2019/20 TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY, PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS AND MINIMUM REVENUE PROVISION (RESOURCES)

Synopsis of report:

The report sets out the Treasury Management Strategy, Prudential and Treasury Management Indicators, and Minimum Revenue Provision Statement for 2019/20.
This report should be read in conjunction with the Capital Strategy report set out elsewhere on this agenda

Recommendations:

i) The proposed 2019/20 Treasury Management Strategy encompassing the Annual Investment Strategy as set out in this report be approved

ii) The Prudential and Treasury Management Indicators for 2019/20 set out in this report be approved

iii) The revised Treasury Management Practices and Treasury Management Schedules set out in the Appendices be approved

iv) The authorised limit for external borrowing by the Council in 2019/20, be set at £720,939,000 (this being the statutory limit determined under Section 3 (1) of the Local Government Act 2003

v) That there be no change to the previously adopted MRP policy as set out below:

The Council will use the asset life method as its main method for calculating MRP.

***In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated. Where schemes require interim financing by loan, pending receipt of an alternative source of finance (for example capital receipts) no MRP charge will be applied*.**

1. Context of report

1.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.2 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.

1.3 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. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 Revised reporting is required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities and Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the Chartered Institute of Public Finance Accountants (CIPFA) Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. **The capital strategy is being reported elsewhere on this agenda and should be read in conjunction with this report**.

1.5 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council’s Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy and Treasury Management Strategy.

1.6 The Council has adopted both the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes – 2017 Edition (the TM Code) and the Prudential Code (the Code) and this report fulfils the Council’s legal obligation under the *Local Government Act 2003* to have regard to both the relevant CIPFA Codes and MHCLG Guidance.

1.7 The 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 are:

- Prudential and Treasury Indicators and Treasury Management Strategy (this report)
- A mid year Treasury Management Report
- An annual Treasury Report

1.8 The Treasury Management Strategy (TMS) sets out the framework each year for the Council’s treasury operations. It covers:

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

Treasury management issues:
- Policy on the use of external service providers
- The economy and prospects for interest rates
- The current treasury position
- Borrowing strategy
- Policy on borrowing in advance of need
- Debt restructuring
- Annual investment strategy
- Treasury indicators which limit the risk and activities of the Council
- Other treasury matters (required under MHCLG Investment Guidance)

1.9 The Council has delegated responsibility for the implementation and regular monitoring of its treasury managemnet policies and practices to the Corporate Management Committee, and for the execution and administration of treasury management decisions to the Corporate Director of Resources, who will act in accordance with the Council’s Treasury Policy Statement and Treasury Management Practices (TMP).

1.10 These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Overview and Scrutiny Select Committee which will be considering this report at its meeting on 6 February 2018

1.11 A glossary of treasury terms has been included at Appendix "C" to assist Members with some of the terms covered in this report.

2 Capital Strategy

2.1 Both the CIPFA Codes and the MHCLG Guidance recognise that authorities may make investments for policy reasons outside of normal treasury management activity i.e. service investments (held in the course of normal operations – including regeneration), or commercial investments taken for financial reasons (i.e. shares and loans in subsidiaries and Investment Properties).

2.2 Runnymede has for some time, produced an annual Capital Strategy. In order to address a growing concern over the number of service and commercial investments, the revised CIPFA Codes now make the production of a Capital Strategy a requirement for all local authorities. The aim of this is to ensure that all elected members fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite associated with the capital plans of the Council.

2.3 The Capital Strategy is reported separately from the Treasury Management Strategy Statement to ensure 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 shows:

- 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.

2.4 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.

2.5 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.

2.6 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this TMS report.

3 Minimum Revenue Provision (MRP) Policy Statement

3.1 When a Council funds capital expenditure by borrowing, the costs are charged to the Council Tax payer in future years, reflecting the long-term use of the assets. Unlike a mortgage where amounts of principal are repaid each month, the borrowing undertaken by a Council is usually repayable on maturity at an agreed future date. The interest on borrowing is charged in the year it is payable.

3.2 To reflect this, the Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge (the minimum revenue provision – MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision – VRP). The MRP exists as a charge to revenue each year in order to have sufficient monies set aside to meet the future repayment of principle on any borrowing undertaken. There isn't an earmarked reserve for MRP, it is represented in the accounts as increased cash.

3.3 There is no requirement on the HRA to make a minimum revenue provision.

3.4 Revised statutory guidance has been issued by the MHCLG which local authorities are required to have regard to which require the full Council to approve an MRP Statement in advance of each year. The aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is commensurate with that over which the capital expenditure provides benefits. The guidance recommends 4 options for calculating a prudent MRP as follows:

1. Regulatory Method
2. CFR Method
3. Asset Life Method (repayment over the useful life of the asset on an asset life basis)
4. Depreciation Method (cost less estimated residual value)

Opitons 1 and 2 should normally only be used for Government-supported borrowing with options 3 and 4 being used for self-financed borrowing.

3.5 In December 2014 the Council set a new MRP Statement to reflect impending property transactions. As the new proposals essentially relate to prudent provisions and the relevant useful lives of assets, these will be unique to each asset borrowed against and as such will not affect the overall method chosen for calculating MRP, there are therefore currently no plans to amend the statement at the present time. The Council's MRP statement for 2018/19 will therefore be as follows:

"The Council will use the asset life method as its main method for calculating MRP.

In normal circumstances, MRP will be set aside from the date of acquisition. However, in relation to capital expenditure on property purchases and/or development, we will start setting aside an MRP provision from the date that the asset becomes operational and/or revenue income is generated. Where schemes require interim financing by loan, pending receipt of an alternative source of finance (for example capital receipts) no MRP charge will be applied".

