

**TREASURY MANAGEMENT STRATEGY STATEMENT,  
MINIMUM REVENUE PROVISION POLICY  
STATEMENT AND ANNUAL INVESTMENT  
STRATEGY FOR 2019-20**

Meeting **Governance and Audit Committee – 5 Dec 2018**

Report Author **Tim Willis, Deputy Chief Executive & Section 151 Officer**

Portfolio Holder **Councillor Ian Gregory, Cabinet Member for Financial Services and Estates**

Status **For Decision**

Classification: **Unrestricted**

**Executive Summary:**

This report and annexes includes the proposed Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement, Annual Investment Strategy, Capital Strategy and Non-Treasury Investments Report for 2019-20

**Recommendation(s):**

That the Governance and Audit Committee approves this report and annexes and recommends that it is approved by Cabinet and council.

**CORPORATE IMPLICATIONS**

<b>Financial and Value for Money</b>	The financial implications are highlighted in this report and annexes.
<b>Legal</b>	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the council's finances. For this council, this is the Deputy Chief Executive, Tim Willis, and this report and annexes is helping to carry out that function.

<b>Corporate</b>	Failure to undertake this process will impact on the council's compliance with the Treasury Management Code of Practice.
<b>Equalities Act 2010 &amp; Public Sector Equality Duty</b>	<p>There are no equity and equalities implications arising directly from this report and annexes, but the council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.</p> <p>It is important to be aware of the council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by council.</p>

<b>CORPORATE PRIORITIES (tick those relevant)✓</b>	
A clean and welcoming Environment	
Promoting inward investment and job creation	
Supporting neighbourhoods	

<b>CORPORATE VALUES (tick those relevant)✓</b>	
Delivering value for money	✓
Supporting the Workforce	
Promoting open communications	

## 1 INTRODUCTION

### 1.1 Background

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.

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.

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.

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

CIPFA defines treasury management as:

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

Revised reporting is required for the 2019-20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital 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 separately.

## **1.2 Reporting requirements**

### **1.2.1 Capital Strategy**

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare additional reports which will provide the following:

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

The aim of this is to ensure that all elected members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

For this council, these additional reports are the Capital Strategy and the Non-Treasury Investments Report.

### **1.2.2 Treasury Management reporting**

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

- a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
  - the capital plans, (including prudential indicators);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy, (the parameters on how investments are to be managed).
- b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- c. **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### **Scrutiny**

The above reports are required to be adequately scrutinised before being recommended to the council. This role is undertaken by the Governance and Audit Committee.

## **1.3 Treasury Management Strategy for 2019-20**

The strategy for 2019-20 covers two main areas:

### **Capital issues**

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

### **Treasury management issues**

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

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

## **1.4 Training**

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury

management. This especially applies to members responsible for scrutiny. Training was last undertaken by members on 21 September 2015 and further training will be arranged following the local elections in May 2019.

The training needs of treasury management officers are periodically reviewed.

## 1.5 External service providers

The council uses Link Asset Services, Treasury Solutions as its external treasury management advisors.

The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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.

The council uses the Institutional Cash Distributors (ICD) Portal to invest or redeem trades in its Money Market Funds (MMFs). The portal provides advanced reporting tools so that the authority can assess its exposure to certain banks or countries.

Some investments via the ICD portal are made via JP Morgan who act as a clearing house for seven of the nine MMFs the council currently uses. The clearing house allows the authority to make several investments in different MMFs but only requires one payment to the clearing house, therefore saving the authority costs in CHAPS fees.

