.54	17.91	18.36
HRA	9.08	11.72	16.78	20.65	20.72	20.72

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

2.3 **Table 10: HRA Indicators**

	2018/19 Revised Budget	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
HRA debt **£m**	67.682	98.195m	135.674	167.834	167.834	167.834
Number of dwellings	4,445	4,412	4,319	4,331	4,475	4,475
Debt per dwelling **£m**	0.015	0.022	0.031	0.039	0.038	0.038

3. Prudential Indicators for Treasury Management

3.1. The key objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable. Further, that Treasury Management decisions are taken in accordance with good professional practice. To demonstrate that local authorities have fulfilled these objectives, the Prudential Code of Practice and CIPFA Treasury Management Code set out the indicators, and the factors that must be taken into account. Prudential Indicators for Treasury Management relate to:

- Limits for external debt;
- Interest rate exposures;
- Maturity structure of borrowings; and
- Investment for periods of longer than one year.

The Treasury Management indicators are not targets to be aimed at, but are instead limits within which the Treasury Management policies of the Council are deemed to be prudent.

3.2 **Authorised limit for External Debt**: this is a key prudential indicator and represents a control on the maximum level of borrowing, gross of investments, and separately identifies borrowing from other long-term liabilities such PFI Schemes and Finance leases. It reflects the level of debt which, while not necessarily desired, could be afforded in the short term, but is not sustainable in the longer term. The limits have been set to allow sufficient headroom to flex the Council's priority capital schemes. This limit is required to be set and revised by Council.

Table 11: Authorised limit for external debt

GF & HRA	2018/19 Revised Budget £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt Operational	346.386	409.302	457.669	520.826	547.467	532.379
Non-Operational/ Non-Financial	30.297	96.838	157.049	173.908	170.430	167.021
OLTL	11.406	10.875	10.299	9.674	8.997	8.262
Total	**388.089**	**517.015**	**625.017**	**704.408**	**726.893**	**707.662**

3.3 **Operational Boundary for External Debt**: This is the limit beyond which external borrowing is not normally expected to exceed.

Table 12: Operational Boundary

GF & HRA	2018/19 Revised Budget £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt Operational	331.386	394.302	442.669	505.826	532.467	517.379
Non-Operational/ Non-Financial	30.297	96.838	157.049	173.908	170.430	167.021
OLTL	11.406	10.875	10.299	9.674	8.997	8.262
Total	**373.089**	**502.015**	**610.017**	**689.408**	**711.893**	**692.662**

3.4 **Interest rate exposure:** the management of interest rate risk is a priority for the Council. The purpose of these limits is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of adverse movement in interest rates. In setting these limits a balance needs to be struck because if the limits are too restrictive they will impair the opportunities to reduce costs / improve performance. The limits are set out in the table overleaf.

Table 13: Interest rate exposures

	2019/20 Upper %	2020/21 Upper %	2021/22 Upper %
Limits on fixed interest rate: Borrowing	100	100	100
Limits on variable interest: Borrowing	50	50	50
Limits on fixed interest rate: Investments	100	100	100
Limits on variable interest: Investments	80	80	80

3.2. **Maturity Structure of Borrowing**: the Council is required to set upper and lower limits with respect to the maturity structure of its borrowings for fixed and variable rates. These have been set to avoid the need to refinance a significant proportion of outstanding debt on an annual basis, and to provide the Council with flexibility to manage its debt portfolio efficiently

Table 14: Maturity Structure of Borrowing

Fixed Rate	Upper Limit %	Lower Limit %
Under 12 months	30	-
12 Months and within 2 years	45	-
2 years and within 5 years	60	-
5 years and within 10 years	80	-
10 years and above	100	-

Variable Rate	Upper Limit %	Lower Limit %
Under 12 months	30	-
12 Months and within 2 years	30	-
2 years and within 5 years	30	-
5 years and within 10 years	40	-

3.3. **Investments for longer than 365 days –** within the Treasury Annual Investment Strategy, at Annex D paragraphs 4.12 – 4.13, the following amounts have been identified as available for longer term investment:

Table 15: Upper Limit for Principal Sums Invested for more than 365 days

	2019/20 £m	**2020/21 £m**	**2021/22 £m**
Limit for principle sums invested for more than 365 days	40	40	40
Current investments over 365 days as at 30.11.18 maturing in each year	10*	-	-

* relates to the long- term investment in the CCLA property fund which has no fixed maturity date and therefore included in the above table at the earliest year it could be redeemed

3.4. The Council is requested to approve the Prudential Indicators for Capital and Treasury Management as set out in Annex C.