3.6 A change introduced by the revised MHCLG Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision (VRP) or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, the Council's MRP policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 the Council had made no such VRP overpayments.

4 Treasury Management Strategy (TMS)

<u>Treasury management consultants and training</u>

4.1 The Council recognises that there is value in employing external providers of treasury management services in order to secure access to specialist skills and resources. Link Asset Services provide this service to the Council, although responsibility for final decision making remains with the Council and its officers at all times.

4.2 The quality of this service is controlled by the Corporate Director of Resources assessing the quality of advice offered and other services provided by Link. In particular, the Corporate Director of Resources holds regular meetings with Link (normally 3 to 4 times a year) where, in addition to discussing treasury strategy, the performance of the consultants is reviewed.

4.3 The needs of the Council's treasury management staff for training in investment management are assessed every year as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Relevant training courses, seminars and conferences are provided by a range of organisations including Link and CIPFA.

4.4 The CIPFA Code requires the Corporate Director of Resources to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Member training was last carried out by Link Asset Services to 22 Members on 29 November 2017. Further training will be arranged as required.

The economy and prospects for interest rates

4.5 The Council has appointed Link as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table and paragraph's gives Link's view on interest rates and the ecomony:

Link Asset Services Interest Rate View	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%	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	0.90%	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	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	1.20%	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	2.10%	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%	2.60%	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%	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%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

4.6 The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter of 2018. At their November quarterly Inflation Report 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.

4.7 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through 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. 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.

4.8 Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed funds 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. We therefore saw US 10 year Treasury yields rise above 3.2% during October 2018 and also saw investors causing a sharp fall in equity prices as they sold riskier assets. However, by early January 2019, US 10 year 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.

4.9 From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crises, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

4.10 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.

4.11 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.

The current treasury position and prospects for investment

4.12 All Investments are made with reference to the Council's core balances and cash flow requirements which are derived from the annual budget, the Medium Term Financial Strategy, the Capital Programme and Capital Strategy, and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

4.13 Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 of 2022. With increasing rates, money will be kept in short term investments and as a result, the probable investment earnings rates for returns on investments placed for periods up to about three months during each financial year can be expected to be as follows:

	Base Rate	Investment return
2018/19	0.75%	0.85%
2019/20	1.25%	1.10%
2020/21	1.50%	1.60%
2021/22	2.00%	1.75%
2022/23	2.00%	2.00%

4.14 It is important that the Council manages its treasury management activities to maximise investment income and reduce debt interest, whilst managing its exposure to risk and maintaining appropriate liquidity to meet its needs. Based on the above forecasts, the 2019/20 estimate for investment income and debt interest split between the General Fund and Housing Revenue Account (HRA) is as follows:

	General Fund £'000	HRA £'000	Total £'000
Gross external investment income	252	232	484
Interest on loans to RBC companies	1,414	-	1,414
Interest paid on deposits and other balances	(6)	-	(6)
Net Investment Income	**1,660**	**232**	**1,892**
Debt Interest	(14,535)	(3,426)	(17,961)
Management Expenses	(35)	-	(35)
Net Investment Income / (Debt interest)	**(12,910)**	**(3,194)**	**(16,104)**

4.15 The estimate is based on achieving the assumed investment returns set out in paragraph 3.11, using the level of revenue and capital reserves for 2019/20 as set out in the latest capital and revenue budgets contained in the Medium Term Financial Strategy.

Policy on charging interest to the Housing Revenue Account (HRA)

4.16 The Council operates a two-pooled approach to its loans portfolio, which means we separate HRA and General Fund long-term loans. Interest payable and other costs or income arising from long-term loans (for example premiums and discounts on early redemption) are charged or credited to the respective revenue account.

4.17 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. We will calculate an average balance for the year and interest will be transferred between the General Fund and HRA at the Council's weighted average return on all its investments, adjusted for credit risk. This credit risk adjustment reflects the risk that any investment default will be a charge to the General Fund and cannot be applied to the HRA.

Borrowing Strategy

4.18 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

4.19 The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period which the funds are required. Against this background and 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:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the 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.

4.20 The Council's strategy for long term borrowing is as follows:

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

- *Public Works Loan Board (PWLB)*
- *any institution approved for investments*
- *any other bank or building society approved by the Financial Conduct Authority*
- *UK public and private sector pension funds (except the Surrey Pension Fund)*
- *Capital market bond investors*
- *UK Municipal Bond Agency plc and other special purpose companies created to enable joint local authority bond issues.*

<u>Debt instruments</u>
Borrowing will be arranged by one of the following debt instruments:
- *fixed term loans at fixed or variable rates of interest, subject to the limits in the treasury management indicator, below*
- *lender's option borrower's option (LOBO) loans, subject to a maximum of £10 million*
- *bonds*

4.21 Any proposed borrowing will only be undertaken on a phased basis in accordance with agreed plans and requirements at that time. The borrowing of money purely to invest or lend-on to make a return is unlawful.

<u>Policy on Borrowing in Advance of Need</u>

4.22 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the sums borrowed. Any decision to borrow in advance will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

4.23 Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism. In determining whether borrowing will be undertaken in advance of need the Council will:
- Ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.
- Ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.
- Evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.
- Consider the merits and demerits of alternative forms of funding.

4.24 The total amount borrowed will not exceed the authorised borrowing limit. The maximum period between borrowing and expenditure is expected to be no more than six months, although the Council does not link particular loans with particular items of expenditure.