## 2 THE CAPITAL PRUDENTIAL INDICATORS 2019-20 – 2021-22

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

### 2.1 Capital expenditure

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

Capital expenditure £m	2017-18 Actual	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
General Fund	6.234	13.512	12.456	13.436	4.014
HRA	4.492	7.408	15.909	7.579	6.582
<b>Total</b>	<b>10.726</b>	<b>20.920</b>	<b>28.365</b>	<b>21.015</b>	<b>10.596</b>

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

<b>Capital expenditure £m</b>	<b>2017-18 Actual</b>	<b>2018-19 Estimate</b>	<b>2019-20 Estimate</b>	<b>2020-21 Estimate</b>	<b>2021-22 Estimate</b>
General Fund	6.234	13.512	12.456	13.436	4.014
HRA	4.492	7.408	15.909	7.579	6.582
<b>Total</b>	<b>10.726</b>	<b>20.920</b>	<b>28.365</b>	<b>21.015</b>	<b>10.596</b>
<b>Financed by:</b>					
Capital receipts - GF	1.816	4.161	5.181	0.503	0.314
Capital receipts - HRA	0.434	0.655	1.577	1.050	1.300
Capital grants - GF	3.206	4.511	4.588	5.630	3.200
Capital grants - HRA	0.376	1.857	0.192	0.000	0.000
Reserves - GF	0.211	0.202	0.302	0.000	0.000
Reserves - HRA	2.881	4.486	6.875	3.222	1.950
Revenue - GF	0.000	0.006	0.089	0.050	0.000
Revenue - HRA	0.392	0.410	0.856	0.300	0.300
<b>Net financing need for the year</b>	<b>1.410</b>	<b>4.632</b>	<b>8.705</b>	<b>10.260</b>	<b>3.532</b>

Other long term liabilities: The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

## 2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the council's Capital Financing Requirement (CFR). The 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 indebtedness and so its 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 indebtedness 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 scheme include a borrowing facility and so the council is not required to separately borrow for these schemes. The council had £2.911m of long term liabilities (excluding pensions) as at 31 March 2018.

The council is asked to approve the CFR projections below:

£m	2017-18 Actual	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
<b>Capital Financing Requirement</b>					
CFR – General Fund	23.812	27.086	28.086	33.442	32.235
CFR – HRA	20.787	20.786	26.337	29.210	32.056
<b>Total CFR</b>	<b>44.599</b>	<b>47.872</b>	<b>54.423</b>	<b>62.652</b>	<b>64.291</b>
<b>Movement in CFR</b>	<b>(2.484)</b>	<b>3.273</b>	<b>6.551</b>	<b>8.229</b>	<b>1.639</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	1.410	4.632	8.705	10.260	3.532
Less HRA – loan repayments	0.000	0.000	(0.858)	(0.134)	(0.186)
Less GF – liability repayments	(2.963)	(0.294)	(0.000)	(0.347)	(0.000)
Less MRP/VRP and other financing movements	(0.931)	(1.065)	(1.296)	(1.550)	(1.707)
<b>Movement in CFR</b>	<b>(2.484)</b>	<b>3.273</b>	<b>6.551</b>	<b>8.229</b>	<b>1.639</b>

### 2.3 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 balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2017-18 Actual	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
Fund balances / reserves	19.826	18.848	15.717	17.157	18.267
Capital receipts	9.221	4.006	2.429	1.379	0.079
Earmarked reserves	13.021	8.819	8.285	7.833	8.706
<b>Total core funds</b>	<b>42.068</b>	<b>31.673</b>	<b>26.431</b>	<b>26.369</b>	<b>27.052</b>
Balances incl working capital*	9.416	6.789	11.880	14.899	13.670
(Under)/over borrowing	(10.602)	(10.462)	(10.311)	(13.268)	(12.722)
<b>Expected investments</b>	<b>40.882</b>	<b>28.000</b>	<b>28.000</b>	<b>28.000</b>	<b>28.000</b>

\*Working capital balances shown are estimated year end; these may be different mid-year.

### 2.4 Minimum revenue provision (MRP) policy statement

The council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) 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).

MHCLG 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, so long as there is a prudent provision. The council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice** - MRP will follow the existing practice outlined in former MHCLG regulations (option 1).

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

This option provides for a reduction in the borrowing need over approximately the asset's life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made.

Repayments included in annual PFI or finance leases are applied as MRP.

**MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory MRP, 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 any cumulative overpayment made each year.

### 3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the council. 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 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.

#### 3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2018 and for the position as at 30 September 2018 are shown below for both borrowing and investments.