Annex D

1. Annual Investment Strategy 2019/20

1.1. The Council is required to produce an Annual Investment Strategy that sets out the Council's policies for managing its investments. The Council's investment strategy must have regard to the CIPFA Code of Practice on Treasury Management (the Code) and the revised "Statutory Guidance on Local Government Investments" issued by the MHCLG (the Guidance), which came into operation from the 1st April 2018.

1.2. The Code and the revised Guidance have extended the meaning of "investments" to include both financial and non-financial investments. The Treasury Management Strategy deals solely with financial investments, (as managed by the Treasury Management function). Non-financial investments, essentially the purchase of income yielding assets, or loans, are covered in the Capital Investment Strategy.

1.3. The key intention of the Guidance is to maintain the requirement for Councils to invest prudently and that priority is given to the security and liquidity of investments before yield. The Guidance requires the Council to set out within its Annual Investment Strategy:

- Security, creditworthiness criteria, risk assessment and monitoring arrangements for investments;
- The liquidity of investments;
- Which investments the Council may use for the prudent management of its treasury balances and limits for each class of investment.

All investments are carried out in sterling.

2. Investment Objectives

2.1. The Council's investment strategy gives priority to:

- the **security** of the investments it makes;
- the **liquidity** of its investments to meet known liabilities.

2.2. The Council's objective is therefore to achieve, within this constraint, the optimum return on its investments with the appropriate levels of security and liquidity.

2.3. Within the prudent management of its financial affairs, the Council may temporarily invest funds that are borrowed for the purpose of expenditure expected to be incurred in the reasonably near future. Borrowing purely to invest or on-lend for speculative purposes remains unlawful and the Council will not engage in such activity.

3. Security of Capital

3.1. The Council seeks to maintain the security of its investments by investing in high credit quality institutions. These institutions comprise the Council's lending list. In order to establish the credit quality of the institutions and investment schemes in which the Council invests, the Council primarily makes use of credit ratings, both country (sovereign) ratings, and institution ratings compiled and published by the three main ratings agencies, Fitch Rating Ltd, Moody's and Standard & Poors.

3.2. The Council's treasury advisers provide information from the above mentioned rating agencies as part of the creditworthiness service provided to the Council.

3.3. **Credit Risk Assessment:** As set out above, the creditworthiness of counterparties is evidenced by the application of minimum credit quality criteria, primarily through the use of credit ratings from the three main ratings agencies. These ratings are used to formulate a credit matrix to determine prudent investment periods and monetary limits.

3.4. In formulating the credit matrix, consideration has been given to the levels of historic default against the minimum criteria used in the Council's investment strategy. The information in the table below, provided by Fitch Ratings, shows average defaults for differing periods of investment grade products for each long term rating category.

Long-Term Rating	Percentage Historic Experience of Default				
	Less than 1 year	1 – 2 years	2 – 3 years	3 – 4 years	4 – 5 years
AA	0.02%	0.04%	0.10%	0.17%	0.24%
A	0.05%	0.15%	0.28%	0.42%	0.59%
BBB	0.16%	0.44%	0.77%	1.15%	1.55%

3.5. The Council's credit matrix minimum long-term rating for investments with banks (excluding part nationalised banks) is "A". The Council's investment strategy is therefore considered low risk.

3.6. Other Counterparties and Investment Schemes that may be included on the approved lending list are:

- UK Part Nationalised Banks
- Money Market Funds;
- The UK Government (Debt Management Office and Gilts);
- Building Societies with assets in excess of £3 billion;
- Enhanced Cash Funds;
- Equity / Bond / Multi Asset Funds;
- Property Funds;
- Other Local Authorities, Parish Council's and Community Councils; and
- Non UK Government and Supranational Institutions.

3.7. All counterparties must meet the Council's Creditworthiness Criteria as set out at Annex Di.

3.8. **Credit Quality Monitoring**: The Council's treasury advisers provide credit rating information as and when ratings change, and these are acted upon when received. An institution's credit quality is reviewed before any investment is made.

3.9. On occasion, credit ratings may be downgraded after an investment has already been made. The creditworthiness criteria used are such that minor downgrades should not affect the full receipt of the principal and interest. Any counterparty whose ratings fall to the extent that they no longer meet the approved credit quality criteria is immediately removed from the lending list. If an institution or investment scheme is upgraded so that it fulfils the Council's criteria, its inclusion will be considered. The inclusion of institutions and investment schemes that meet the agreed credit criteria is delegated to the Corporate Director of Resources.