<u>Debt restructuring</u>

4.25 From time to time there may be potential opportunities to generate savings by switching from long term debt to short term debt and vice versa. Any such debt restructuring will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

4.26 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;
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

4.27 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

4.28 All rescheduling will be reported to the Council, at the earliest meeting following its action.

Annual Investment Strategy

4.29 The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments are held for two purposes, to generate income and to meet a strategic priority. These are entered into outside of normal treasury management activities, but nevertheless the TMS comes into play in their financing. The Council recognises that investment in other financial investments taken for non-treasury management purposes, requires careful investment management and all such investments are covered in the Capital Strategy (reported elsewhere on this agenda).

4.30 Local authorities must draw up an “Annual Investment Strategy” for the following financial year. This strategy may be revised at any time, but full Council must approve the revisions. Both the TM Code and the MHCLG Guidance place a high priority on the management of risk and require the Council to invest its funds prudently. This approach is inherent in our treasury management strategy.

4.31 In accordance with the above guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration of risk.

4.32 The MHCLG Guidance requires local authorities to cover a number of issues in their Annual Investment Strategy and the Council’s strategy fully complies with these requirements. The Council approved its Annual Investment Strategy for 2018/19 in March 2018 and an updated Strategy for 2019/20 is set out at Appendix D.

4.33 There are two changes to the proposed strategy for next year. The first is the removal of the requirement to limit investments in Building Societies to 50% of total funds invested. This was introduced at a time when the Council used unrated Building Societies, however with only four Building Societies now on the Council’s counterparty list, all of which are rated the same way as banks, this requirement is now surplus to requirements.

4.34 The second change is to clarify the Council’s use of Money Market Funds following the introduction of the European Money Market Fund Reforms. Money Market funds have now been separated into three fund types:

- Government Constant Net Asset Value (CNAV)
- Low Volatility Net Asset Value (LNAV) - NEW
- Variable Net Asset Value (VNAV)

The regulation changes revolve around structure, composition, valuation, liquidity requirements, liquidity fees/redemption gates, understanding investor behaviour and information reporting. CNAV funds must have at least 99.5% of their assets in public debt, secured with government debt or cash so their dealing price will not change (i.e. it will be constant). LVNAV funds are permitted to maintain a constant dealing NAV provided that certain criteria are met, including that the market NAV of the fund does not deviate from the dealing NAV by more than 20 basis points. All other funds are VNAV funds whose prices can change, so the principal sum could fluctuate on a regular basis.

4.35 The current Investment Strategy does not distinguish between these types of funds so clarification is required. The strategy has been amended to state that the Council will only use Constant and Low Net Asset Value Money Market Funds (CNAV / LVNAV). All of the Council’s existing Money Market Funds fall under the new LVNAV category.

5 Treasury Management Risks

5.1 Treasury management activity involves risks which cannot be eliminated but need to be managed. Treasury management risks could be defined as: The ongoing activity of adjusting the authority's treasury exposures due to changing market or domestic circumstances, in order to manage risks and achieve better value in relation to the authority's objectives. The effective identification and management of these risks are integral to the Council's treasury management objectives. All treasury activity needs to be managed to maximise investment income and reduce debt interest whilst maintaining the Council's exposure to risk.

5.2 Overall responsibility for treasury management risk remains with the Council at all times. None of the regulations or guidance prescribes any particular treasury management strategy for local authorities to adopt. The Council's lending & borrowing list is regularly reviewed during the financial year and credit ratings are monitored throughout the year to minimise future risks.

5.3 The MHCLG issued revised statutory guidance on Local Government Investments in 2018 (the Guidance), and this forms the structure of the Council's policies. The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. This means that first and foremost the Council must ensure the security of the principal sum invested (i.e. ensure the full investment is returned), then ensure that we have the liquidity we need (i.e. ensure we have the funds available when we need them), and only then should the yield on return be considered. In order to facilitate this objective the Guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2017 Edition). The Council adopted the Code in March 2018 and applies its principles to all investment activity.

5.4 In accordance with the TM Code, the key treasury risks are discussed in detail in the Council's Treasury Management Practices (TMPs) which are set out at appendix "E" and in the Council's Statement of Accounts both of which can be found on the Council's website. The key risks are as follows:

- Credit and counterparty risk management
- Liquidity Risk Management
- Interest Rate Risk Management
- Exchange Rate Risk Management
- Inflation Risk Management
- Refinancing Risk Management
- Legal and Regulatory Risk Management
- Fraud, error and corruption, and contingency management
- Price / Market risk management

UK banks – ring fencing

5.5 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), were required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up at any time. Several banks are very close to the threshold already and so may come into scope in the future regardless.

5.6 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.

5.7 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, and any others choosing to opt up in the future, 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.

6. Prudential and Treasury Management Indicators 2019/20

6.1 The Prudential Code requires all local authorities to look at capital expenditure and investment plans in light of the overall organisational strategy and resources and make sure that decisions are being made with sufficient regard to the long run financial implications and potential risks to the authority. 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; that treasury management decisions are taken in accordance with good professional practice; and that local strategic planning, asset management planning and proper option appraisal are supported.

6.2 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Strategic Business Plan, Medium Term Financial Strategy, Capital Strategy (including the Property Investment Strategy) and Treasury Management Strategy.

6.3 In setting or revising their prudential indicators, local authorities must have regard to:

- Service objectives e.g. strategic planning for the authority
- Stewardship of assets e.g. asset management planning
- Value for money e.g. option appraisal
- Prudence and sustainability e.g. implications for external borrowing
- Affordability e.g. implications for Council Tax and balances
- Practicality e.g. achievability of the forward plan.

6.4 To demonstrate that these objectives are being fulfilled the Prudential Code operates through the provision of prudential indicators which highlight particular aspects of capital expenditure planning. Each indicator is annually updated as part of the budget process and projected forward for the next three years. The Code requires that the Council approves certain mandatory prudential indicators.

6.5 Prudential Indicators are designed to support and record local decision making. They are not performance indicators and are not comparable between authorities, all of whom will have differing policies and debt positions. In addition the indicators should not be taken individually; the benefit from monitoring will arise from following the movement in indicators and the year on year changes over time.

6.6 Both the Prudential and Treasury Management Codes set definitions for the terms used and the method of calculating the indicators. A complete set of all indicators, which are a mix of estimated and actual figures, ratios, and limits, is set out in Appendix "F".

7 Legal Implications

7.1 The powers for a local authority to borrow and invest are governed by the Local Government Act 2003 (LGA 2013) and associated Regulations. A local authority may borrow or invest for any purpose relevant to its functions, under any enactment, or for the purpose of the prudent management of its financial affairs. The Regulations also specify that authorities should have regard to the CIPFA Treasury Management Code and the MHCLG Investments Guidance when carrying out their treasury management functions.

7.2 Part 1 of the LGA 2003 established the legislative framework for the prudential capital finance system for local authorities.

7.3 The LGA 2003 requires each Council to set an affordable borrowing limit. The Full Council must carry out this duty; it cannot be delegated. Having set this limit the Council may not exceed it except for specified temporary purposes. However, the Council can make a new limit at any time.

7.4 Regulations require local authorities to have regard to The Prudential Code when carrying out their duties under Part 1 of the LGA 2003. The Code requires that all prudential indicators are set, and revised, only by the Full Council. This is because the need for Members to approve prudential indicators for capital finance is regarded as an important part of the governance responsibilities of a local authority.

7.5 The LGA 2003 provides the government with reserve powers to set borrowing limits for local authorities that override their locally determined limits. This could be in the form of a national limit – this can only be imposed for national economic reasons – or a specific limit to prevent an individual authority borrowing more than it could afford.

7.6 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended) state:

> *"A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent."*

8. Conclusions

8.1 The Council recognises that effective financial planning, option appraisal, risk management and governance processes are essential in achieving a prudent approach to capital expenditure, investment and debt. Therefore, all investment decisions (treasury and non-treasury) are taken in light of the Council's Corporate Business Plan, Medium Term Financial Strategy, Capital Strategy and Treasury Management Strategy.

8.2 We remain in a very difficult investment environment. Whilst counterparty risk appears to have eased, market sentiment has still been subject to bouts of, sometimes, extreme volatility and economic forecasts abound with uncertainty. However, we also have a very accommodating monetary policy - reflected in a 0.75% Bank Rate. As a consequence, The Council is not getting a material return from deposits but is benefitting from low borrowing rates.

8.3 It is easy to forget recent history, ignore market warnings and search for that extra return to ease revenue budget pressures. Any option in which an investor hopes to generate an elevated rate of return will almost always introduce a greater level of risk, this strategy ensures that any such risks are minimised and appropriately managed.

Annual investment strategy
for the 2019/20 financial year

Introduction

1. The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments (3rd Edition) ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (2017 Edition) ("the TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

2. This strategy applies to both in-house and externally managed funds. External managers must confirm the acceptability of a counterparty before an investment is made.

3. The Council approved the Annual Investment Strategy for 2018/19 in March 2018.

Investment Policy

4. In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflected in the eyes of each agency. Using our treasury advisers ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

5. Further, the Council's Officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisers to maintain and monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

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

7. The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration of risk.

8. The intention of the strategy is to provide security of investment and minimisation of risk.

Creditworthiness Policy

9. The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

    - It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security; and

    - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

10. The Corporate Director of Resources will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as

necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties that are considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

11. The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies and one meets the Council's criteria, and the other does not, the institution will fall outside the lending criteria. Credit rating information is supplied by Link Asset Services, the Council's treasury advisers, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to Officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use.

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

Investment criteria and limits

13. The Guidance defines specified investments as those expected to offer relatively high security and liquidity, and can be entered into with the minimum of formalities. The Guidance defines specified investments as those:

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

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

Specified investments				
	Paragraph (where applicable)	**Fitch Long term Rating (or equivalent)**	**£ Limit**	**Duration**
Banks 1	16	A+ A A-	£5.0m £4.0m £3.0m	364 days 189 days 98 days
Banks 2 (Part nationalised)	17	N/A	£3.0m	364 days
Banks 3 (Council's own bankers)	18	N/A	£1.0m	1 day
Building Societies	19	A+ A A-	£5.0m £4.0m £3.0m	364 days 189 days 98 days
UK Central Government (DMADF – Debt Management Agency Deposit Facility)		AAA	Unlimited	189 days
Local, Police, Fire, Civil Defence & Transport Authorities		N/A	£5.0m	364 days
Money Market Funds (CNAV / LVNAV)	20	AAA	£6.0m	Liquid
Government bonds (gilts) and treasury bills	21	N/A	No limit	364 days
Multinational Development Banks		AAA	£1.0m	364 days

14. Investments in any parent and its wholly owned subsidiaries are to be aggregated for the purpose of calculating the limit of investment to that parent or its subsidiaries.

15. With the exception of investments with the UK Government, no investment with any one provider/organisation will exceed £6m in total.

Banks

16. **Banks 1** – Banks will be regarded as having high credit quality if they meet the following criteria:

    i) are UK banks (no country limit will apply to investments in the UK, irrespective of the sovereign credit rating); and/or
    ii) are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA or AA+

    and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

    i) Short term – F1 / P-1 / A-1
    ii) Long term – A- / A3 / A-

17. **Banks 2 –** Part nationalised UK banks. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.