TREASURY PORTFOLIO				
	Actual 31 March 2018	Actual 31 March 2018	Actual 30 Sept 2018	Actual 30 Sept 2018
<b>Treasury Investments</b>	<b>£000</b>	<b>%</b>	<b>£000</b>	<b>%</b>
Banks	17.814	43.6	18.287	38.5
Money Market Funds	23.068	56.4	29.210	61.5
<b>Total (all managed in-house)</b>	<b>40.882</b>	<b>100.0</b>	<b>47.497</b>	<b>100.0</b>
<b>Treasury External Borrowing</b>				
PWLB	26.547	85.4	26.236	85.3
LOBOs	4.500	14.5	4.500	14.6
Salix	0.039	0.1	0.035	0.1
<b>Total</b>	<b>31.086</b>	<b>100.0</b>	<b>30.771</b>	<b>100.0</b>
<b>Net treasury investments / (borrowing)</b>	<b>9.796</b>		<b>16.726</b>	

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

£m	2017-18 Actual	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
<b>External Debt</b>					
Debt at 1 April	31.669	31.086	35.133	42.175	48.134
Expected change in Debt	(0.583)	4.047	7.042	5.959	2.525
Other long-term liabilities (OLTL) at 1 April	3.264	2.911	2.277	1.937	1.250
Expected change in OLTL	(0.353)	(0.634)	(0.340)	(0.687)	(0.340)
<b>Actual gross debt at 31 March</b>	<b>33.997</b>	<b>37.410</b>	<b>44.112</b>	<b>49.384</b>	<b>51.569</b>
The Capital Financing Requirement	44.599	47.872	54.423	62.652	64.291
<b>Under / (over) borrowing</b>	<b>10.602</b>	<b>10.462</b>	<b>10.311</b>	<b>13.268</b>	<b>12.722</b>

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.

The Section 151 Officer 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.

### 3.2 Treasury Indicators: limits to borrowing activity

**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 and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
Debt	55.000	63.000	71.000	73.000
Other long term liabilities (incl leases)	22.000	20.000	20.000	20.000
Total	77.000	83.000	91.000	93.000

**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 £m	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate	2021-22 Estimate
Debt	60.000	68.000	76.000	78.000
Other long term liabilities (incl leases)	27.000	25.000	25.000	25.000
Total	87.000	93.000	101.000	103.000

Historically the Council has also been limited to a maximum HRA CFR through the HRA self-financing regime. However, the HRA cap that controls local authority borrowing for house building was abolished from 29 October 2018 in the Budget.

#### Composition of Operational Boundary and Authorised Limit

Debt (in both the Operational Boundary and Authorised Limit above) for 2019-20 onwards includes:

- a) £3m to allow for capital expenditure being incurred in advance of generating capital receipts to fund this expenditure. As this is anticipated to be a relatively short-term timing difference it has not been reflected elsewhere in this report.
- b) £5m to allow for any commercial activities/non-financial investments that the council may pursue. This has not been reflected elsewhere in this report, pending the formulation and approval of any such items.

Other long term liabilities (in both the Operational Boundary and Authorised Limit above) includes an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). Once full details are known, the Operational Boundary and/or Authorised Limit may need to be revised for approval. The impact of IFRS 16 has not been reflected elsewhere in this report, pending further information from CIPFA.

### 3.3 Link's economic and interest rate forecast (issued by Link on 30 October 2018)

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 Link's central view.

Link Asset Services Interest Rate View														
	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.50%	1.75%	1.75%	2.00%
3 Month LIBID	0.80%	0.80%	0.90%	1.10%	1.10%	1.20%	1.40%	1.50%	1.60%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	0.90%	0.90%	1.00%	1.20%	1.20%	1.30%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%
12 Month LIBID	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.60%	1.70%	1.80%	1.80%	1.90%	2.00%	2.10%	2.20%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.00%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%	3.60%	3.70%
50yr PWLB Rate	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.40%	3.50%

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the Monetary Policy Committee (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%. However, the MPC emphasised again, that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time but they declined to give a medium term forecast. It is unlikely that the MPC will increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Similarly, the MPC is more likely to wait until August 2019, than May 2019, before the next increase, to be followed by further increases of 0.25% in May and November 2020 to reach 1.5%. However, the cautious pace of even these limited increases is dependent on a reasonably orderly Brexit.