3.10. Reliance is not placed on credit ratings alone. Regard is also given to other sources of information such as:

- Publicity from sources such as the quality financial press, share price and other such information pertaining to the banking and financial sector to establish the most robust scrutiny process of potential investment counterparties;

- Investment rates being paid, and whether they are out of line with the market as this could indicate that the investment is of a higher risk;
- Where available, price movements of Credit Default Swaps, which are a financial instrument for swapping the risk of debt default, can be plotted to give an indicator of relative confidence about credit risk.

All information received is acted upon promptly as appropriate.

3.11. **Investments and Diversification across Asset Classes** - Additional security of capital is also achieved through diversification and specifying the type of investment that the Council is prepared to invest in.

3.12. The Guidance requires the Council to set out the investments in which it is prepared to invest under the headings of Specified Investments, Loans and Non-Specified Investments.

3.13. **Specified Investments** are an investment in an organisation or in an investment scheme that meet the Council's high credit quality criteria as set out above and meet the following criteria;

- The Council has a contractual right to repayment within twelve months, either because that is the expiry term of the investment or through a non-conditional option;
- The investment is denominated in sterling and all repayments in respect of the investment are only payable in sterling;
- The investment is not defined as capital expenditure by virtue of the Local Authority Capital Finance Regulations.
- The investment is made with the following organisations:
  - The United Kingdom Government;
  - A local Authority, as defined in regulation; and
  - A Parish Council or Community Council.

Specified investments are deemed to be of lower risk.

3.14. **Loans** to local enterprises, local charities, wholly owned companies and joint ventures provided as part of a wider strategy for local economic growth, even though those loans may not be seen as prudent if adopting a narrow definition of prioritising security and liquidity, can be made whilst having regard to the Guidance. The Council must demonstrate compliance with the specified guidance requirements. This will be set out in the Capital Investment Strategy.

3.15. **Non-Specified Investments** are any financial investments, that is not a loan, and does not meet the criteria to be treated as a specified investment. Non-specified investments are deemed to have a greater potential of risk, such as investments for longer than one year or with institutions that do not have credit ratings, such as some Building Societies. Limits must be set on the amounts that may be held in such investments at any one time during the year. The Council's creditworthiness criteria for selecting non-specified investments are set out at Annex D(i). Specified and Non-Specified Investment categories are detailed at Annex D(ii).

3.16. **UK banks – ring fencing -** The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing".

3.17. Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity’s core activities are not adversely affected by the acts or omissions of other members of its group.

3.18. While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

3.19. **Accounting for Investments** - As a result of the change in International Financial Reporting Standard 9 (IFRS 9) the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charge to the General Fund at year end.

3.20. Following a consultation, MHCLG has provided a temporary override to delay implementation of IFRS 9 for pooled investments for a period of five years from 1st April 2018. All other investments that fall within the remit of IFRS 9, including loans to third parties, will be required to be valued in accordance with the requirements of the accounting standard.

3.21. **Asset class limits** - The maximum percentage of the treasury investment portfolio which may be directly invested in each asset class is as set out below:

UK Government	100%
Local Authorities	85%
UK Banks- Specified	80%
Money Market Funds (CNAV and LVNAV)	40%
Enhanced Cash Funds / Money Market Funds (VNAV)	15%
Building Societies - Specified	45%
Total Unspecified Investments	50%
Non UK Banks – Specified (subject to group limit)	40%
Non UK Government and Supranational Bonds (subject to group limit)	30%
Total Group Non UK Investments	40%
Corporate Bonds	15%
Property Funds	25%

These limits have been set to reflect the revised regulatory structure of entities, and to ensure that the Council retains maximum flexibility and can react quickly to changing market conditions. A breach of an asset class limit due to unexpected cashflow movements will not result in the immediate sale of investments if the position is to be rectified within a short timeframe. The actual balance between the above asset classes will depend, at any one time, on the relative levels of risk and return and the overall balance of the portfolio.

3.22. The creditworthiness criteria for choosing counterparties set out above provides a sound approach to investment in "normal" market circumstances. Under exceptional market conditions institutions can face real and sudden difficulties with a time lag before the credit rating agencies reflect this. Therefore, it is vital that the council maintains a strategy of responding swiftly and the Corporate Director of Resources will restrict further investment activity to those counterparties that are at any one time considered of the highest credit quality. Security of the Council’s money will always remain the main priority and this strategy will take precedence over yield.

