

Appendix 1 - Treasury Management Strategy 2019/20

Cabinet

Date: 6th February 2019

TREASURY MANAGEMENT STRATEGY 2019/20

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1 Current Portfolio Position

- 1.1 The capital expenditure plans set in Annex 1 to Appendix 1 summarises the Council's current and future plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.
- 1.2 The Council's actual treasury portfolio position at 31 March 2018, with forward projections are summarised below.

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.18	31.3.18	27.12.18	27.12.18
Treasury investments	£m	%	£m	%
UK Banks	0.0	0%	5.0	11%
Non UK Banks	5.0	10%	5.0	11%
Local authorities	11.0	23%	6.5	15%
Call Accounts	10.0	21%	10.0	22%
Money market funds	7.0	15%	3.0	7%
Total managed in house	33.0	69%	29.5	66%
Property funds	15.0	31%	15.0	34%
Total managed externally	15.0	31%	15.0	34%
Total treasury investments	48.0	100%	44.5	100%
Treasury long term external borrowing				
Local authorities	10.0	3%	8.6	3%
Other Financial Institutes	10.0	3%	30.0	10%
PWLB	267.8	87%	271.3	88%
LOBOs	20.0	6%	0.0	0%
Total external borrowing	307.8	100%	309.9	100%
Net treasury investments / (borrowing)	(259.8)	0	(265.4)	0

- 1.3 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing requirement, (the Capital Financing Requirement or "CFR"), highlighting any over or under borrowing.

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CAPITAL FINANCING REQUIREMENT						
	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24
	(£m's)	(£m's)	(£m's)	(£m's)	(£m's)	(£m's)
CFR excl. PFI b/fwd. 1 April	411.0	420.5	446.4	474.8	509.0	515.9
PFI liabilities	51.3	49.6	47.6	45.5	43.1	40.4
CFR incl. PFI	462.2	470.1	494.1	520.3	552.0	556.3
Add Capital Expenditure funded through borrowing	16.1	32.6	35.1	41.8	16.0	1.1
Less NEV Developer s106	-	-	-	-	-	(70.3)
Less MRP (debt repayment)	(6.5)	(6.7)	(6.8)	(7.6)	(9.1)	(8.6)
Underlying Borrowing Requirement	420.5	446.4	474.8	509.0	515.9	438.1
PFI Liabilities	49.6	47.6	45.5	43.1	40.4	37.4
CFR c/fwd. 31 March	470.1	494.1	520.3	552.0	556.3	475.5
External Borrowing b/fwd. 1 April	(307.8)	(311.3)	(334.8)	(357.7)	(386.6)	(398.6)
Loan Maturities	16.5	6.5	17.7	17.0	18.0	9.7
New Loans	(20.0)	(30.0)	(40.6)	(45.9)	(30.0)	(30.0)
External Borrowing c/fwd. 31 March	(311.3)	(334.8)	(357.7)	(386.6)	(398.6)	(418.9)
Under Borrowing (excluding PFI liabilities)	109.3	111.7	117.1	122.4	117.3	19.2
<i>Under borrowing as a % of Underlying Borrowing Requirement (excludes PFI)</i>	26%	25%	25%	24%	23%	4%
Net Investments c/fwd.	(50.5)	(50.5)	(50.5)	(50.5)	(50.5)	(50.5)

1.4 Within the range of 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 or speculative purposes.

1.5 The Director of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

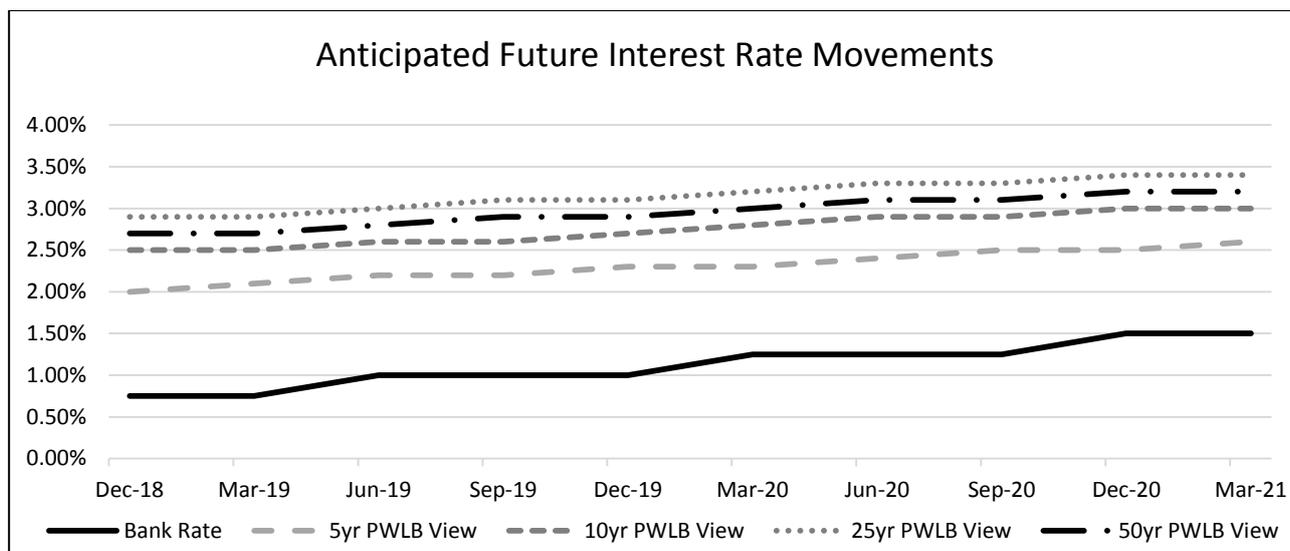
2 Prospects for Interest Rates and Economic Outlook

2.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Link view on interest rate movements.

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2.2 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 above 0.5% since the financial crash, from 0.5% to 0.75%. Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

2.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates as linked, to rise, albeit gently. 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.

2.4 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.

2.5 In summary:

- 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 have increased modestly since the summer. 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

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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

3 Minimum Revenue Provision Policy Statement

3.1 The Council is required to charge an element of the accumulated General Fund capital spend each year (measured through the CFR) to revenue (the minimum revenue provision or “MRP”), although it is also allowed to undertake additional voluntary payments if required.

3.2 CLG Regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to Councils, as long as there is a prudent provision. The Council is recommended to approve the following MRP Statement for 2019/20:

- *For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP will be based on the CFR as per the regulatory method in the MRP guidance. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.*
- *From 1 April 2008 for all unsupported borrowing the MRP will be based on the estimated life of the assets, on an annuity basis, in accordance with the regulations. Annuity method charges will be calculated using the relevant PWLB annuity rates for the estimated asset lives as at 31st March in the year of expenditure. MRP charges commence the year after the asset becomes operational.*
- *MRP will be deferred in relation to capital expenditure funded through borrowing where there is an intention to repay the borrowing from future receipts and where there is a strong likelihood that this will happen. Should there be a shortfall between the debt and eventual receipts, the balance will incur an annual MRP charge.*
- *MRP Overpayments - A change introduced by the revised MHCLG MRP 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, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 no VRP overpayments had been made, the Council will apply this policy as required in future years.*
- *For PFI contracts MRP will be based on the estimated life of the assets, on an annuity basis, in accordance with the regulations. Annuity method*

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charges will be calculated based on the PWLB annuity rates at 31st March in the year that the assets became operational.

- Where non-ring-fenced capital receipts are available, these can be applied to meet the cost of PFI liability repayment (or part thereof). Where capital receipts are applied in this manner, the MRP charge for the PFI would be reduced by an equal amount in that year.*
- For any future finance leases the MRP requirement would be met by a charge equal to the element of the charge applied to write down the liability.*

3.3 No revenue charge is currently required for the HRA, although the existing voluntary policy is to repay £5m per annum.

4 Borrowing Strategy

- 4.1 The Council is currently maintaining an under-borrowed position. This means that there is a shortfall between the amount of long-term loans required, and the actual level of long term loans taken out. Long term loans are required to fund capital expenditure which Cabinet has approved as “funded through borrowing”, but there is a timing difference between when the expenditure is made and when the long term loan is taken out. The timing of the taking of long term loans is part of the wider cash management strategy.
- 4.2 The difference between long term borrowing required and what has actually been taken out is known as “Internal Borrowing” and represents the temporary use of cash reserves and working capital to bridge the timing difference. As cash from reserves and working capital is currently invested at historically low rates, then the policy of delaying long-term borrowing and using existing cash balances as an interim measure is currently a cheaper option for the Council.
- 4.3 While the council will maintain an under borrowed position on the General Fund (the HRA is fully borrowed up to the CFR), future movements in interest rates will dictate the future policy and the timing of taking out long-term loans, and will be kept under careful review.
- 4.4 Against this background and the risks within the economic forecast, caution will continue to be adopted with the 2019/20 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
 - If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an

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acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

5 Borrowing in Advance of Need

- 5.1 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6 Loan Re-scheduling

- 6.1 Opportunities from rescheduling loans to generate savings will be monitored through the year but need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).
- 6.2 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;
 - Amending the balance of the portfolio (amend the maturity profile and/or the balance of volatility).
- 6.3 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.
- 6.4 All rescheduling will be reported to the Cabinet at the earliest meeting following its action.

7 Municipal Bond Agency

- 7.1 The UK Municipal Bond Agency (UKMBA) is hoping to be able to offer loans to local authorities in the near future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Council may wish to make use of this new source of borrowing as and when appropriate.
- 7.2 The bond agency documentation pack is attached as Appendix 2, but key points are as follows:
- UKMBA is owned by 56 local authorities and the LGA
 - UKMBA will borrow from third parties and only lend to local authorities
 - UKMBA will lend for between 10 & 15 years

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- UKMBA are expecting to provide loans at rates lower than the PWLB
- Accessing funds requires a joint and several guarantee from all borrowers to achieve reduced borrowing costs. This is explained in the following paragraphs.
- There is no fee to the Council from agreeing to join the UKMBA

Explanation of Joint and Several guarantee (extract from Appendix 2)

- 7.3 UK local authorities are heavily supervised and subject to tight statutory control that significantly reduces the probability that a local authority will default on its financial obligations. Furthermore, the Agency will undertake credit assessments of local authorities and limit its exposure to authorities to reduce credit risk. In the event that a local authority needs to refinance its borrowings from the Agency, the PWLB is available to all local authorities as lender of last resort provided that the borrowing from the PWLB is not unlawful. No UK local authority has ever defaulted on one of its primary debt obligations. Taken together, the risk of a default is judged to be low and thus the risk of entering into the Framework Agreement and guarantee is deemed to be low.
- 7.4 If a local authority does default, the Agency has liquidity facilities available to it so that it can meet the interest payments due on a bond and cover a limited default on a principal repayment by a local authority; the provisions of the Framework Agreement will be used only if these facilities are exhausted. The Council has adequate reserves of £6m and in the unlikely event of a call for contributions under the Framework Agreement or payment under joint and several guarantee, has access to PWLB funds at 48 hours' notice if required.
- 7.5 The risks associated with the joint and several guarantee are mitigated by the contribution arrangements. Therefore, from a practical perspective, the real risk to the Council is the requirement to make contributions in the event of a default by another borrower and this exposure is proportional because it is calculated by reference to the amount borrowed by the Council as a proportion of all non-defaulting loans made by the Agency. **If the Council has no borrowings via the Agency, it will not be called upon under the Framework Agreement.**
- 7.6 In the unlikely event that the guarantee is called upon, it is also unlikely that bond holders or other providers of finance to the Agency will pursue a single Council for payment because the best outcome for lenders is likely to be achieved by pursuing all the guarantors because this maximises the potential revenues available to repay them.
- 7.7 Section 13 of the Local Government Act secures all debts of a local authority on its revenues and therefore it is extremely likely that the Agency will be able to recover amounts owed to it by a defaulting authority. In turn, this will enable the Agency to repay sums lent to it under the Framework Agreement or paid out by the Council under the guarantee.
- 7.8 The risk that the Council suffers a loss under the Framework Agreement and the joint and several guarantee is therefore a combination of the low risk of a default

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by a local authority and the low risk that if a local authority does default, local authorities cannot recover sums owed to them.

- 7.9 In return for accepting this low level risk, the Council will receive access to more diverse and cheaper sources of capital finance via the Agency.

8 Investment Policy, Creditworthiness Policy and Investment Strategy

Investment Policy

- 8.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (Appendix 5 the Capital Report).
- 8.2 The Council's investment policy has regard to the following: -
- MHCLG's Guidance on Local Government Investments ("the Guidance")
 - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
 - CIPFA Treasury Management Guidance Notes 2018
- 8.3 The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).
- 8.4 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -
- 8.5 Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- 8.6 **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
- 8.7 **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.
- 8.8 As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant

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charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1/4/18.)

- 8.9 Investment instruments identified for use in the financial year are listed in Annex 2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

Creditworthiness Policy

- 8.10 This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:
- Credit watches and credit outlooks from credit rating agencies;
 - CDS spreads to give early warning of likely changes in credit ratings;
 - Sovereign ratings to select counterparties from only the most creditworthy countries.
- 8.11 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.
- 8.12 The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.
- 8.13 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 8.14 All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.
- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

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- In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

8.15 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process.

UK banks – ring fencing

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

8.17 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.

8.18 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.

Country limits

8.19 The Council has determined that it will only use approved counterparties from the UK and countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). This list will be amended by officers should ratings change in accordance with this policy.

Investment Strategy

8.20 **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to

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manage the ups and downs of cash flow, 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.

8.21 **Investment returns expectations.** Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.50%

Investment Periods

8.22 Investment periods are currently restricted to no longer than 24 months. Lending to counterparties is in line with the creditworthiness policy detailed above and recommended by Link and these are limited to a total of £20m. Any investments to banks and building societies for a period in excess of 365 days would be classed as a “non-specified investment” as detailed in Annex 2 to this strategy.

8.23 Investments are limited to a maximum of £10m for any one counterparty, however investments in the Local Authority Property Fund or any similar multi asset fund may exceed this limit. These investments will be subject to a specific approval before they are undertaken.

Investment risk benchmarking

8.24 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBOR. At the end of the financial year, the Council will report on its investment performance as part of its Annual Treasury Report.

9 Policy on the use of external service providers

9.1 The Council uses Link Asset Services as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the Council at all times and will ensure that undue

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reliance is not placed upon our 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 properly agreed and documented, and subjected to regular review.

Annexes

- Annex 1 - Prudential Indicators.
- Annex 2 - Credit and Counterparty Risk Management, Specified and Non-Specified Investments

Key Decision / Decision in Forward Plan

This is not a key decision for the Cabinet (as the approval of the full Council is required) and is included in the Cabinet Forward Plan