The overall longer run future trend is for gilt yields, and consequently Public Works Loan Board (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. Unsurprisingly, the Federal Reserve (Fed) has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

### **Investment and borrowing rates**

- 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 able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry (the difference between higher borrowing costs and lower investment returns) to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

### 3.4 Borrowing strategy

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.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019-20 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast*, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### 3.5 Policy on borrowing in advance of need

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.

Borrowing in advance will be made within the constraints that:

- The authority would not look to borrow more than 18 months in advance of need.

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.

### **3.6 Debt rescheduling**

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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.

All rescheduling will be reported to Cabinet at the earliest meeting following its action.

### **3.7 Municipal Bond Agency**

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

## **4 ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment policy - management of risk**

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 and Non-Treasury Investments Report (separate reports).

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

The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

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: -

1. 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.
2. **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.
3. **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.
4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in annex 2 under the categories of ‘specified’ and ‘non-specified’ investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.
5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £5m (see paragraphs 4.2 and 4.4).
6. **Lending limits** (amounts and maturity) for each counterparty will be set through applying the matrix table in paragraph 4.2.
7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraphs 4.2 and 4.4).
8. Investments will only be placed with counterparties from foreign countries which have a specified minimum **sovereign rating**, (see paragraph 4.3). This does not apply to pooled investment vehicles.
9. This authority has engaged **external consultants**, (see paragraph 1.5) to provide expert advice on how to optimise an appropriate balance of security, liquidity and

yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in **sterling**.
11. 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 charges at the end of the year to the General Fund. The Ministry of Housing, Communities and Local Government (MHCLG), are currently conducting a consultation for a temporary override to allow English local authorities time to adjust their portfolio of investments.

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see paragraph 4.5). Regular monitoring of investment performance will be carried out during the year.

#### **Changes in risk management policy from last year.**

The above criteria are unchanged from last year apart from changing the duration threshold from 364 to 365 days (in line with revised investment guidance).

## **4.2 Creditworthiness policy**

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

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

The Section 151 Officer 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 considered high quality which the council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury advisors, 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 the longer term bias outside the central rating view) 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 may be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA-

and have, as a minimum, the following credit rating from at least one of Fitch, Moody's and Standard and Poors (where rated):

  - i. Short term – F1 (or equivalent)
  - ii. Long term – A (or equivalent)
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland Group ring-fenced operations. This bank can be included provided it continues to be part nationalised or it meets the above criteria.
- Banks 3 – The council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time invested.
- Bank subsidiary and treasury operations: If separately rated, the council will use those that meet the ratings/criteria for banks outlined above. If not separately rated, the council will use these where the parent bank has the necessary ratings/criteria outlined above.
- Building societies: The council will use all societies which meet the ratings/criteria for banks outlined above.
- Pooled investment vehicles (including money market funds, enhanced money market funds and bond funds) – AAA
- UK Government (including gilts, treasury bills and the DMADF)
- Local authorities, parish councils, community councils, companies controlled by the council (either alone or with other public sector organisations) etc
- Housing associations
- Supranational institutions

A limit of £5m will be applied to the use of investments with a maturity of over 365 days.

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

**Time and monetary limits applying to investments.** The time and monetary limits for institutions on the council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating (or equivalent)*	Money Limit	Time Limit
<b>Higher quality</b>	<b>AA-</b>	<b>£6m per institution</b>	<b>370 days</b>
<b>Medium quality</b>	<b>A</b>	<b>£5m per institution</b>	<b>370 days</b>
<b>Part nationalised</b>	<b>N/A</b>	<b>£7m per institution</b>	<b>370 days</b>
<b>Debt Management Account Deposit Facility</b>	<b>UK sovereign rating</b>	<b>unlimited</b>	<b>6 months</b>
<b>Pooled investment vehicles (including money market funds, enhanced money market funds and bond funds)</b>	<b>AAA</b>	<b>£6m per fund</b>	<b>370 days</b>
<b>Local authorities, parish councils, community councils, companies controlled by the Council (either alone or with other public sector organisations), Supranational institutions etc</b>	<b>N/A</b>	<b>£4m per institution</b>	<b>5 years</b>

*\*The institution must have this minimum credit rating from at least one of Fitch, Moody's, and Standard and Poors (where rated).*

The proposed criteria for specified and non-specified investments are shown in Annex 2 for approval.

