BLAENAU GWENT COUNTY BOROUGH COUNCIL

Treasury Management Strategy Statement

Annual Investment Strategy and Minimum Revenue Provision Policy Statement

2019/2020

INDEX

1.0 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

Treasury management is defined as:

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

1.2 Statutory requirements

The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy. The Treasury Strategy details the expected activities of the Treasury function in the forthcoming financial year (2019/20). The Investment Sstrategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

Statutory Instrument WSI 2008 no. 588 section 3 lays down that:
"A local authority must calculate for the current financial year an amount of mi nimum revenue provision which it considers to be prudent."

Along with the above duty, the Welsh Assembly Government issued guidance in March 2008 (and further updated in November 2018) which requires that a Statement on the Authority's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate. The Annual MRP Policy Statement is therefore included at section 5.

1.3 CIPFA requirements

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/2020, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following: -

- a high-level 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 report is to ensure that all elected members on the full council fully understand the overall strategy, long term policy objectives, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

The primary requirements of the Treasury Management Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the

execution and administration of treasury management decisions, which in this Council is the Chief Officer Resources.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Corporate Overview Scrutiny Committee.

1.4 Reporting Arrangements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

The Treasury Strategy (this report) - The first, and most important report covers:

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

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and an assessment of whether the treasury strategy is being met or whether any policies require revision.

An annual treasury report – This 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 Corporate Overview Scrutiny Committee.

The table below sets out these reporting requirements:

Area of Responsibility	Council/ Committee	Frequency
Treasury Management Strategy / Investment Strategy / MRP policy	Full council	Annually before the start of the financial year
Treasury Management Strategy / Investment Strategy / MRP policy – mid year outturn report	Full Council	Mid year
Treasury Management Strategy / Investment Strategy / MRP policy – updates or revisions at other times	Full Council	Ad hoc
Annual Treasury Outturn Report	Full Council	Annually by 30 September after the year end.
Scrutiny of Treasury Management Strategy	Corporate Overview Scrutiny Committee	Annually before the start of the financial year.
Scrutiny of Treasury Management performance	Corporate Overview Scrutiny Committee	Mid year & annually by 30 September after the year end.

1.5 Treasury Consultants

The Council currently uses Link Asset Services as its external treasury management advisors. The Council recognises that responsibility for Treasury Management decisions remains with the Authority 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 contract with Link Assets Services expires on 30th April 2019. A review has been undertaken prior to this date in order to determine whether to extend the current contract or go through a tendering exercise to appoint Treasury Management advisors for the two years from 1st May 2019. The outcome of the review, which has been agreed by the Chief Officer Resources, is to extend the contract until 30th April 2021.

1.6 The role of the S151 Officer

The role of the S151 Officer in relation to Treasury management has been embodied in the CIPFA Code of Practice for many years. The 2017 revised Code, further enhanced this role in relation to the following areas:-

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
    - creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed,

2. The Capital Prudential Indicators 2019/2020 – 2021/2022

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

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. The actual capital expenditure that was incurred in 2017/2018 and the estimates of capital expenditure to be incurred for the current and future years that are recommended for approval are:

Capital Expenditure £000's					
	2017/2018 Actual	**2018/2019 Revised Estimate**	**2019/2020 Estimate**	**2020/2021 Estimate**	**2021/2022 Estimate**
Total	8,589	13,154	28,582	31,210	22,968

Note

Actual figures for 2017/2018 & estimated figures for 2018/2019 represent total gross capital expenditure (I.e. include all expenditure financed from grant).
Estimated figures for 2019/20, 2020/21 & 2021/22 are based on the Authority's approved capital programme plus external funding approvals received at this stage.and estimated spend

The table below shows how the above capital expenditure plans are planned to be financed.