4. Investment of Cash Balances and the Liquidity of Investments

4.1. **Cashflow Management** - To assist in managing the Council's finances, a cashflow model is maintained. The model details all known major items of income and expenditure, based on the council's revenue and capital budget proposals, detailed elsewhere in the budget report. Cash balances can fluctuate significantly during the course of the year due to timing differences between the receipt of cash such as grants and the corresponding expenditure. It is estimated that the average balance during 2019/20 will be approximately £105.5m, but could be lower if used to fund borrowing requirements.

4.2. **Liquidity:** The Council is required to have available, or access to, adequate resources to enable it at all times to have the level of funds which are necessary for the achievement of its service objectives. The cashflow model provides the Council with information on its cash requirements, detailing immediate cash requirements and indicating cash balances that are available for investment for longer periods. The liquidity of the investment portfolio is monitored regularly and reported at monthly treasury meetings with the Operational Director of Finance. The minimum amount of cash balances required to support cashflow management on a monthly basis is £25m.

4.3. The borrowing strategy permits the use of internal balances to temporarily fund capital expenditure. Whilst this will help reduce the need for investing, this must be balanced against the future requirement to replace these balances, and ensure that sufficient cash is available to meet the Council's liquidity requirements.

4.4. For debt management purposes the Council has in place overdraft facilities with the Council's bankers, National Westminster Bank plc. and has access to the PWLB and the money market to fund capital projects and maturing debt.

4.5. **Borrowing in Advance of Need:** As set out in the borrowing strategy, the Council has an extensive borrowing requirement over the next five years. The Council has some flexibility to borrow funds this year for use in future years. The Corporate Director of Resources may do this under delegated authority, where for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed rates will be economically beneficial to meet budgetary constraints.

4.6. The Corporate Director of Resources will adopt a cautious approach to any such borrowing, and will only do so to fund approved capital schemes or future debt maturities. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates. The investment of funds borrowed ahead of need would be within the constraints of the approved investment strategy.

4.7. **In-House Funds**: Investments will be made with reference to core balances, cashflow requirements and the outlook for interest rates. Link provide economic forecasting information to assist the Council to formulate a view on interest rates.

4.8. **Interest Rate Expectations:** On the assumption that the UK and EU agree a Brexit deal by spring 2019, the Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.0% by March 2022. Bank Rate forecasts at financial year ends are:

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

More detailed information on interest rate forecasts is set out at paragraph 8.1 of the main report.

4.9. Indicative investment returns on the council's short-term investments for the next three years are:

- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%

4.10. The Council uses the Seven day LIBID rate plus 20 basis points as a benchmark for comparing the Council's return on its investments.

4.11. Link's current view is that the overall balance of risks to economic growth in the UK is probably neutral at present. The balance of risks to increases in Bank Rate and shorter dated PWLB rates, are probably also even and are dependent on how strong GDP growth turns out to be, how slowly inflation pressures subside, and whether Brexit negotiations move forward positively. The Council will monitor the situation and implement a more cautious investment strategy if deemed appropriate.

4.12. **Investments Longer than 365 days**: This limit is set with regards to the Council's liquidity requirements and is based on the availability of funds after each year-end. Having given due consideration to the level of balances over the next three years it is determined that up to £40m of total fund balances could be invested for longer than one year. When making such investments consideration must be given to the current economic outlook and the prospect for continued market volatility.

4.13. It is recommended that the Council approve an upper limit for principal sums to be invested for longer than 365 days of £40m.

4.14. **Market in Financial Instruments Directive II (MiFID II):** These regulations came into effect on the 3 January 2018. Under these regulations local authorities are classified as retail clients, which restrict access to certain investment products that were previously available for investment. The regulations allow for the Council to seek to opt up to "elective professional client status" if they meet certain regulatory requirements. On the 16 November 2017, Council agreed that applications for elective professional client status be completed with relevant financial institutions in order that an effective investment strategy can be maintained.

5. Provision for Credit-related Losses

5.1. If any of the Council's investments were to appear at risk of loss due to default, provision would need to be made from revenue for the appropriate amount.

6. Investment Strategy

6.1. In **summary –** considering the factors set out in Paragraphs 1 to 4 the recommended Investment Strategy is:

i) That cash balances, not immediately required to finance expenditure, are lent to the money market for the most appropriate periods as indicated by the cashflow model and current market and economic conditions;

ii) That liquidity is maintained by the use of overnight deposits and money market funds;

iii) That the minimum amount of short-term cash balances required to support monthly cashflow management is £25m;

iv) That the upper limit for investments longer than 365 days is £40m;

v) That all investment with institutions and investment schemes is undertaken in accordance with the Council's creditworthiness criteria as set out in Annex D(i);

vi) That more cautious investment criteria are maintained during times of market uncertainty;

vii) That all investment with institutions and investment schemes is limited to the types of investment set out under the Council's approved "Specified" and "Non-Specified" Investments detailed in Annex D(ii), and that professional advice continues to be sought where appropriate;

viii) That all investment is managed within the Council's approved asset class limits as set out at paragraph 3.21.