18. **Banks 3 –** The Council's own banker for transactional purposes if the bank falls below the above criteria. This is because it is needed to facilitate short term liquidity requirements (overnight and weekend) and to provide business continuity.

Building societies

19. The Council will use all building societies with assets in excess of £1bn which meet the ratings for banks outlined above.

Money market funds

20. Money market funds are pooled investment vehicles consisting of instruments similar to those used by the Council. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

Government bonds (gilts) and treasury bills (T-bills)

21. Conventional gilt is a liability of the Government which guarantees to pay the holder of the gilt a fixed cash payment (coupon) every six months until the maturity date, at which point the holder receives the final coupon payment and the return of the principal.

22. T-Bills are short term securities issued by HM Treasury on a discount basis. For example a £100 coupon will be issued below its value to the investor and on maturity the investor will receive £100. The difference will be the capital gain received. The security can also be cashed before maturity in the active secondary market giving the lending party more freedom to cash in the T-bill before maturity date.

Foreign countries

23. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA+ from Fitch. This list will be added to, or deducted from, by Officers should ratings change in accordance with this policy.

24. Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 (paragraph 17) above and will be limited to a maximum of £1 million to be placed with any non-UK country at any time;

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

Non-specified investments

26. Any investment not meeting the definition of a specified investment (see paragraph 13) is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any with low credit quality bodies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement.

27. The limit on the amount that may be held in non-specified investments, these being long-term investments only, at any time in the financial year is £3 million (excluding any accrued interest).

28. The advice of our treasury management consultants will be sought prior to making any long-term investment as to appropriateness of the investment.

Non Specified investments				
	Paragraph (where applicable)	**Fitch Long term Rating (or equivalent)**	**£ Limit**	**Duration**
Any bank or building society (including forward deals in excess of one year from inception to repayment).	37	AAA AA+ AA AA-	£1.0m £1.0m £1.0m £1.0m	3 years 3 years 3 years 2 years
Gilt edged securities.	37	N/A	£1.0m	3 years
Supranational bonds greater than 1 year to maturity a) Multilateral development bank bonds b) A financial institution that is guaranteed by the United Kingdom Government	30, 37	AAA N/A	£1.0m £1.0m	3 years 3 years
Short Dated Bond Funds / Enhanced Cash Funds	30, 37	N/A	£2.0m per fund £6m in total	2 years
Pooled Funds and Collective Investment Schemes	31	N/A	£2.0m per fund £6m in total	N/A
UK Small & Medium Sized Enterprises via the Funding Circle	32	N/A	£5,000 per organisation (subject to an overall limit of £0.5m)	N/A
Investment in Property	33	Subject to the limits set out in the Capital Strategy		

Supranational bonds

29. The Council will invest in two types of bonds:

a) **Multilateral development bank bonds** are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Investment Bank etc.).

b) **A financial institution that is guaranteed by the United Kingdom Government** (e.g. The Guaranteed Export Finance Company {GEFCO}). The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity

Short Dated Bond Funds / Enhanced Cash Funds

30. Short dated Bond Funds / Enhanced Cash Funds are pooled investment vehicles with an average duration of between 3 months and 2 years with a variable net asset value (NAV) meaning their values can go down as well as up. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager and should be looked at as short to medium term investments.

Pooled Funds and Collective Investment Schemes

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

UK Small & Medium Sized Enterprises via the Funding Circle

32. The Council will make loans for periods of up to three years to small and medium sized enterprises (SME) in the UK that have been independently assessed as being of suitable credit quality. Nevertheless, it is anticipated that such companies will, on occasion, fail to repay the money lent. The Council will therefore ensure that the interest rate secured on such loans is high enough to cover the cost of defaults in all but the most exceptional circumstances.

Non-Treasury Investments

33. In addition to traditional treasury investments, the Council may also invest in property and make loans and investments for financial return and/or for service or policy purposes. Such investments will be subject to the Council's normal approval processes for revenue and capital expenditure and controls around their use are included in the Council's Capital Strategy and therefore do not comply with this Treasury Management Strategy.

Liquidity Management

34. Liquidity is defined by the CIPFA Treasury Code of Practice as "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable the Council at all times to have the level of funds available to which are necessary for the achievement of its business/service objectives"

35. The proportion of the in-house portfolio that may be held in short-term and long-term investments will vary at any one time dependant on the cash flow position of the Council. The Council uses a manual cash book and spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

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

37. The amount of investments (both managed in house and externally) that may be held in long-term investments will be, measured on a rolling basis, at any point in time:

    - No more than £1 million of outstanding investments are to be over 3 years until maturity, and

- No more than £3 million of outstanding investments are to be over 1 year until maturity.

38. The maximum term of any one investment is 3 years with the exception of those loans invested via the Funding Circle (see paragraph 32).

Planned Investment Strategy for 2019/20

39. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). The cash flow forecast will be used to divide surplus funds into three categories:
    - Short-term – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
    - Medium-term – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
    - Long-term – cash not required to meet cash flows, and used primarily to generate investment income.

40. Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash.

41. Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. The majority of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks; this may be achieved by the use of suitable medium-term money market funds. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations.

42. Cash that is not required to meet any liquidity need can be invested for the longer term with a greater emphasis on achieving returns that will support spending on local authority services. Security remains important, as any losses from defaults will impact on the total return, but fluctuations in price and even occasional losses can be managed over the long term within a diversified portfolio. Liquidity is of lesser concern, although it should still be possible to sell investments, with due notice, if large spending commitments arise unexpectedly. A wider range of instruments, including structured deposits, certificates of deposit, gilts and corporate bonds will be used to diversify the portfolio. The Council will consider employing external fund managers that have the skills and resources to manage the risks inherent in a portfolio of long-term investments.

Forward deals up to one year

43. Forward deals may be entered into with banks and building societies that meet the appropriate credit rating criteria for specified investments where the total period of the investment (i.e. negotiated deal period plus period of deposit) is less than one year.

Annex A

Credit ratings and definitions

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

Table A: Comparison of long-term credit ratings		
Moody's	**S&P**	**Fitch**
Investment grade		
Aaa	AAA	AAA
Aa1	AA+	AA+
Aa2	AA	AA
Aa3	AA-	AA-
A1	A+	A+
A2	A	A
A3	A-	A-
Baa1	BBB+	BBB+
Baa2	BBB	BBB
Baa3	BBB-	BBB-
Speculative grade		
Ba1	BB+	BB+
Ba2	BB	BB
Ba3 and below	BB- and below	BB- and below

<u>(Negative) Rating Watch – Fitch Ratings</u>
Rating Watches indicate that there is a heightened probability of a rating change and the likely direction of such a change. These are designated as "Positive", indicating a potential upgrade, "Negative", for a potential downgrade, or "Evolving", if ratings may be raised, lowered or affirmed. However, ratings that are not on Rating Watch can be raised or lowered without being placed on Rating Watch first, if circumstances warrant such an action.

<u>Review for possible downgrade – Moody's (Standard & Poor's is very similar)</u>
Moody's uses the 'Watchlist' to indicate that a rating is under review for possible change in the short-term. A rating can be placed on review for possible upgrade (UPG), on review for possible downgrade (DNG), or more rarely with direction uncertain (UNC). A credit is removed from the Watchlist when the rating is upgraded, downgraded or confirmed

<u>(Negative) Rating Outlook – Fitch Ratings (Moody's and Standard & Poor's are similar)</u>
Rating Outlooks indicate the direction a rating is likely to move over a one- to two-year period. They reflect financial or other trends that have not yet reached the level that would trigger a rating action, but which may do so if such trends continue. The majority of Outlooks are generally Stable, which is consistent with the historical migration experience of ratings over a one- to two-year period. Positive or Negative rating Outlooks do not imply that a rating change is inevitable and, similarly, ratings with Stable Outlooks can be raised or lowered without a prior revision to the Outlook, if circumstances warrant such an action. Occasionally, where the fundamental trend has strong, conflicting elements of both positive and negative, the Rating Outlook may be described as Evolving.

CAPITAL & AFFORDABILITY RELATED INDICATORS

The Council's capital expenditure plans are the key driver of treasury management activity. The Capital Programme is set out in detail in the Capital Strategy. 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.
,766

1 **Capital Expenditure –** This prudential indicator is a summary of the Council's capital expenditure plans, and financing requirements which have been updated in line with the phased borrowing requirements of the new property investment plans. Any shortfall of resources results in a funding borrowing need.

Capital Expenditure	**2017/18 Actual £000s**	**2018/19 Probable £000s**	**2019/20 Estimate £000s**	**2020/21 Estimate £000s**	**2021/22 Estimate £000s**
HRA	5,395	3,704	7,771	7,300	1,300
Housing Services	331	934	951	951	951
Environment & Sustainability	482	701	2,205	2,222	2,000
Community Development	8,910	9,432	6,132	1,155	255
Corporate & Business					
- Non Financial Investments	153,984	290,678	11,084	308	0
- Other	488	11,717	47,036	47,550	5,523
Total	**169,590**	**317,166**	**75,179**	**59,486**	**10,029**
Financed by:					
Capital Receipts	25,641	20,106	11,882	8,989	2,826
Earmarked Reserves	0	0	1,500	1,147	1,000
Capital Grants & Contributions	787	957	545	535	535
Revenue	4,620	2,692	5,711	1,168	1,168
Net financing need for the year	**138,542**	**293,411**	**55,541**	**47,647**	**4,500**

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

Non-financial investments	**2017/18 Actual £000s**	**2018/19 Probable £000s**	**2019/20 Estimate £000s**	**2020/21 Estimate £000s**	**2021/22 Estimate £000s**
Capital Expenditure	153,984	290,678	11,884	308	0
Financing costs met	24,014	10,463	1,509	63	0
Net financing need for the year	**129,970**	**280,215**	**9,575**	**245**	**0**
Percentage of total net financing need	93.8%	95.5%	17.2%	0.5%	0%

2 **The Council's borrowing need (the Capital Financing Requirement)** – The Council's Capital Financing Requirement (CFR) is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not 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 in line with each assets life and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes.

The Council is asked to approve the CFR projections below:

	2017/18 Actual £000s	2018/19 Probable £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
CFR: – HRA	101,956	101,956	101,956	101,956	100,000
– Non HRA	8,571	14,665	60,631	108,033	112,532
– non-financial investments	134,930	265,849	509,610	513,173	553,517
CFR at 1 April	**245,457**	**382,470**	**672,197**	**723,162**	**766,049**
Net financing need for the year (from above)	138,542	293,411	55,541	47,647	4,500
Less MRP/VRP and other financing movements	(1,529)	(3,684)	(4,576)	(4,759)	(4,950)
CFR at 31 March	**382,470**	**672,197**	**723,162**	**766,049**	**765,599**

3 **Core funds and expected investment balances** – 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.). Detailed below are estimates of the year end investment balances based on assumed cash movements in the MTFS and Capital Programmes.