Capital Expenditure £000's	2017/2018 Actual	2018/2019 Revised Estimate	2019/2020 Estimate	2020/2021 Estimate	2021/2022 Estimate
Total	8,589	13,154	28,582	31,210	22,968
Financed by:					
Grants, Capital Receipts, revenue and other sources	4,720	9,179	26,049	29,237	20,995
Net financing need for the year from USB and PB	**3,869**	**3,975**	**2,533**	**1,973**	**1,973**

** USB – Unhypothecated Supported Borrowing – borrowing that is supported through the Revenue Support Grant.

PB – Prudential Borrowing – borrowing that is not supported through the Revenue Support Grant.

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 underlying borrowing need. Any capital expenditure, which has not immediately been paid for (i.e. is borrowed 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.

The CFR includes any other long term liabilities (e.g. 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 currently has £0.414m of such schemes within the CFR.

The CFR projections recommended for approval are shown in the table below:

Capital Financing Requirement					
	2017/18 Actual £000	2018/19 Revised Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2020122 Estimate £000
CFR at start of financial year	158,171	162,824	166,449	168,461	169,895
CFR at end of financial year	162,824	166,449	168,461	169,895	171,263
Movement in CFR	4,653	3,625	2,013	1,434	1,368
Movement in CFR represented by:					
Net Financing need for the year (above)	5,743	3,975	2,533	1,973	1,973
New Finance Leases	116	150	150	150	150
less MRP	-1,206	-500	-670	-~~7~~689	-755
	4,653	3,625	2,013	1,434	1,368

2.3 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. The Council is asked to approve the following indicators:

2.4 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.

Ratio of financing costs to net revenue stream					
	2017/18 Actual %	2018/19 Revised Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
General Fund	3.48%	3.24%	3.11%	3.20%	3.28%

Note:
The estimates of financing costs for 2019/2020 include current commitments and the proposals in the budget report to be presented to Council in February
The net revenue stream for 2020/2021 & 2021/2022 are based on the following assumptions, which have been used as the basis for the Authority's medium term financial strategy (MTFS).

- *RSG & NNDR – per MTFS assumptions for 2020/2021 (-2%) & 2021/2022 (-2%).*
- *Council Tax - 2.6% for 2019/20 & 2.6% for 2020/21 (per MTFS).*
- *Council Tax Base – remains at 2019/2020 level*

3.0 Treasury Management Strategy for 2019/2020

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

The suggested strategy for 2019/2020 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor, Link Asset Services.
The Strategy covers:

3.1 the current treasury portfolio position;
3.2 Treasury management prudential Indicators for 2019/2020 to 2021/2022
3.3 prospects for interest rates;
3.4 the borrowing strategy;
3.5 policy on borrowing in advance of need;
3.6 debt rescheduling;
3.7 strategy on the use of usable capital receipts;

3.1 Current Treasury Portfolio Position

The Council's treasury portfolio position at 31 March 2018, with forward projections are summarised below. 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.

Treasury Portfolio Position					
	2017/18 actual £000	**2018/19 estimate £000**	**2019/20 estimate £000**	**2020/21 estimate £000**	**2021/22 estimate £000**
External Debt:					
Debt	148,690	158,002	154,941	156,225	158,537
Other Long Term Liabilities	285	289	263	207	121
Gross Debt as at 31 March	148,975	158,291	155,204	156,432	158,658
The Capital Financing Requirement	162,824	166,449	168,461	169,895	171,263
Under / (Over) Borrowing	13,849	8,158	13,257	13,463	12,605

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 it minimises counterparty risk. In the longer term the forecast is for the under-borrowing position to reduce over time by gradually externalising the Authority's internal borrowing.

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 2018/2019 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 Chief Officer Resources 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 the budget report.

3.2 Treasury Management Prudential Indicators for 2018/19 – 2020/21

The following section sets out the Treasury Management Prudential Indicators that are recommended for approval.