6.2 The Council is requested to approve the Annual Investment Strategy for Treasury Investments as set out in Annex D

Annex D(i)

CREDITWORTHINESS (Extract from Treasury Management Practices)

The Council is required to invest prudently and demonstrate that priority is given to security and liquidity before yield. Creditworthiness covers:-

1. Credit quality for selecting counterparties.

2. Credit ratings for institution and country.

1) Credit Quality

The criteria for providing a pool of high quality investment counterparties for both Specified and Non Specified investments are as follows:

- **Banks with a Good Credit Quality**

a) UK banks (ring fenced and non-ringfenced)
b) Non UK banks domiciled in a country, which has a minimum Sovereign long term rating of AA-.
c) Meet the requirements of the short term and or long-term credit matrixes set out in 2 below.

- **UK Part Nationalised Banks**

Royal Bank of Scotland Group whilst it continues to be part nationalised, or meets the requirements of the credit matrixes.

- **The Council's banker – National Westminster Bank (NWB),** NWB is a subsidiary of the Royal Bank of Scotland. For investment purposes investments can be made with NWB and the Royal Bank of Scotland (RBS). RBS is a part nationalised bank. If this were to cease and the ratings of RBS did not meet the creditworthiness criteria then cash balances would be minimised in both monetary size and time.

- **Bank Subsidiary and Treasury Operations**

The Council will use these where the parent bank has the necessary ratings outlined above.

- **Building Societies** –the Council will use Building Societies that:

a) Meet the requirements of the short term and or long-term credit matrixes set out in 2 below; or
b) Have assets in excess of three billion pounds.

- **Money Market Funds** (including CNAV, LVNAV and VNAN)
- **UK Government** (including the Debt Management Account Deposit Facility)
- **Enhanced Cash Funds**
- **Local Authorities** (including the GLA, Police and Fire Authorities and Parish Councils)
- **Non UK Government**
- **Supranational Institutions**
- **Property Funds**
- **Bond Funds**
- **Equity Funds**
- **Multi Asset Funds.**

2) Credit Criteria

The Council adopts a range of credit rating criteria. Creditworthiness is based on the credit ratings supplied by Fitch, Moody's, and Standard & Poor.

Short Term Credit Matrix

For short term lending (364 days or less) the following minimum credit criteria for Banks and Rated Building Societies will apply:

	Fitch	Fitch	Moody's	Moody's	S&P's	S&P's
	Highest	Lowest	Highest	Lowest	Highest	Lowest
Long term credit	AAA	A-	Aaa	A3	AAA	A-
Short term credit	F1+	F1	P-1	P-1	A-1	A-1

Long Term Credit Matrix

For Long Term lending (365 days or more), the following minimum credit criteria will apply:

	Fitch	Fitch	Moody's	Moody's	S&P's	S&P's
	Highest	Lowest	Highest	Lowest	Highest	Lowest
Long term credit	AAA	A	Aaa	A2	AAA	A-
Short term credit	F1+	F1	P-1	P-1	A-1	A-1

Long Term – relates to long term credit quality
Short Term – relates to short term credit quality

- **Monitoring of Investment Counterparties**

The credit rating of counterparties is monitored regularly. The Council receives credit rating information (changes, rating watches and outlooks) from the treasury advisers as and when ratings change and counterparties are checked promptly. Any counterparty failing to meet the creditworthiness criteria is removed from the list immediately.

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

The Code of Practice requires the Council to supplement credit rating information. The above criteria relates primarily to the application of credit ratings, however additional operational market information such as negative ratings watches /outlooks and financial press information must be considered before any specific investment decision can be made. In addition, movement in credit default swap prices can provide an indication of credit risk, as can the rate of interest being offered if it is out of line with the market.

- **Country Sovereignty Considerations**

Due care will be taken to consider the country, group and exposure of the Council's investments. No more than 40% of the total investment portfolio will be directly placed with non UK countries at one any time.

For countries other than the UK, sovereignty ratings must fall within the ratings matrix below, before the country can be considered for inclusion on the lending list and then each individual institution domiciled to that country must meet the high credit quality criteria as detailed, and the credit matrixes.

	Fitch	Fitch	Moody's	Moody's	S&P's	S&P's
	Highest	Lowest	Highest	Lowest	Highest	Lowest
Sovereign ratings	AAA	AA-	Aaa	Aa3	AAA	AA-

A Fitch rating of 'AAA' denotes the highest credit rating quality with the lowest expectation of default risk. The lowest rating "C" denotes that default is imminent and a rating of 'D' denotes that the issuer is currently in default.

- **Time and Monetary Limits applying to Investments**

<u>Credit rated institutions</u>							
Minimum Credit Rating Short Term			**Minimum Credit Rating Long Term**			**Limit**	**Time Limit**
Fitch	**S & P**	**Moody's**	**Fitch**	**S & P**	**Moody's**	**£m**	**Years**
F1	A-1	P-1	A	A	A2	25	1
F1	A-1	P-1	A-	A-	A3	20	1
F1	A-1	P-1	AA-	AA-	Aa3	20	2
F1	A-1	P-1	A+	A+	A1	15	2
F1	A-1	P-1	A	A	A2	10	2
F1	A-1	P-1	AA-	AA-	Aa3	15	3
F1	A-1	P-1	A+	A+	A1	10	3
F1	A-1	P-1	A	A	A2	8	3
F1	A-1	P-1	AA-	AA-	Aa3	10	5
F1	A-1	P-1	A+	A+	A1	5	5
<u>Other Institutions</u>							
Property Funds						25	5
Money Market Funds - CNAV				Fund rating AAA		15	1
Money Market Funds - LVNAV				Fund rating AAA		10	1
Money Market Funds - VNAV				Fund rating AAA		5	2
Unrated Building Societies				Assets greater £3bn		5	1
Enhanced Cash Funds				AAA/V1		5	2
Multi Asset Funds						5	2
<u>Other</u>							
UK Government – Debt Management account deposit facility						unlimited	5
UK Government - Bonds						25	5
UK Government - Part Nationalised Banks				per group		25	2
UK Corporate Bonds						5	5
Local Authorities						15	5
Covered Bonds				secured		5	5
				Sovereign Ratings			
Non-UK Government Bonds				AA-		5	5
Supranational Bonds				AA-		5	5

The creditworthiness criteria detailed above provides a sound approach to investment in "normal" market circumstances. However, under exceptional market conditions institutions can face real and sudden difficulties with a time lag before the credit rating agencies reflect this. Therefore, the Council will maintain a strategy of responding swiftly and the Corporate Director of Resources will restrict further investment activity to those counterparties that are at any one time considered to be of the highest credit quality. Security of the Council's money always remains the main priority and this strategy will take precedence over yield.

Annex D(ii)

APPROVED LIST OF SPECIFIED INVESTMENTS, CREDITWORTHINESS AND USAGE FOR UNDERTAKING THE COUNCIL'S INVESTMENT MANAGEMENT STRATEGY (extract from Treasury Management Practices)

Specified Investments are sterling investments of not more than one year maturity, or those which could be for a longer period, but where the Council has the right to be repaid within 12 months if it wishes. These are considered lower risk assets where the possibility of loss of principal is small.

INVESTMENT	SECURITY / CREDIT RATING	USE
Debt Management Agency Deposit Facility	-	In House
Local Authorities and Parish Councils	-	In House
Money Market Funds	Rated AAAmf	In House
Enhanced Cash Funds	Rated AAA/V1	In House
UK Part Nationalised Banks	Government backed	In House
Banks	See table and criteria above Credit matrix Meets sovereign criteria	In House
Building Societies	See table and criteria above Credit matrix Secured on tangible assets	In House
Supranational Bonds	Sovereign rating criteria	In house / external fund manager
Certificates of Deposit, Floating Rate Notes, Commercial Paper, issued by banks and building societies	Short-term matrix Sovereign rating criteria Government Backed	In house / external fund manager
UK Government gilts and treasury bills	UK Sovereign rating	In house / external fund manager
Local Government Bills	UK Sovereign rating	In house / external fund manager
UK Gilt and Bond Funds	Sovereign rating criteria and /or AAA rated fund	In house / external fund manager
Non-UK Government Bonds	Sovereign rating criteria	In house / external fund manager
Corporate Bonds	See table and criteria above Credit matrix Meets sovereign criteria Secured on tangible assets	In house / external fund manager

APPROVED LIST OF NON-SPECIFIED INVESTMENTS, CREDITWORTHINESS AND USAGE FOR UNDERTAKING THE COUNCIL'S INVESTMENT MANAGEMENT STRATEGY
(Extract from Treasury Management Practices)

Non Specified Investments are any other type of investments that do not fall under the Specified classification.

In accordance with the guidance issued by MHCLG effective from 1 April 2018, an upper limit must be stated for the percentage of the investment portfolio that may be held in non-specified investments at any time. This (principle sums) limit has been set at 50% of the total portfolio as per the asset class limit set in the Treasury Annual Investment Strategy Report.

Unrated banks, building societies and other institutions are classed as non-specified investments irrespective of the investment period.

INVESTMENT	SECURITY/CREDIT RATING	Maximum Term	USE
Unrated Building Societies	Market capitalisation over £3bn	1 year	In House

Long-term investments must be undertaken within the approved creditworthiness criteria and total exposure constrained within the boundaries of the approved Limits.

The table below details the total percentage of the Principal Sums Invested for more than 365 days that can be held in each category of investment, for example 100% of the Principal Sums limit can be held with the UK Government at any one time.

INVESTMENT **(All in Sterling)**	**SECURITY/CREDIT RATING**	**Max term**	**USE**	**Upper Limit % of the Total Principal sums for each year**
UK Government - DMO / Gilts	Sovereign rating criteria	5 years	In House	100%
Bond Funds	Sovereign rating criteria /Regulatory approved investment company	5 years	In house / external fund manager	50%
Enhanced Cash Funds	Sovereign rating criteria / AAA /V1	5 years	In house / external fund manager	25%
Property Funds	Regulatory approved Meets sovereign criteria	5 years	In house / external fund manager	60%
Equity Funds	Sovereign rating criteria /Regulatory approved investment company	5 years	In house / external fund manager	20%
Multi Asset Funds	Sovereign rating criteria /Regulatory approved investment company	5 years	In house / external fund manager	20%
Local Authorities	Sovereign rating	5 years	In House	100%

	criteria			
INVESTMENT – cont. **(All in Sterling)**	**SECURITY/CREDIT RATING**	**Max term**	**USE**	**Upper Limit % of the Total Principal sums for each year**
Banks	See table and criteria above Long Term credit matrix Meets sovereign criteria	5 years	In House	100%
Building Societies	See credit criteria table Long term credit matrix.	5 years	In House	60%
Non UK Government Bonds	Sovereign rating criteria	5 years	In house / External fund manager	30%
Supranational Bonds	Sovereign rating criteria	5 years	In house / external fund manager	35%
The Council's own banker –	Government backed	2 years	In house	50%
Corporate Bonds / Covered Bonds	See table and criteria above Long Term credit matrix Meets sovereign criteria	5 years	In house / external fund manager	15%

Share Capital in a body corporate	The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources.
Loan Capital in a body corporate	The criteria for making such investments is set out in the Council's Capital Investment Strategy.

Annex E

Treasury Management Delegations and Responsibilities

The respective roles of the Council, Cabinet, Governance and Assurance Committee, Strategy and Resources Scrutiny Committee and the Section 151 officer are summarised below. Further details are set out in the Treasury Management Practices.

Council

Council will approve the annual Treasury Management Strategy; a mid-year annual review and the annual out-turn report on treasury activities. In doing so Council will establish and communicate their appetite for risk within treasury management having regard to the Prudential Code

Cabinet

Cabinet will receive and recommend to Council the annual treasury management strategy, the mid-year annual report and annual out-turn report on treasury activities.

Strategy and Resources Scrutiny Committee

This committee receives the mid-year annual report and annual outturn report on treasury activities.

Governance and Assurance Committee

This committee is responsible for ensuring effective scrutiny of the Treasury strategy and policies prior to the start of each financial year.

Corporate Director of Resources - Section 151 Officer

Council has delegated responsibility for the implementation and monitoring of treasury management decisions to the Section 151 Officer to act in accordance with approved policy and practices. The Section151 Officer has full delegated powers as set out in the Council's Scheme of Delegations and Financial Standing Orders and is responsible for the following activities:

- Investment management arrangements and strategy;
- Borrowing and debt management strategy;
- Monitoring investment activity and performance;
- Overseeing administrative activities;
- Ensuring compliance with relevant laws and regulations;
- Provision of guidance to officers and members.

Treasury Team

The Corporate Finance team undertakes day to day treasury investment and borrowing activates in accordance with the Treasury Management Strategy, policies, practices and procedures.

Annex F

GLOSSARY

Asset Class Limits	The Council is required to set limits in terms of percentages for each class of investment held as a percentage of the total portfolio.
Asset Life	How long an asset, e.g. a Council building is likely to last.
Borrowing Portfolio	A list of loans held by the Council.
Borrowing Requirements	The principal amount the Council requires to borrow to finance capital expenditure and loan redemptions.
Capitalisation direction or regulations	Approval from central government to fund certain specified types of revenue expenditure from capital resources.
CIPFA Code of Practice on Treasury Management	A professional code of Practice which regulates treasury management activities.
Constant Net Asset Value (CNAV)	Amortised cost accounting to value fund assets to aim to maintain a value of a share of the fund at £1.
Counterparty	Financial institutions with which the Council transacts with for borrowing and lending.
Credit Arrangements	Methods of Financing such as finance leasing
Credit Ratings	A scoring system issued by credit rating agencies such as Fitch, Moody's and Standard & Poors that indicate the financial strength and other factors of a bank or similar institution.
Creditworthiness	How highly rated an institution is according to its credit rating.
Debt Management Office / DMADF	The DMO is an agency of the HM Treasury which is responsible for carrying out the Government's Debt Management Policy.
Debt Rescheduling	The refinancing of loans at different terms and rates to the original loan.
Depreciation Method	The spread of the cost of an asset over its useful life.
Fitch Ratings	A credit rating agency who provides credit rated worthiness information.
Gilts	Issued by the UK Government in order to finance public expenditure. Gilts are generally issued for a set period and pay a fixed rate of interest for the period.
Guidance on Local Government Investments	Statutory guidance issued by the Department for Communities and Local Government in respect of local authority investments
Interest Rate exposures	A measure of the proportion of money invested and what impact movements in the financial markets would have on them.
Lender Option Borrower Option (LOBO)	Loans taken by the Council that have a fixed rate for a specified number of years and then the rate can be varied by the lender at agreed intervals for the remaining life of the loan. If the revised rate offered by the lender is

	unacceptable to the Council, then the Council has the option to repay the loan in full and the loan agreement will end.
Limits for external debt	The limit set for the total amount of external debt based on the Council's spending plans, allowing for cashflow movements and sufficient headroom.
Liquidity	The availability of finance to ensure that the Council has adequate cash to be able to pay its obligations when they fall due.
Low Volitivity Net Asset Value (LVNAV)	Similar to CNAV but has some mark to market pricing. Seeks to maintain a share value of £1 in normal market conditions
Maturity	The date when an investment is repaid or the period covered by a fixed term investment.
Maturity Structure of Borrowings	The composite repayment obligations of the Council's debt portfolio in order of maturity.
Minimum Revenue Provision	The minimum amount which must be charged to an authority's revenue account each year and set aside to repay debt.
Minimum Revenue Provision Policy Statement	An annual statement which sets out the options available to the Council to calculate its minimum revenue provision
Money Market	The financial markets where investments and loans are traded.
Money Market Funds	An open ended mutual fund that invests in a mix of short term securities.
Moody's	A credit rating agency who provides credit rated worthiness information.
Non Specified Investments	Investments deemed to have a greater element of risk such as investments for longer than one year
Prudential Borrowing	Borrowing in accordance with the requirements of the Prudential Code
Prudential Code for Capital Finance in Local Authorities	A professional code of practice for local authorities to meet statutory requirements of the Local Government Act
Prudential Indicators	Indicators specified in the Prudential Code that are set to ensure that capital investment is affordable, prudent and sustainable.
Public Works Loan Board (PWLB)	Statutory body operating within the UK Debt Management Office, who lend money and collect repayments from local authorities and other prescribed bodies
Credit Rated	Institutions that possess a credit rating from a credit rating agency such as Fitch, Moody's or Standard and Poors.
Risk Control	Putting in place processes to control exposures to risk.
Security	The safety of an investment and the likelihood that it will be repaid.
Specified Investments	Investments that meet the Council's high credit quality criteria and repayable within 12 months.
Standard and Poors	A credit rating agency who provides credit

	rated worthiness information.
Supranational Institutions	Multinational structures - an amalgamation of different countries offering investment opportunities - for example Euro Investment Bank
Treasury Bills	Short term, Government backed debt obligation with a maturity of less than one year. Very liquid and secure.
Unrated institution	An institution that does not possess a credit rating from one of the main credit rating agencies.
Unsupported Borrowing	Borrowing where costs are wholly financed by the Council.
Variable Net Asset Value (VNAV)	Most fund assets priced on a mark to market basis resulting in a changing share price.