	2017/18 Actual £000s	2018/19 Probable £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
HRA Balances	19,424	25,405	21,561	18,075	15,075
General Fund (GF) Balance	5,848	3,223	4,260	2,317	2,234
GF Earmarked reserves	4,960	5,960	3,664	2,185	1,593
Capital receipts	5,783	5,895	11,858	11,882	14,712
Other	5,837	4,492	0	0	0
Expected investments	**41,852**	**44,975**	**41,343**	**34,459**	**33,614**

4 **Affordability Prudential Indicators –** The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

5 **Ratio 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 net revenue stream is a term used to describe the amount in the General Fund to be met from Government grant and local taxpayers. For the HRA it is the total HRA income shown in the accounts i.e. rent and other income.

	2017/18 Actual %	2018/19 Probable %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
HRA	39.27	32.18	32.05	31.67	31.43
Non-HRA	51.39	149.44	277.67	257.52	274.81

The General Fund increase is due to additional borrowing to fund the Property Investment Strategy and ongoing property developments. These costs are fully met by additional revenue income rather than Government grant and local taxpayers hence the sharp increase in the percentage.

TREASURY RELATED INDICATORS

6 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. The upper limit for principal sums invested for longer than 365 days is set at:

	2017/18 Actual £000s	2018/19 Probable £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
Principal sums invested for longer than 365 days	0	3,000	3,000	3,000	3,000

7 **Investment risk benchmarking** - The Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day, 3, 6 or 12 month LIBID (The London Interbank Bid Rate – the rate at which a bank is willing to brrow from other banks).

8 **Borrowing** – The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury/ prudential indicators, the current and projected debt positions and the annual investment strategy.

9 **Current Portfolio Position** – The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2017/18 Actual £000s	2018/19 Probable £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
External Debt					
Debt at 1 April	232,792	356,989	660,400	710,941	758,588
Expected change in debt	124,197	303,411	50,541	47,647	2,544
Actual gross debt at 31 March	**356,989**	**660,400**	**710,941**	**758,588**	**761,132**
CFR	382,470	672,197	723,162	766,049	765,599
Under / (over) borrowing	**25,481**	**11,797**	**12,221**	**7,461**	**4,467**

The positive balances show that the Council is under borrowing (i.e. borrowing internally using cash balances).

Within the above figures the level of debt relating to non-financial investment is:

	2017/18 Actual £000s	2018/19 Probable £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
Debt at 1 April	246,462	546,064	555,638	555,884	555,884
Percentage of total external debt	69.04%	82.69%	78.16%	73.28%	73.03%

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt 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 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Corporate Director of Resources reports that the Council has so far 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, and the proposals in the budget report.

10 **The Operational Boundary** – This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational Boundary	**2017/18 Actual £000s**	**2018/19 Probable £000s**	**2019/20 Estimate £000s**	**2020/21 Estimate £000s**	**2021/22 Estimate £000s**
HRA	101,956	101,956	101,956	101,956	100,000
Non HRA	8,623	14,665	60,630	108,033	112,533
Non-financial investments	246,213	543,778	548,353	548,599	548,599
Other long term liabilities	-	2,000	2,000	2,000	2,000
Total Operational Boundary	**356,792**	**662,399**	**712,939**	**760,588**	**763,132**

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

1. 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.

2. The Council is asked to approve the following authorised limit:

Authorised limit	**2017/18 Actual £000s**	**2018/19 Probable £000s**	**2019/20 Estimate £000s**	**2020/21 Estimate £000s**	**2021/22 Estimate £000s**
HRA	101,956	101,956	101,956	101,956	100,000
Non-HRA	8,623	14,665	60,630	108,033	112,533
Non-Financial Investments	246,213	543,778	548,353	548,599	548,599
Other long term liabilities	-	10,000	10,000	10,000	10,000
Total Authorised Limit	**356,792**	**670,399**	**720,939**	**768,588**	**771,132**

Separately, the Council was limited to a maximum HRA CFR through the HRA self-financing regime – known as the HRA debt cap. In October 2018 the Prime Minister announced a policy change of the abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date for the abolition was 29.10.18. The former capped limit has been reproduced below:

HRA Debt Limit	**2017/18 Actual £000s**	**2018/19 Probable £000s**	**2019/20 Estimate £000s**	**2020/21 Estimate £000s**	**2021/22 Estimate £000s**
HRA debt cap*	103,647	103,647	103,647	103,647	103,647
HRA CFR	101,956	101,956	101,956	101,956	100,000
HRA headroom	1,691	1,691	1,691	1,691	3,647

12 **Treasury Management Limits on Activity**

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

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

The Council is asked to approve the following treasury indicators and limits:

Interest rate exposure UPPER limits	2018/19 £000s	2019/20 £000s	2020/21 £000s
on fixed interest rates based on net debt	660,400	710,940	758,588
on variable interest rates based on net debt	0	0	0

The Upper Limit on fixed interest rates is calculated using the maximum allowed debt (The Authorised Borrowing Limit) less Fixed Term investments. The Council heavily uses Money Market Funds whose rates change on a daily basis therefore it has been assumed that of the year end balances only £10m will be invested in fixed term investments.

As the Council does not borrow at variable interest rates, the upper limit on this type of debt will always be nil.

Maturity structure of interest rate borrowing 2019/20				
	FIXED interest		VARIABLE interest	
	Lower	Upper	Lower	Upper
Under 12 months	0%	25%	0%	0%
12 months to 2 years	0%	25%	0%	0%
2 years to 5 years	0%	25%	0%	0%
5 years to 10 years	0%	50%	0%	0%
10 years and above	0%	100%	0%	0%
20 years to 30 years	0%	100%	0%	0%
30 years to 40 years	0%	100%	0%	0%
40 years to 50 years	0%	100%	0%	0%

This indicator is set to control the Council's net exposure (taking borrowings and investments together) to interest rate risk. Its intention is to ensure that the Council is not exposed to interest rate rises which could adversely impact the revenue budget. The upper limits proposed on fixed and variable rate interest rate exposures, expressed as the principal sums outstanding in respect of borrowing.

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate. If it is not clear whether an instrument should be treated as fixed or variable rate, then it is treated as variable rate.
The variable rate upper limit of zero means that the Council is minimising its exposure to uncertain future interest rates on its debt. This will still allow a proportion of the debt to be taken as variable as fixed term investments maturing within one year are classified as variable for the purposes of this indicator.

GLOSSARY OF TREASURY TERMS

Term	Definition
Basis Point	1/100th of 1%, i.e. 0.01%
Call Accounts	Deposit accounts with banks and building societies that provide same day access to invested balances. Interest paid is usually linked to the level of the official base rate.
CFR – Capital Financing Requirement	The underlying need to borrow for capital purposes
CDs – Certificates of Deposit	Negotiable time deposits issued by banks and building societies which can pay either fixed or floating rates of interest. They can be traded on the secondary market, enabling the holder to sell the CD to a third party to release cash before the maturity date.
CPI – Consumer Price Index	This is a measure of the general level of price changes for consumer goods and services but excludes most owner occupier housing costs such as mortgage interest payments, council tax, dwellings insurance, rents etc.
Corporate bonds	Corporate bonds are those issued by companies. Generally, however, the term is used to cover all bonds other than those issued by governments. The key difference between corporate bonds and government bonds is the risk of default.
Cost of Carry	Costs incurred as a result of an investment position, for example the additional cost incurred when borrowing in advance of need, if investment returns don't match the interest payable on the debt.
Counterparties	These are the organisations responsible for repaying the Council's investment upon maturity and making interim interest payments.
CDS – Credit Default Swaps	A swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
DMADF – Debt Management Agency Deposit Facility	An investment facility run by part of the HM Treasury taking deposits at fixed rates for up to 6 months.
Diversification / diversified exposure	The spreading of investments among different types of assets or between markets in order to reduce risk.
Derivatives	Financial instruments whose value, and price, are dependent on one or more underlying assets. Derivatives can be used to gain exposure to, or to help protect against, expected changes in the value of the underlying investments. Derivatives may be traded.
DMO – Debt Management Office	An Agency of HM Treasury whose responsibility includes debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

GLOSSARY OF TREASURY TERMS

ECB – European Central Bank	Sets the central interest rates in the European Monetary Union area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%
EIP – Equal Instalments of Principal	A repayment method whereby a fixed amount of principal is repaid at regular intervals with interest being calculated on the principal outstanding.
Fixed Deposits	These are loans to banks, building societies or other local authorities which are for a fixed period and at a fixed rate of interest.
FRN – Floating Rate Notes	Debt securities with payments that are reset periodically against a benchmark rate, such as the three month London inter-bank offer rate (LIBOR). FRNs can be used to balance risks incurred through other interest rate instruments in an investment portfolio.
Gilts / Gilt Edged Securities	These are 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. At the end of the set period the investment is repaid (at face value) by the Government. However, during the life of a gilt it will often be traded (bought and sold) at a price decided by the market.
LIBID – London Interbank BID Rate	The interest rate at which London banks are willing to borrow from one another.
LIBOR – London Interbank Offer Rate	The interest rate at which London banks offer one another. Fixed every day by the British Bankers Association to five decimal places.
Maturity loans	A repayment method whereby interest is repaid throughout the period of the loan and the principal is repaid at the end of the loan period.
MMF – Money Market Funds	Externally managed pooled investment schemes investing in short term cash instruments.
MRP – Minimum Revenue Provision	The minimum amount which must be charged to an authority’s revenue account each year and set aside towards repaying borrowing.
MPC – Monetary Policy Committee	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.
Multilateral Investment banks	International financial institutions that provide financial and technical assistance for economic development.
Municipal Bonds Agency	An independent body owned by the local government sector that seeks to raise money on the capital markets at regular intervals to on-lend to participating local authorities.
Pooled Funds	Investments made with an organisation who pool together investments from other organisations and apply the same investment strategy to the portfolio. Pooled fund investments benefit from economies of scale, which allows for lower trading costs per pound, diversification and professional money management.

GLOSSARY OF TREASURY TERMS

Prudential Code	A governance procedure for the setting and revising of prudential indicators. Its aim is to ensure, within a clear framework, that the capital investment plans of the Council are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good practice.
PWLB – Public Works Loans Board	A central government agency which provides long- and medium-term loans to local authorities at interest rates only slightly higher than those at which the Government itself can borrow. Local authorities are able to borrow to finance capital spending from this source.
Repo – Reverse Repurchase Agreements	An agreement to purchase a security from a counterparty, typically a bank, and then sell the security back to the bank on a predetermined date for the principal amount plus interest. The security is collateral to be used in the event of a default by the counterparty.
Supranational Bonds	These are very similar in nature to gilts except that rather than being issued by the UK Government they are issued by supranational bodies supported by more than one national government such as the European Investment Bank which is supported by all of the EU member states.
Treasury Bills	Tradable debt securities issued by the UK Government with a short term maturity (3 months to 1 year) issued at a discount. The income from these is in the form of a capital gain rather than interest income.
TMP – Treasury Management Practices	Schedule of treasury management functions and how those functions will be carried out.
TMS – Treasury Management Schedules	More detailed schedules supporting the TMP at a detailed operational level specifying the systems and routines to be employed and the records to be maintained in fulfilling the Council's treasury functions
VRP - Voluntary Revenue Provision	A voluntary amount charged to an authority's revenue account and set aside towards repaying borrowing.
Working Capital	Timing differences between income and expenditure (debtors and creditors).