3.2.1 Adoption of CIPFA Code of Practice for Treasury Management

In December 2017, CIPFA issued revised CIPFA Code of Practice for Treasury Management in the Public Services

3.2.2 Treasury management limits on activity

There are four 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 Limit on Fixed Interest exposure***

  Blaenau Gwent County Borough Council has always adopted a risk averse strategy in relation to variable rate debt, and should interest rates rise the Authority would wish to continue with its strategy of maintaining a stable long term portfolio by drawing longer term fixed rate funding. In order to be consistent with this strategy, the upper limit on fixed rate exposures for 2019/2020, 2020/2021 & 2021/2022 should be set at 100%

of its net outstanding sums.

- ***Upper Limit on Variable Interest Exposure***

In order to give the flexibility to enable debt rescheduling opportunities to be undertaken, the upper limit on variable rate exposures for 2019/20, 2020/2021 & 2021/2022 should be set at 30% of its net outstanding sums.

- ***Range of Exposures***

This means that the Chief Officer Resources will manage fixed interest exposures within the range 70% to 100% and variable rate exposures within the range 0% to 30%. This is a continuation of current practice.

- ***Maturity Structure of Fixed Rate Borrowing***

It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

The amount of projected borrowing that is fixed rate and maturing in each period, as a percentage of total projected borrowing that is fixed rate, is illustrated in the table below. This is a continuation of the current practice.

	Upper Limit	**Lower Limit**
Under 12 months	20%	0%
12 months & within 24 months	20%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and above	95%	5%

3.2.3 Authorised Limit

This is a key Prudential Indicator that represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited and 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.

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.

It is recommended that the Council approves the following Authorised Limits for its Total External Debt Gross of Investments for the next three financial years.

Authorised limit for external debt				
	2018/2019 £000	**2019/2020 £000**	**2020/2021 £000**	**2021/2022 £000**
Borrowing	167,319	170,435	171,848	174,381
Other long term liabilities	289	318	289	228
Total	**167,599**	**170,753**	**172,137**	**174,618**

3.2.4 Operational Boundary

The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit but reflects directly the Chief Officer Resources' prudent estimate of the most likely but not worst case scenario. It excludes the contingency included within the Authorised Limit (to allow for example for unusual cash movements), and equates to the maximum of external debt projected by this estimate. The Operational Boundary represents a key management tool for in year monitoring by the Chief Officer Resources.

It is recommended that the Council approves the following Operational Boundary Limits for the next three financial years.

Operational Boundary for external debt				
	2018/2019 £0	**2019/2020 £0**	**2020/2021 £0**	**2021/2022 £0**
Borrowing	152,108	154,941	156,225	158,537
Other long term liabilities	255	289	263	207
Total	**152,363**	**155,230**	**156,88**	**158,744**

3.2.5 Actual External Debt

The Council's actual external debt as at 31 March 2018 was £148.9 million (including temporary borrowing), comprising 99.8% borrowing and 0.2% other long term liabilities. It should be noted that actual external debt is not directly comparable to the Authorised Limit and Operational Boundary, since the actual debt reflects the position at one point in time.

3.3 Prospects for Interest Rates

As part of their service, the Council's treasury advisor for 2018/2019, Link Asset Services assist the Council to formulate a view on interest rates. The following table illustrates this :

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

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. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

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

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.

3.4 The Borrowings 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 it minimises counterparty risk.

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer term stability of the debt portfolio. With short term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources, or to borrow short term loans instead.

By doing so, the Authority is able to reduce borrowing costs and reduce overall treasury risk. The benefits of short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long term borrowing rates are forecast to rise. Link Asset Services will assist the Authority with this cost of carry and breakeven analysis.

The Authority may also consider arranging forward starting loans during 2019/2020, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition the Authority will borrow short term loans to cover cash flow shortages.

The borrowing strategy to be adopted will therefore be:
(Each strand of the strategy will be considered together and decisions made based on the most advantageous position for the Authority at that time).

To utilise the Authority's overdraft facility:
to fund unexpected daily cash deficits;
to fund temporary cash shortfalls where there are no other sources of funding available within the marketplace.

To borrow over the short term:
to fund temporary cash shortfalls;
to maintain a suitably balanced maturity profile;
to make short term savings required in order to meet budgetary constraints;
in anticipation of securing longer term loans at more attractive rates.

To borrow over the long term:
to reduce the Authority's average cost of borrowing;
to maintain a stable, longer term portfolio;
to maximise the potential for future debt rescheduling.

If appropriate to avoid all new external borrowing:
to maximise savings in the short term;
to run down temporary investment levels;
to minimise exposure to interest rate and credit risk.

Sensitivity of the forecast – In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Council officers, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

- *if it were 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 were 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 a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/2020 treasury operations. The Chief Officer Resources will monitor interest rates in the financial markets and adopt a pragmatic approach to changing circumstances reporting any changes to the above strategy to Council 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 carefully considered to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

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
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.
- consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

3.6 Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual 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 size of premiums incurred, their short term nature, and the likely cost of refinancing those short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

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 strategy outlined in paragraph 3.4 above
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Variations in risk will be considered when evaluating such opportunities, in order to ensure that the Authority's risk averse strategy is maintained.

All rescheduling will be reported to Council as part of the mid-year and Annual Treasury Outturn reports.

3.7 Strategy on the use of Usable Capital Receipts

The long standing policy on usable capital receipts is that they are immediately invested internally, thereby helping to improve the Authority's cashflow position and reducing the level of external loans that need to be raised. This in turn reduces external interest charges from the money market. This approach is consistent with what is regarded as good practice in terms of strategic level treasury management and overall produces savings in debt servicing costs for the Authority. However, as approved sums of usable capital receipts are subsequently used to finance part of the annual capital programme each year, appropriate allowance then needs to be made for the use of these receipts in determining the estimated level of external borrowing required for that year. Hence usable capital receipts are released on a controlled basis and the annual estimates for external interest charges are adjusted accordingly.

4.0 Investment Strategy – Revised (September 2017)

4.1 Background

CIPFA has 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, (a separate report).

In setting its investment strategy the Council has to comply with various legislation and Codes of practice, being:

- Part 1 of the Local Government Act 2003
- Welsh Assembly guidance on investments
- 2017 revised CIPFA Treasury Management in Public Services Code of Practice
- CIPFA Treasury Management Guidance Notes 2018

The Council's investment priorities are:

1. The security of the capital sum –ensuring that our investments are safe and not at risk of being lost;
2. The liquidity of its investments – ensuring that our investments are easily accessible i.e. not tied up for long periods of time;
3. Return on investment – once security and liquidity have been satisfied then and only then will the Council seek the maximum return on its investment.

The Borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

The Council maintains only temporary, short term investments (i.e. for periods of less than a year, although it very rarely invest for periods of longer than a few months) and investments will accordingly only normally be made with reference to the cash flow requirements, including the investing of sums borrowed at prevailing low interest rates in anticipation of capital spending.

This is because the Council does not have large cash balances to invest over a longer period of time. It needs its cash on a short term basis in order to be able to manage its daily cash flow requirements.

4.2 Definition of Investments – Specified and non-specified

The Local Government Act 2003 refers to specified and non-specified investments. The Welsh Assembly Government's Guidance on Local Government Investments, effective from 1st April 2010, defines the following:-

Specified Investments:

An investment is a **specified** one if **all** of the following apply:-

(a) it is denominated in sterling and any payments or repayments in respect of it are payable only in sterling

(b) the investment is not a long-term one i.e. one which is due to be repaid within 12 months of the date on which the investment was made or one which may require to be repaid within that period

(c) the making of the investment is not defined as capital expenditure by virtue of regulation 20(1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 [SI 3239 as amended]

(d) the investment is made with a body or in an investment scheme of ***** high credit quality or with one of the following public sector bodies:

i. the UK Government

ii. a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland

iii. a parish or community council.

***** High credit quality is defined in the creditworthiness policy in 3.0

Non-specified Investments:

(i) An investment is non-specified if it does not meet the above definition.

As this Council maintains only short term investments (i.e. less than 365 days) then by definition it will only invest in specified investments.

4.3 Creditworthiness policy

In accordance with the guidance from the Welsh Government and CIPFA, 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 avoid a concentration of risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings derived from the three credit rating agencies, Fitch, Moody's and Standard & Poor's (S&P).

Counterparties for investment purposes are selected using specific criteria, as follows:

Banks - high credit quality **–** the Council will only use banks which:

- are UK banks; and/or
- are non-UK and domiciled in a country which has a minimum sovereign Long Term rating of AAA (any non UK transactions would be undertaken in Sterling).
- and have, as a **minimum**, the following Fitch, Moody's and Standard and Poor's credit ratings (where rated):

Table 1:

	Fitch	Moody's	S&P
Long Term	A-	A3	A-
Short Term	F1	P-1	A-1

Long term rating *– covers maturities of up to five years. It provides an assessment of the ongoing stability of the institutions prospective financial condition.* ***A*** *indicates high credit quality and low expectation of credit risk. The + or – suffixes are appended to a rating to denote the relative status within the long term rating category. The Moody's and S&P definitions are similar to Fitch. The Moody's numerical suffix indicates a rating at the higher end of the scale (1) to the lower end of the scale (3), with 1 having higher credit quality than 3.*

Short term rating *– covers obligations which have a maturity of less than one year. This rating places greater emphasis on the liquidity necessary to meet financial commitments. Rating* ***F1 (Fitch)*** *is the highest short term credit quality rating. It indicates the strongest capacity for timely payment of financial commitments.*
The Moody's and S&P definitions are similar to Fitch.

- **Part nationalised UK bank** – Royal Bank of Scotland Group (NatWest, Royal Bank of Scotland, Ulster Bank). This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks above.

- **The Council's own banker (Barclays)** – Since under existing arrangements excess surplus funds can be held overnight with the Council's Bank, unexpected credit rating downgrades to the Bank could result in these short-term investments technically being placed with a counterparty that does not meet the minimum approved credit criteria specified above. The S&P short term rating for Barclays is A-2, and has been since 2012. A-2 means that S&P consider Barclays capacity to meet its financial commitment on its obligations as satisfactory. Fitch and Moody's both consider this to be strong. The minimum credit rating for Barclays will therefore be A-2 (S&P) with F1 for Fitch and P-1 for Moody's. Whilst this will mean that Barclay's S&P credit ratings will be slightly lower than those required for other institutions (as detailed above), investments with Barclays will be restricted to the overnight (or over weekend) sweep facility (where surplus balances are "swept" into an interest bearing account) up to a maximum of £6 million.

  Should Barclays' credit ratings improve and meet the credit criteria required for other institutions (above), then the investment periods for meeting the minimum criteria will once again be applied. See below for contingency arrangements in relation to the Authority's bank.

Table 2:

	Fitch	**Moody's**	**S&P**
Long Term	A-	A3	A-
Short Term	F1	P-1	A-2

- **Building societies** - The Council will *use **only*** the Nationwide Building Society, unless their short term credit ratings fall below the minimum specified in table 1 above for banks.

- **AAA rated Money market funds (MMFs**) – Triple A rated MMFs are considered to be highly credit rated.

- **UK Government** - The Debt Management Account Deposit Facility DMADF of the Debt Management Office (DMO). The DMO is legally and constitutionally part of HM Treasury and as an Executive Agency of Her Majesty's Treasury it operates at arm's length from Ministers. The DMO is considered to be highly credit rated.

- **UK Local authorities**, Police Authorities, parish councils etc

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 must be applied before making any specific investment decision from the agreed pool of counterparties. Ratings will therefore not be the sole determinant of the quality of an institution and the assessment will therefore also take account of information that reflects the opinion of the markets, as follows:

Credit default swaps (CDS)

The Council will engage with its Treasury advisors, Link Asset Services, to maintain a monitor on market pricing such as "credit default swaps (CDS)" and overlay that information on top of the credit ratings.

CDS spreads offer a timely market perception of the risk attached to the relevant institution. These can, on occasion, pre-empt actions by the credit rating agencies whose ratings can lag behind market reaction to changes in the credit institutions situation. Since they are traded instruments, they carry in them market perception related to that entity's credit quality. In order to "measure" the CDS data, Link use a benchmark system which allows the CDS spread of an institution to be compared against a predetermined benchmark rate. This data is then used to assess whether the market is indicating that an institution's credit quality is a cause for concern. Where there is a cause for concern then the counterparty will be either downgraded in terms of investment period or removed from the approved list.

Credit Rating Agency Comments

- ***Rating Watch negative (or on review for possible downgrade)***

Where the credit rating agencies have placed counterparties on "rating watch negative" or "on review for possible downgrade", then this indicates that there is a reasonable probability of a rating change in a relatively short period (a few weeks). If the counterparty is on negative rating watch, then it will be downgraded in terms of the investment period or removed from the list.

- ***Negative Outlook***

This indicates the direction a rating is likely to move over a one to two year period. As the maximum fixed investment period for the Council is 6 months, then this will have no impact on the approved list.

Time and monetary limits applying to investments.
The table below shows the time and monetary limits for institutions on the Council's counterparty list are as follows:

	Long term Rating (Fitch, Moody's, S&P)	Short term rating (Fitch, Moody's, S&P)	Money Limit	Time Limit
Banks - higher quality	*AA, Aa2, AA*	F1+, P-1, A-1+	£6m	6 months
Banks - medium quality (including Nationwide BS)	A-, A3, A-	F1, P-1, A-1	£4m	3 months
Banks – part nationalised	N/A	N/A	£4m	3 months
Council's banker (not meeting Banks - medium)	A-, A3, A-	F1, P-1, A-2	£6m	overnight
DMADF	AAA	N/A	unlimited	6 months
Local authorities – per Authority	N/A	N/A	£6m	3 months
	Fund rating		Money Limit	Time Limit
Money market funds – per MMF	AAA		£6m	liquid

Country and Group Limits

The Council has determined that it will only use approved counterparties from non UK countries with a minimum sovereign rating of AAA from Fitch (Aa2 Moody's, AAA S&P).

In addition, no more than £6m will be placed with any non-UK country at any time.

For financial institutions included within the same banking group, the counterparty limit will apply to the group.

Lloyds Banking Group
- Halifax   Lloyds Bank   Bank of Scotland

RBS Group
- National Westminster   Royal Bank of Scotland   Ulster Bank

4.4 Contingency Arrangements for the Authority's Corporate Bank

If credit agency ratings change and the Authority's Corporate Bank fails to comply with the approved Investment Policy criteria specified above, then delegated authority, to agree appropriate and reasonable interim contingency arrangements prior to approval by Full Council, is granted to the Members and Officers listed below:

a. Nominated Members: Leader of the Council, Deputy Leader of the Council, Chair of Corporate Overview Scrutiny.

b. Nominated Officer: Statutory Section 151 Officer (Chief Officer Resources)

The Statutory Section 151 Officer and at least two of the three nominated Members, must approve unanimously the appropriate and reasonable interim contingency arrangements.

4.5 Monitoring of credit ratings

Welsh Assembly guidance states that the Annual Investment Strategy must state how credit ratings are to be monitored and what action is to be taken when ratings change.

The responsibility for constructing and amending the Council's approved counterparty investment list is delegated to the Chief Officer Resources and is contained within the Treasury Management Practice Schedules. All investments will be made in accordance with this list and the limits therein.

Credit ratings for individual counterparties can change at any time. The Chief Officer Resources is responsible for applying the stated credit rating criteria above, and will add or delete counterparties as appropriate to / from the approved counterparty list when there is a change in the credit ratings of individual counterparties or in banking structures. The Authority is alerted to changes in credit ratings through its Treasury Advisors, Link Asset Services.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.

- If a body is placed on negative rating watch (i.e. there is a reasonable probability of a rating change and the likelihood of that change being negative) and it is currently near at the minimum acceptable rating for placing investments with that body, then no further investments will be made with that body.

The only exception permitted to these criteria will be the contingency arrangement for the Authority's bank described in section 4.4

4.6 Liquidity of Investments

Welsh Assembly guidance states that the Annual Investment Strategy is to specify the maximum periods for which funds may be committed and the minimum amount to be held in investments during the financial year.

The maximum period for which funds may be committed is 365 days but the actual period of investment will depend upon future cash flow requirements and will comply with the maximum period permitted in the table above.

As the Authority only maintains temporary, short term investments with reference to its cash flow requirements, then the minimum amount of investment to be held during the financial year will be nil.

4.7 Investment monitoring reports

The Council will report on its investment activity as part of its mid-year and Annual Treasury Outturn Report.

5. Annual Minimum Revenue Provision (MRP) Statement

The Secretary of State recommends that before the start of each financial year a local authority prepares a statement of its policy on making MRP in respect of that financial year and submits it to full Council.

Under regulation 21 of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003, local authorities are required to charge to their revenue account for each financial year MRP to account for the principal cost of their debt in that financial year.

For 2007/8 and subsequent financial years, the detailed calculation has been replaced with a requirement that local authorities calculate an amount of MRP which they consider to be prudent. Local Authorities are legally obliged to "have regard" to such guidance (i.e. set a prudent MRP) – which is exactly the same duty as applies to other statutory guidance including the Prudential Code and CIPFA Treasury Management Code.

The broad aim of prudent provision is to ensure that debt is repaid over a period reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Revenue Support Grant (RSG), reasonably commensurate with the period implicit in the determination of that grant.

The legislation does not define what constitutes a "prudent provision". However the MRP guidance issued by the Secretary of State (WG) interprets the term and provides some ready-made examples of acceptable methods for calculating a prudent level of MRP.

In December 2017, Council approved an amended MRP policy to be applied from 2017/18 and beyond, as follows:

MRP on Supported Borrowing – this will be based on a 2% straight line approach and will be applied retrospectively back to 1st April 2007.

MRP on Unsupported Borrowing – this will be based on Option 3 of the statutory guidance that allows for MRP provision using the asset life methodology on an annuity basis. This will be applied retrospectively back to 1st April 2007. It is applied to particular items of capital expenditure and spreads the expenditure over the useful life of the asset. MRP is chargeable in the first financial year after the relevant asset becomes operational. The annuity method MRP will be the amount presumed to be the principal element of the equal amounts that would be payable each year in respect of a loan at a specified rate of interest that would reduce the outstanding principal amount to zero at the end of the estimated useful life. The annuity method can be argued as providing a fairer charge than equal instalments as it takes into account the time value of money. The interest rate to be used in the annuity calculation is the average PWLB annuity rate for a loan with a term equivalent to the estimated life of the asset. Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

MRP on Finance Leases - Option 3 will apply in a modified form, to ensure that the MRP for Finance Leases is equal to the rental payable each year, with the following exception.

Capital Receipts – In circumstances where it is prudent to do so and to protect Council Tax payers from unnecessary MRP charges, capital receipts received under finance lease arrangements (where there is a head and sub lease agreement) will be used to reduce the Council's overall borrowing requirement, rather than making a conventional MRP charge to revenue.

Loans to other bodies – where loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

Application of retrospective sum – the retrospective application of the supported and unsupported borrowing option back to 1st April 2007 results in a sum of £15.5 million that is to be applied for a 5 year period from 2017/18 to 2021/22 in order to reduce the MRP charge for those years.

In November 2018, Welsh Government issued further guidance, to apply from April 2019. In summary, the changes are as follows:-

- Changing the method of calculation of MRP cannot lead to retrospective application
- MRP cannot be a negative amount
- MRP can only be nil under certain circumstances

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