### **UK banks – ring fencing**

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

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.

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.

### 4.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the council's investments.

The council has determined that it will only use approved counterparties from the UK (irrespective of the UK sovereign credit rating) or other countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than £5m will be placed with any non-UK country at any time (this limit applies to each non-UK country individually and not to non-UK countries in total);
- limits in place above will apply to a group of companies;

The above restrictions do not apply to pooled investment vehicles (including money market funds, enhanced money market funds and bond funds). The council only invests in sterling denominated pooled investment vehicles.

### 4.4 Investment strategy

**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 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.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

**Link's Investment returns expectations (issued by Link on 30 October 2018):**  
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	1.00%
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	2.75%

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

**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 Council is asked to approve the following treasury indicator and limit: -

<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2019-20</b>	<b>2020-21</b>	<b>2021-22</b>
Principal sums invested for longer than 365 days	£5m	£5m	£5m
Investments as at 31 September 2018 invested for longer than 365 days	£nil	£nil	£nil

For its cash flow generated balances, the Council will seek to utilise its instant access and notice accounts, pooled investment vehicles and term deposits in order to benefit from the compounding of interest.

#### 4.5 Investment risk benchmarking

These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.05% historic risk of default when compared to the whole portfolio (excluding unrated investments).

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted average life benchmark is expected to be 0.5 years, with a maximum of 5 years.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is (excluding unrated investments):

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

#### 4.6 End of year investment report

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

#### 4.7 Use of external fund managers

It is the Council's policy not to use external fund managers for any part of its investment portfolio.

### 5 OPTIONS

That the Governance and Audit Committee:

a) Approves this report and annexes, including each of the key elements of this report and annexes listed below, and recommends that it is approved by Cabinet and Council.

- The Capital Plans, Prudential Indicators and Limits for 2019-20 to 2021-22, including the Authorised Limit Prudential Indicator.
- The Minimum Revenue Provision (MRP) Policy.
- The Treasury Management Strategy for 2019-20 to 2021-22 and the Treasury Indicators.
- The Investment Strategy for 2019-20 contained in the Treasury Management Strategy, including the detailed criteria.
- The Capital Strategy for 2019-20.
- The Non-Treasury Investments Report for 2019-20.

b) Does not approve this report and annexes and does not recommend that it is approved by Cabinet and Council (advising the reason(s) why); thereby not complying with the Treasury Management Code of Practice.

## 6 NEXT STEPS

Under the Treasury Management Code of Practice it is required that the Governance and Audit Committee, Cabinet and Council approve this report and annexes.

This report and annexes is to go to Cabinet and then Council for approval. The next Cabinet meeting is on 16 January 2018.

## 7 DISCLAIMER

This report (including its annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees makes any representation or warranty, express or implied, as to the accuracy or completeness of the information contained herein (such information being subject to change without notice) and shall not be in any way responsible or liable for the contents hereof and no reliance should be placed on the accuracy, fairness or completeness of the information contained in this document. Any opinions, forecasts or estimates herein constitute a judgement and there can be no assurance that they will be consistent with future results or events. No person accepts any liability whatsoever for any loss howsoever arising from any use of this document or its contents or otherwise in connection therewith.

Contact Officer:	Tim Willis, Deputy Chief Executive & Section 151 Officer
Reporting to:	Madeline Homer, Chief Executive

## Annex List

Annex 1	The Capital Prudential and Treasury Indicators 2019-20 – 2021-22 and MRP Statement
Annex 2	Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
Annex 3	Guidance on Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy (TMSS)
Annex 4	Capital Strategy 2019-20
Annex 5	Non-Treasury Investments Report 2019-20

### **Corporate Consultation Undertaken**

Finance	Gary Whittaker, Interim Head of Financial and Procurement Services
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer