Hull City Council

Report to:

Finance and Value for Money Overview and Scrutiny Commission – 25 January 2019
Cabinet – 28 January 2019
Council – 28 February 2019

Wards All

Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2019-20

Report of the Director of Finance and Transformation (S151 Officer)

This item is not exempt
Therefore exempt reasons are not applicable

This is a Non-Key Decision

1. Purpose of the Report and Summary

1.1 To provide details of the Treasury Management Strategy Statement (incorporating Prudential and Treasury Indicators), Minimum Revenue Provision Policy Statement and Annual Investment Strategy proposed for the financial year 2019-20.

1.2 The Council's constitution requires that the Strategy and Policy Statements be approved by Council and this responsibility cannot be delegated.

1.3 The scope and content of this report are in line with the requirements of the Treasury Management Code of Practice and the Prudential Code for Capital Finance, therefore there needs to be more detail included than standard committee reports.

1.4 Due to the nature and complexity of this report, an overview is provided at Appendix 5 which provides Members of the Council with a summary of the main contents of the report. A Glossary of Terms is also included at Appendix 6.

2. Executive Summary

2.1 Treasury Management is an important part of the finance function of the Council. Under the Prudential Regime, the Council has greater freedom with regard to borrowing and investment decisions and the Prudential Indicators provide an important monitoring framework.

2.2 Through the Council's Borrowing and Investment Strategies, the Director of Finance and Transformation will seek to minimise borrowing costs and maximise investment income whilst controlling the Council's exposure to financial risk.

2.3 The Government guidance issued regarding repayment of debt on borrowings (Minimum Revenue Provision) provides the Council with the ability to set realistic levels of provision for the repayment of debt. The MRP Policy remains unchanged, however, it is important to note that in line with Council decision of 25th February 2016 (approval of 2016/17 Treasury Management Strategy), the actual MRP charge to revenue for 2019/20 will be offset by the over provision arising from previous years.

2.4 This report reaffirms the overall Treasury Management Strategy in place and proposes no changes in 2019/20 to the Treasury Management Strategy Statement, Borrowing and Investment Strategies and the Minimum Revenue Provision Policy Statement.

3. Recommendations

3.1 That Council approves;

- i. The Prudential and Treasury Indicators, as set out in the main body of this report and summarised at Appendix 1, numbered 1 to 9;
- ii. The Treasury Management Strategy Statement 2019-20, incorporating the Annual Investment Strategy 2019-20, as set out in the main body of this report, and specifically;
- iii. The Investment Instruments shown at Appendix 2;
- iv. The list of organisations used for the on-lending of surplus funds, shown at Appendix 3, up to the monetary limits stated;
- v. The Minimum Revenue Provision Policy Statement 2019-20 detailed at Appendix 4.

4. Reasons for Recommendations

4.1 Approval of the annual Treasury Management Strategy and Policy Statements cannot be delegated and therefore is required to be approved by Full Council.

5. Impact on other Executive Committees (including Area Committees)

5.1 This report has no impact on other Executive Committees.

6. Introduction

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

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

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

7. Statutory Requirements

7.1 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. These are shown in the report and are summarised in Appendix 1.

7.2 The Act therefore requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included in section 21 of this report); this sets out the Council’s policies for managing its investments and for giving priority to the security and liquidity of those investments as set out in Appendices 2 and 3. The ongoing turbulence in the international financial markets over the last few years highlights the importance of a robust and fully risk assessed strategy.

8. CIPFA Requirements

8.1 The Chartered Institute of Public Finance and Accountancy’s (CIPFA) Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 25 February 2010.

8.2 The five primary requirements of the 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 (stewardship 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.
5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body.

8.3 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. These reports are required to be adequately scrutinised by committee. This role is undertaken by the Finance and Value for Money Overview and Scrutiny Commission.

8.4 Prudential and Treasury Indicators and Treasury Strategy which covers:

- The Council's 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 investments and borrowings are to be organised) including treasury indicators;
- An investment strategy (the parameters on how investments are to be managed).

8.5 A Mid-Year Treasury Management Report – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting its objectives or whether any policies require revision.

8.6 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.

8.7 The Council has adopted the following scheme of delegation and reporting arrangements in accordance with the requirements of the Code:-

Area of Responsibility	**Authority/ Committee/ Officer**	**Frequency**
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Full Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Cabinet	Mid year

Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet	As necessary
Annual Treasury Outturn Report	Cabinet	Annually by 30 September after the end of the year
Treasury Management Monitoring Reports	Director of Finance & Transformation (S151 Officer)	Prudential Indicators to be monitored periodically
Treasury Management Practices	Director of Finance & Transformation (S151 Officer)	Updated on an ongoing basis
Scrutiny of Treasury Management Strategy / Annual Investment Strategy / MRP policy	Finance and Value for Money Overview & Scrutiny Commission	Annually before the start of the year
Scrutiny of treasury management performance	Finance and Value for Money Overview & Scrutiny Commission	At outturn and mid-year monitoring reports

9. Treasury Management Policy Statement 2019-20

9.1 The Treasury Management Policy Statement recommended for adoption defines the policies and objectives of the Council's treasury management activities:

This organisation defines its treasury management activities 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.

- This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage those risks.

- This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

10. Treasury Management Strategy for 2019-20

10.1 The proposed strategy for 2019-20 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 management advisors, Link Asset Services.

10.2 The strategy for 2019-20 covers two main areas:

Capital Issues

- the capital expenditure plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) policy.

Treasury Management Issues

- The current treasury position;
- Treasury indicators which will 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.

10.3 These elements cover the requirements of the Local Government Act 2003, the CIFPA Prudential Code, the Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and the CLG Investment Guidance.

11. The Capital Prudential Indicators 2019-20 – 2021-22

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

11.2 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. Capital expenditure forecasts are summarised in the table below:

Capital Expenditure by Programme Theme	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Adult Services and Public Health	0.089	0.286	0.00	0.00	0.00
Economic Investment, Regeneration and Planning	7.212	9.505	14.758	8.041	3.500
Finance, Land, Property and Change	13.297	14.468	12.812	6.735	2.135
Housing	12.355	7.445	8.776	5.950	3.650
Highways and Transportation	3.315	3.369	0.050	0.300	0.000
Learning, Skills and Safeguarding Children	9.428	5.368	12.009	6.239	4.000
Leisure and Tourism	0.830	1.243	3.750	2.500	1.100
Neighbourhood, Communities and Environment	1.912	2.756	6.230	3.304	1.000
Hull World Class Visitor Destination	48.973	15.908	17.553	11.209	33.936
Other PFI (Extra Care)	57.876	0.000	0.00	0.00	0.00
Other (LGF/Growing Places)	20.161	0.000	0.00	0.00	0.00
Non-HRA	**175.448**	**60.348**	**75.938**	**44.278**	**49.321**
HRA	**46.386**	**39.819**	**51.643**	**53.887**	**51.831**
Total	**221.834**	**100.167**	**127.581**	**98.165**	**101.152**

11.3 The above and below tables include other long term liabilities, such as Private Finance Initiative (PFI) and leasing arrangements which have their own borrowing instruments.

11.4 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.

Capital Expenditure	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Non-HRA	**175.448**	**60.348**	**75.938**	**44.278**	**49.321**
HRA	**46.386**	**39.819**	**51.643**	**53.887**	**51.831**
Total	**221.834**	**100.167**	**127.581**	**98.165**	**101.152**
Financed by:					
Capital receipts	15.687	9.867	10.523	10.188	5.347
Capital grants	57.150	24.789	39.003	29.239	12.998
Capital reserves	27.151	25.972	26.013	26.530	27.166
Revenue	0.416	5.106	2.212	0.200	17.338
Net financing need for the year	**121.430**	**34.433**	**49.830**	**32.008**	**38.303**

12. The Council's Borrowing Need (the Capital Financing Requirement)

12.1 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 above, which has not immediately been paid for, will increase the CFR.

12.2 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

12.3 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases 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 £173 million of such schemes within the CFR.

12.4 The Council is asked to approve the CFR projections below:

	2017/18 Actual £m	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/20 Estimate £m**
Capital Financing Requirement					
CFR – non housing	567.044	587.675	638.476	649.660	662.114
CFR - housing	257.835	245.148	228.748	218.598	216.632
Total CFR	**824.879**	**832.823**	**867.224**	**868.258**	**878.746**
Movement in CFR	**90.415**	**7.944**	**34.401**	**1.034**	**10.488**

Movement in CFR represented by					
Net financing need for the year (above) - General CapEx - PFI liabilities	**121.430**	**34.433**	**49.830**	**32.008**	**38.303**
Less MRP/VRP and other financing movements	31.015	26.489	15.429	30.974	27.815
Movement in CFR	**90.415**	**7.944**	**34.401**	**1.034**	**10.488**

13. Minimum Revenue Provision (MRP) Policy Statement

Proposal

13.1 There are no proposed changes to the Minimum Revenue Provision Policy Statement for 2019/20.

Background

13.2 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. In accordance with proper practice, the financing of such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The Council is therefore 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), which is determined by the Council under guidance.

13.3 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended by Statutory Instrument 2008 no. 414 s4) lay down that:

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

Government Guidance

13.4 The Council is legally obliged to 'have regard' to the guidance issued by CLG, which is intended to enable a more flexible approach to assessing the amount of annual minimum revenue provision (MRP) than was required under the previous statutory requirements. Although it is up to each Council to determine for itself how to calculate MRP, the guidance suggests four methodologies, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits.

13.5 The requirement to 'have regard' to the guidance means that:

- Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.
- It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision after having had regard to the guidance

Method

13.6 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:

- Calculating MRP in accordance with the annuity method over 60 years. The 60 year repayment period is considered a reasonable average assumption for the lives of the assets funded by capital expenditure, as these include assets such as Corporate Buildings and Schools were the life of these assets is expected to extend to 60 years and beyond. This method will ensure the debt is fully repaid.

For capital expenditure incurred from 1 April 2008 for all unsupported borrowing (excluding PFI and finance leases) the MRP Policy will be:

- Asset Life Method – MRP will be calculated in accordance with the annuity method based on the estimated life of the asset, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This method also ensures that the debt is fully repaid at the end of the estimated useful lives of each asset.

13.7 The specified rate of interest used in the annuity calculations will be the average interest rate of the Council's debt as at the end of the year in which the annuity rate is to be applied.

13.8 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.

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

14. Affordability Prudential Indicators

14.1 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.

14.2 The 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.

	2017/18 Actual %	**2018/19 Estimate %**	**2019/20 Estimate %**	**2020/21 Estimate %**	**2021/22 Estimate %**
Non-HRA	2.5	2.9	3.3	4.6	6.1
HRA	31.2	56.4	48.9	59.9	51.3

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

14.3 The incremental impact of capital investment decisions on council tax. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in the budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

Incremental impact of capital investment decisions on the band D council tax

	2017/18 Actual £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
Council tax - band D	4.32	2.58	3.29	8.01	11.67

14.4 The incremental impact of capital investment decisions on housing rent levels. Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels. This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

Incremental impact of capital investment decisions on housing rent levels

	2017/18 Actual £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
Weekly housing rent levels	0.03	0.26	0.58	1.24	2.51

15. Treasury Management Strategy

15.1 The capital expenditure plans set out in Section 11 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 relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

16. Current Portfolio Position

16.1 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.

	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
External Debt					
Borrowing at 1 April	594.904	619.201	621.374	669.141	700.791
Expected change in borrowing	24.297	22.500	47.767	31.650	37.909
Other long-term liabilities (OLTL)	127.132	179.620	173.458	167.113	160.613
Expected change in OLTL	52.488	(6.162)	(6.345)	(6.500)	(6.700)
Actual gross debt at 31 March	**798.821**	**815.159**	**836.254**	**861.404**	**892.613**
CFR – the borrowing need	**824.879**	**832.823**	**867.224**	**868.258**	**878.746**
Over / (under) borrowing	**(26.058)**	**(17.664)**	**(30.970)**	**(6.854)**	**13.867**
Total investments at 1 April	103.274	47.192	50.000	50.000	50.000
Total investments at 31 March	47.192	50.000	50.000	50.000	50.000
Investment change	(56.082)	2.808	0.000	0.000	0.000
Net debt	**751.629**	**765.159**	**786.254**	**811.404**	**842.613**

16.2 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019-20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

16.3 The Director of Finance and Transformation (S151 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 the budget report.

17. Treasury Indicators: Limits to Borrowing Activity

17.1 The Operational Boundary. This is the limit beyond which external borrowing 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	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Borrowing	619.201	621.374	669.141	700.791
Additional Borrowing	22.500	47.767	31.650	37.909
10% Net Budget Requirement	28.640	28.584	29.092	29.998
Other long term liabilities	173.458	167.113	160.613	153.913
Total	**843.799**	**864.838**	**890.496**	**922.611**

17.2 The Authorised Limit for external borrowing. 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 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.

17.3 The Authorised Limit 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.

17.4 The Council is asked to approve the following Authorised Limit:

Authorised limit	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Operational Debt (as above)	843.799	864.838	890.496	922.611
Possible additional borrowing (grants/capital receipts)	34.656	49.526	39.427	18.345
Total	**878.455**	**914.364**	**929.923**	**940.956**

18. Prospect for Interest Rates and Economic Environment

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

18.2 Public Works Loans Board (PWLB) rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

18.3 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 became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank

Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

18.4 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.

18.5 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.

18.6 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..

18.7 Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Brexit – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- Minority government vulnerability.
- US corporate debt negatively impacting profits and cash flow.

18.8 The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates, include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- Brexit if both sides were to agree a compromise that removed all threats of economic and political disruption.

19. Investment and borrowing rates

19.1 Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

19.2 Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have back tracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

19.3 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.

20. Economic Commentary

20.1 The following paragraphs are designed to impart a degree of knowledge around factors impacting on the treasury management function at the Council. This environment is constantly changing, no more so than in recent years. Any significant issues that arise between the report being written and the actual committee date will be reported verbally.

Key Risks - central bank monetary policy measures

20.2 Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

20.3 The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close. A new period Is well advanced in the US, and started more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we have indeed, seen a sharp fall in equity values in the last quarter of 2018.

20.4 It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks. At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and was likely to cause a recession in the US economy.

20.5 The world economy also needs to adjust to a sharp change in liquidity creation over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt, (currently about $50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

UK Economy

20.6 The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

20.7 At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten year time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide a further fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

20.8 It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

20.9 In the political arena, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

Global Economy

20.10 World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the Eurozone, overall world growth is likely to weaken.

20.11 Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

20.12 In the USA President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November, However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the rate and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles, of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world plunging under the weight of fears around the Fed's actions, the trade war between the US and China, an expectation that world growth will slow, Brexit etc.

20.13 Economic growth in the EU was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank has ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend

20.14 Economic growth in China has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

20.15 Japan has been struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

20.16 Emerging countries. Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

21. Borrowing Strategy

21.1 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.

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

- *If it was felt 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 was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the US 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.

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

Treasury Management Limits on Activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position, net of investments.

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates.

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

	2019/20 %	**2020/21 %**	**2021/22 %**
Interest Rate Exposures			
Limits on fixed interest rates based on net debt	90	90	90
Limits on variable interest rates based on net debt	75	75	75

Maturity Structure of interest rate borrowing (fixed and variable) 2019/20		
	Lower %	**Upper %**
Under 12 months	0	35
12 months to 2 years	0	30
2 years to 5 years	0	50
5 years to 10 years	0	75
10 years and above	0	90

22. Policy on Borrowing in Advance of Need

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

22.2 Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

23. Debt Rescheduling

23.1 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).

23.2 The reasons for any rescheduling to take place will include:

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

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

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

24. Municipal Bonds Agency

24.1 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.

25. Other Issues

Capital Strategy

25.1 In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, 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

25.2 The aim of this report is to ensure that all elected members of Council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

25.3 The Capital Strategy allows all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

25.4 The Capital Strategy for 2019/20 to 2021/22 is presented to Council on this agenda.

MIFID II

25.5 As reported to Members as part of the 2017/18 Treasury Management Mid-Year Update Report (Cabinet 27/11/17), the Council has successfully opted up to professional status under the MIFID II reforms, which govern the relationship that financial institutions conducting lending and borrowing transactions have with local authorities from the 3rd January 2018. This has had little effect on the Council and has had no impact on the current Borrowing and Investment Policies.

26. Annual Investment Strategy

Changes to Credit Rating Methodology – Link Asset Services

26.1 The main rating agencies (Fitch, Moody's and Standard & Poor's) have, through much of the financial crisis, provided some institutions with a ratings "uplift" due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies have begun removing these "uplifts" with the timing of the process determined by regulatory progress at the national level. The process has been part of a wider reassessment of methodologies by each of the rating agencies. In addition to the removal of implied support, new methodologies are now taking into account additional factors, such as regulatory capital levels. In some cases, these factors have "netted" each other off, to leave underlying ratings either unchanged or little changed. A consequence of these new methodologies is that they have also lowered the importance of the (Fitch) Support and Viability ratings and have seen the (Moody's) Financial Strength rating withdrawn by the agency.

26.2 In keeping with the agencies' new methodologies, the rating element of our own credit assessment process now focuses solely on the Short and Long Term ratings of an institution. While this is the same process that has always been used for Standard & Poor's, this has been a change in the use of Fitch and Moody's ratings. It is important to stress that the other key elements to our process, namely the assessment of Rating Watch and Outlook information as well as the Credit Default Swap (CDS) overlay have not been changed.

26.3 The evolving regulatory environment, in tandem with the rating agencies' new methodologies also means that sovereign ratings are now of lesser importance in the assessment process. Where through the crisis, clients typically assigned the highest sovereign rating to their criteria, the new regulatory environment is attempting to break the link between sovereign support and domestic financial institutions. This is in relation to the fact that the underlying domestic and where appropriate, international, economic and wider political and social background will still have an influence on the ratings of a financial institution.

26.4 It is important to stress that these rating agency changes do not reflect any changes in the underlying status or credit quality of the institution. They are merely reflective of a reassessment of rating agency methodologies in light of enacted and future expected changes to the regulatory environment in which financial institutions operate. While some banks have received lower credit ratings as a result of these changes, this does not mean that they are suddenly less credit worthy than they were formerly. Rather, in the majority of cases, this mainly reflects the fact that implied sovereign government support has effectively been withdrawn from banks. They are now expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, in many cases, the balance sheets of banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the "support" phase of the financial crisis.

Investment Policy

26.5 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments (the Guidance) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (the CIPFA TM Code). The Council's investment priorities will be security first, portfolio liquidity second, then return (yield).

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

26.7 Continuing regulatory changes in the banking sector are designed to see greater stability, lower risk and the removal of expectations of Government financial support should an institution fail. This withdrawal of implied sovereign support is anticipated to have an effect on ratings applied to institutions. This will result in the key ratings used to monitor counterparties being the Short Term and Long Term ratings only. Viability, Financial Strength and Support Ratings previously applied will effectively become redundant. This change does not reflect deterioration in the credit environment but rather a change of method in response to regulatory changes.

26.8 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is fully integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour codings which show the varying degrees of suggested creditworthiness.

26.9 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.

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

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

26.12 The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments;
- The principles to be used to determine the maximum periods for which funds can be committed;
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.

26.13 The investment instruments identified for use in the financial year 2019-20 are set out at Appendix 2 under the 'Specified' and 'Non-Specified' Investments categories. Organisations to which the Council will lend and associated counterparty limits are detailed at Appendix 3.

Creditworthiness Policy

26.14 The Council applies the creditworthiness service provided by Link Asset Services. This service employs sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moodys and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
- Sovereign ratings to select counterparties from only the most creditworthy countries.

26.15 Credit Default Swap (CDS) is a contract between two counterparties, which basically gives protection, or insurance, in case of credit default. The payments involved in the contract are based on a spread currently traded in the market. The spread of CDS indicates the market perception of the likelihood of a credit event or default occurring. The higher the spread the more likely the market considers an event of default will occur.

26.16 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Blue 1 year (only applies to nationalised or semi-nationalised UK banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

26.17 Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

26.18 Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

26.19 All credit ratings will be monitored on a weekly basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service.

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

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

26.20 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that supporting government.

26.21 If financial institutions are upgraded in rating and therefore meet the Council's criteria as defined, then committee approval will be sought prior to inclusion on the counterparty list.

Country Limits

26.22 The Council has determined that it will only use approved counterparties from the UK only.

Investment Counterparty Selection Criteria

26.23 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.

26.24 The Director of Finance and Transformation 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.

26.25 The minimum rating criteria use the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, then the institution will fall outside the lending criteria. This is in compliance with a CIPFA Treasury Management Panel recommendation in March 2009 and the CIPFA Treasury Management Code of Practice.

26.26 Credit rating information is supplied by Link Asset Services, the Council's treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be considered for suspension from use, with all others being reviewed in light of market conditions.

26.27 On occasions ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest.

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

- Banks 1 – a good credit quality – the Council will only use banks/building societies which
  are UK banks only and have, as a minimum, the following Fitch credit ratings:

- Banks 1 – a good credit quality – the Council will only use banks which hold a minimum rating of:
    - Short term – F1
    - Long term – A-

- Banks 2 – part nationalised UK bank – Royal Bank of Scotland. This bank can be included if it continues to be part nationalised or it meets the rating in Banks 1 above.

- Banks 3 – The Council's own banker (Natwest Bank) 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 operation – The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building societies – The Council will use all societies which meet the ratings for banks as outlined above.

- Money Market Funds – AAA rating.

- Enhanced Money Market Funds – AAA rating.

- UK Government (DMADF)

- Local authorities.

Group Considerations

26.29 Due care will be taken will be taken to consider the group exposure of the Council's investments. In addition limits in place above will apply to a group of companies.

Use of Additional Information other than Credit Ratings

26.30 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

26.31 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover specified and non-specified investments):

	Fitch Long Term Rating (minimum)	*Fitch Short Term Rating (minimum)*	*Money Limit*	*Time Limit*
Banks 1 category high quality	AA-	F1+	£15 million	1 yr
Banks 1 category medium quality	A	F1	£7.5 million	1 yr
Banks 1 category lower quality	A-	F1	£5 million	1 yr
Banks 2 category – part nationalised – high quality	AA-	F1+	£20 million	1 yr
Banks 2 category – part nationalised – medium quality	A	F1	£10 million	1 yr
Banks 2 category – part nationalised – low quality	A-	F1	£7.5 million	1 yr
Limit 3 category – Council's banker (not meeting Banks 1)	N/A	N/A	£2.5 million	1 day
UK Government (DMADF)	N/A	N/A	Unlimited	6 mths
Local authorities	N/A	N/A	£15 million	1 yr
Money Market Funds	AAA		£15 million	liquid

26.32 The proposed criteria for Specified and Non-Specified investments are shown in Appendix 3 for approval.

27. Investment Strategy

In House Funds

27.1 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).

Investment Returns Expectations

27.2 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 1.25%
- 2021/22 2.00%

27.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

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

27.4 The overall balance of risks to economic growth in the UK is probably neutral.

27.5 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

27.6 Total principal funds invested for greater than 364 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.

27.7 The Council is asked to approved the treasury indicator and limit:

Maximum principal sums invested > 364 days			
	2019/20 £m	**2020/21 £m**	**2021/22 £m**
Principal sums invested > 364 days	0	0	0

27.8 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

End of Year Investment Report

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

Policy on the use of External Service Providers

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

27.11 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. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

27.12 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.

Training

27.13 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. Members attended a recent Treasury Management update session, provided by the Director of Finance and Transformation and Council's Principal Treasury Officer, in November 2017. Training requirements will be continually assessed and further training will be arranged as required.

27.14 The training needs of treasury management officers are periodically reviewed.

The Treasury Management role of the Section 151 Officer

27.15 The Director of Finance and Transformation (S151 Officer) will be responsible for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money

27.16 The responsibilities of the Director of Finance and Transformation (S151 Officer) has developed with the revision to the Treasury Management Code of Practice and Prudential Indicators in December 2017, which extends the definition of treasury management and investments to include non-financial assets (non-treasury investments).

28. Options and Risk Assessment

28.1 Although the content and criteria stated in the Treasury Management Strategy are statutory requirements, there are some options available to the Council in how this is managed, in terms of the following:

- Investment Options – alternative investment products, counterparties, limits and durations.
- Prudential Indicators – alternative limits for certain indicators, i.e. debt maturity profile, interest rate exposure.
- Minimum Revenue Provision – alternative options for the revenue charge.

28.2 The options proposed are based on the Council investing surplus monies with low risk counterparties in line with the Council's low risk appetite. This provides the Council with adequate liquidity and security of funds before considering investment return.

29. Risk Assessment

29.1 The main risks surrounding the Council's Treasury operations, mitigated through the Treasury Management Strategy and Investment Policy, are as follows:

- Prudential Indicator limits are breached – set and approved locally and regularly monitored as part of ongoing Treasury Management activity.
- Investments lost due to the inability of a Bank or Building Society to repay the loan – key criteria as part of the Creditworthiness Policy which ensures investments are made with only high credit quality counterparties for set durations.
- Too cautious an approach to investments could result in lower investment income being achieved – Investment Policy provides flexibility to use other non-specific investment products if it is considered prudent.

30. Consultation

30.1 This report requires no further consultation.

31. Comments of the Town Clerk (Monitoring Officer)

31.1 The Council's Treasury Management activities are regulated under the Local Government Act 2003 (the Act) and regulations issued pursuant to the Act which provide the powers to borrow as well as providing controls and limits on capital finance and accounts.

31.2 S15 of the Act requires the Council to have regard to guidance issued by the Secretary of State together with such other guidance as the Secretary of State may by regulations specify, this includes the Prudential Code for Capital Finance in Local Authorities published by CIPFA when determining their affordable borrowing limit and Government Guidance upon making the Minimum Revenue Provision which they consider to be prudent, in respect of the financing of capital expenditure incurred in that and previous years.

31.3 Government guidance in relation to the Minimum Revenue Provision references what are described as "ready-made" options but makes clear: "other approaches are not meant to be ruled out, provided that they are fully consistent with the statutory duty to make prudent revenue provision. Authorities must always have regard to the guidance, but having done so, may in some cases consider that a more individually designed MRP approach is justified. That could involve taking account of detailed local circumstances, including specific project timescales and revenue-earning profiles."

32. Comments of the Section 151 Officer

32.1 The Director of Finance and Transformation (S151 Officer) is the author of the report.

33. Comments of the HR City Manager and Compliance with the Equality Duty

33.1 There are no staffing or equality issues arising from the report.

34. Comments of Overview and Scrutiny

34.1 This report will be considered at the Finance and Value for Money Overview and Scrutiny Budget meeting on Friday, 25 January, 2019. Any comments or recommendations made by the Commission will be tabled at Cabinet. (Ref. Sc5181)

35. Comments of the Portfolio Holder for Strategic Finance

35.1 There are a number of ongoing external pressures that could influence the Council's future finances, one being an increase in interest rates, another being inflationary pressures and thirdly uncertainty around Brexit and the value of the pound. That being said at the moment the Council's borrowing is under control but I would add that any opportunity to reschedule debt in cooperation with our financial advisors should be taken.

David Bell
Director of Finance and Transformation (S151 Officer)

Background Documents:	CIPFA Prudential Code and Treasury Management Code of Practice (2011 Edition) Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 Guidance on Minimum Revenue Provision issued by DCLG – Feb 2008
Officer Interest	None
Contact Officer:	David Bell/Mike Armstrong
Telephone No.:	613084/613282

Implications Matrix

I have informed and sought advice from HR, Legal, Finance, Overview and Scrutiny and the Climate Change Advisor and any other key stakeholders i.e. Portfolio Holder, relevant Ward Members etc prior to submitting this report for official comments	Yes
I have considered whether this report requests a decision that is outside the Budget and Policy Framework approved by Council	Yes
Value for money considerations have been accounted for within the report	Yes
The report is approved by the relevant City Manager	Yes
I have included any procurement/commercial issues/implications within the report	n/a
I have considered the potential media interest in this report and liaised with the Media Team to ensure that they are briefed to respond to media interest.	Yes
I have included any equalities and diversity implications within the report and where necessary I have completed an Equalities Impact Assessment and the outcomes are included within the report	There are no equality and diversity implications within this report.
Any Health and Safety implications are included within the report	n/a
Any human rights implications are included within the report	There are no human rights implications within this report.
I have included any community safety implications and paid regard to Section 17 of the Crime and Disorder Act within the report	n/a
I have liaised with the Climate Change Advisor and any environmental and climate change issues/sustainability implications are included within the report	n/a
I have included information about how this report contributes to the City Plan/ Area priorities within the report	n/a

Appendix 1

Prudential and Treasury Indicators

1. Prudential and Treasury Indicators

1.1 The following show the proposed Prudential and Treasury Indicators referred to in section six of the main report

1.2 Affordability of Capital Plans

(a) Indicator 1 – Capital Expenditure

“The local authority will make reasonable estimates of the total capital expenditure that it plans to incur during the forthcoming financial year and at least the following two financial years. These prudential indicators will be referred to as estimates of capital expenditure and shall be expressed in the following manner:

Estimate of total capital expenditure to be incurred in years 1, 2 and 3 (and 4 etc if applicable)” (paragraph 47 of the code)

This details the Council’s capital spending plans over the next 3 years and reports on the outturn from the previous financial year. These estimates are in line with the General Fund, HRA and Capital Strategy Reports to be considered by Council on 28 February 2019. There is no subjectivity to this indicator.

	2017/18	**2018/19**	**2019/20**	**2020/21**	**2021/22**
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Non-HRA	175.448	60.348	75.938	44.278	49.321
HRA	46.386	39.819	51.643	53.887	51.831
Total	**221.834**	**100.167**	**127.581**	**98.165**	**101.152**

(b) Indicator 2 – Ratio of Financing Costs to Net Revenue Stream

“The local authority will estimate for the forthcoming financial year and the following two financial years the ratio of financing costs to net revenue stream. This prudential indicator shall be referred to as estimates of the ratio of financing costs to net revenue stream and shall be expressed in the following manner:

Estimates of financing costs / estimate of net revenue stream * 100 %

For years 1, 2 and 3“(paragraph 38 of the code)

Shows the revenue costs (the capital financing costs less investment income earned) associated with funding previous and future capital spending, as a percentage of total revenue spending. Again, as in the previous indicator, these estimates are in line with the General Fund, HRA and Capital Strategy Reports to be considered by Council on 28 February 2019. There is no subjectivity to this indicator.

	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	Estimate	Estimate	Estimate	Estimate
	%	%	%	%	%
Non-HRA	2.5	2.9	3.3	4.6	6.1
HRA	31.2	56.4	48.9	59.9	51.3

(c) Indicator 3 – Capital Financing Requirement

“The local authority will make reasonable estimates of the total of the capital financing requirement at the end of the forthcoming financial year and the following two years. These prudential indicators will be referred to as the estimates of capital financing requirement and shall be expressed as follows:

Estimate of capital financing requirements as at the end of years 1, 2 and 3” (paragraph 50 of the code)

The Capital Financing Requirement measures the Council’s underlying need to borrow for a capital purpose i.e. that element of previous and proposed capital spending which has been/will be funded from borrowing. In order to ensure borrowing is maintained within sustainable limits, the Prudential Code requires that net external borrowing does not exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. The Director of Finance and Transformation (S151 Officer) can confirm that this requirement will be met.

	2019/20	2020/21	2021/22
	Estimate	Estimate	Estimate
	£m	£m	£m
Non-HRA	638.476	649.660	662.114
HRA	228.748	218.598	216.632
CFR Total	**867.224**	**868.258**	**878.746**
Borrowing	**836.254**	**861.404**	**892.613**

(d) Indicator 4 – Incremental impact of Capital Investment Decisions on Council Tax and Housing Rents

“The local authority will forecast the total budgetary requirements for the authority arising from proposed changes to the capital programme and calculate the addition or reduction to the council tax/housing rents that would result.

This calculation shall be undertaken for the forthcoming year and the following two financial years or longer timeframe if required to capture the full effect of capital investment decisions on the council tax/housing rents.

This prudential indicator will be referred to as estimates of the impact of the new capital investment decisions on the council tax/average weekly housing rents, and shall be expressed in the following manner:

£xx.xx (Paragraph 39 of the code)

The indicator seeks to demonstrate the additional costs, to be funded from the Council Tax and Housing Rents, of the Council's capital spending plans.

Again, these estimates are in line with the General Fund, HRA and Capital Strategy Reports to be considered by Council on 28th February 2019.

	2019/20	**2020/21**	**2021/22**
	Estimate	**Estimate**	**Estimate**
	£	**£**	**£**
Non-HRA (Council Tax)	3.29	8.01	11.67
HRA (average weekly rent)	0.58	1.24	2.51

1.3 Treasury Management

(a) Acceptance of the CIPFA TM Code

The Council formally adopted the CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes on 25th February 2010.

(b) Indicator 5 – Authorised Limit for External Debt

"The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, excluding investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the authorised limit and shall be expressed in the following manner:

Authorised limit for external debt = authorised limit for borrowing + authorised limit for other long term liabilities

For years 1, 2 and 3." (Paragraph 54 of the code)

With regard to external debt the Council is required to identify limits consistent with the Revenue Budget and Capital Programme. The Authorised Limit is based on a prudent, but not worse case scenario, with additional headroom to allow for unusual cash movements. The authorised limit will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003.

The indicator is calculated by taking the results from indicator six, Operational boundary for external debt, plus the amount of capital spend forecast to be financed from grants and capital receipts. This would cover the unlikely event of contractually committed spend not being financed from grants/contributions and/or capital receipts as planned and having to be financed from borrowing.

	2018/19	2019/20	2020/21	2021/22
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**
Operational debt indicator (indicator 6)	843.799	864.838	890.496	922.611
Possible additional capital spend financed from borrowing (grants/receipts not received)	34.656	49.526	39.427	18.345
Total Amount	**878.455**	**914.364**	**929.923**	**940.956**
Rounded for indicator	**878.000**	**914.000**	**930.000**	**941.000**

(c) Indicator 6 – Operational Boundary for External Debt

"The local authority will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long term liabilities. This prudential indicator will be referred to as the operational boundary and shall be expressed in the following manner:

Operational boundary for external debt = operational boundary for borrowing + operational boundary for other long term liabilities.

For years 1, 2 and 3." (Paragraph 55 of the code)

The Operational Boundary for external debt is based on the same estimates which underpin the Authorised Limit but does not include the additional headroom included within the Authorised Limit. The Operational Boundary provides an important tool for in year monitoring.

The code goes on to say "It will probably not be significant if the operational boundary is breached temporarily on occasions due to variations in cashflow. However, a sustained or regular trend above the operational boundary would be significant and should lead to further investigation and action as appropriate"

The Operational Limit for external debt has been calculated as the current amount of debt, plus additional borrowing, plus ten per cent of the year's net revenue budget for cash flow purposes in the event of expenditure being higher than income at points during the year.

	2018/19	2019/20	2020/21	2021/22
	Estimate	**Estimate**	**Estimate**	**Estimate**
	£m	**£m**	**£m**	**£m**
Debt	619.201	621.374	669.141	700.791
Additional borrowing	22.500	47.767	31.650	37.909
10% Net budget requirement	28.640	28.584	29.092	29.998
Other liabilities	173.458	167.113	160.613	153.913
Calculated Operational Limit	**843.799**	**864.838**	**890.496**	**922.611**

The Council's actual external debt at 31 March 2018 was £799 million, and is forecast to be £815 million at the 31 March 2019, all of which related to borrowing for capital purposes.

(d) Indicator 7 – Fixed and Variable Rate Exposure

"**The local authority will set for the forthcoming financial year and the following two financial years upper limits to its exposure to the effects of changes in interest rates. These prudential indicators will relate to both fixed interest rates and variable interest rates and be referred to respectively as the upper limits on fixed interest rates and variable interest rate exposures.**

The upper limits on fixed interest rates and variable interest rates exposures may be expressed either as absolute amounts or as percentages. They may be related either to the authority's net interest on, or to its net principal sum outstanding on, its borrowings/investments." (Paragraph 67 and 68)

The indicator seeks to ensure that the Council limits its exposure to the risk of interest rate changes and the consequent impact on the investment income and interest payments on loans, by restricting the proportion of variable rate borrowing.

	2018/19 Estimate	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	%	**%**	**%**	**%**
Limits on fixed interest rates based on net debt – Upper Limit	90	90	90	90
Limits on variable interest rates based on net debt – Upper Limit	75	75	75	75

(e) Indicator 8 – Upper and Lower Limits for the maturity structure of borrowings

"The local authority will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowings. The prudential indicators will be referred to as the upper and lower limits respectively for the maturity structure of borrowing and shall be calculated as follows:

Amount of projected borrowing that is fixed and variable rate maturing in each period expressed as a percentage of total projected borrowing that is fixed and variable rate.

Where the periods in question are

- **Under 12 months**
- **12 months and within 24 months**
- **24 months and within 5 years**
- **5 years and within 10 years**
- **10 years and above"**

(paragraph 74 of the code)

The indicator also seeks to ensure the Council controls its exposure to the risk of interest rate changes by limiting the proportion of debt maturing in any single period. Ordinarily debt is replaced on maturity and therefore it is important that the Council is not forced to replace a large proportion of loans at a time of relatively high interest rates.

	Upper Limit	**Lower Limit**
	%	**%**
Under 12 Months	35	0
12 months and within 24 months	30	0
24 months and within 5 years	50	0
5 years and within 10 years	75	0
10 years and above	90	0

(f) Indicator 9 – Upper limit for maturity structure of investments

"Where a local authority invests, or plans to invest, for periods longer than 364 days, the local authority will set an upper limit for each forward financial year period for the maturing of such investments. These prudential indicators will be referred to as prudential limits for principal sums invested for periods longer than 364 days and shall be calculated as follows:

Total principal invested to final maturities beyond the period end."
(paragraph 77 of the code)

Under the Prudential Regime Councils are free to invest for periods of greater than 1 year. This indicator sets restrictions on the proportion of investments committed for longer periods in order to limit the risks associated with being unable to meet unexpected cash flows and/or being able to take advantage of future increases in interest rates.

	Upper Limit
	%
Under 12 Months	100
12 months and within 24 months	25
24 months and within 3 years	20
3 years and within 4 years	15
4 years and within 5 years	10
5 years and above	10

Appendix 2

Credit and Counterparty Risk Management – Specified and Non-Specified Investments and Limits (Treasury Management Practice (TMP1))

1. Specified and Non-Specified Investments

1.1 Specified investments are investments denominated in sterling, do not exceed 364 days in term, do not involve the acquisition of share or loan capital, are made with the UK Government or a local authority, or with a body or investment scheme meeting the minimum 'high' credit quality criteria where applicable. Non-specified investments are anything that does not satisfy the specified investment criteria, i.e. investments with a maturity of greater than 1 year.

1.2 Importantly the acquisition of share capital or loan capital in any body corporate is defined as capital expenditure under Section 16(2) of the Local Government Act 2003. Such investments will have to be funded out of capital or revenue resources and will be classified as 'non-specified investments'. As a result no such investment instruments, such as equities, are included within this Appendix.

Specified Investments

	Minimum 'High' Credit Criteria	Use
Term deposits – banks	Short-term F1, Long-term A-	In-house
Term deposits – building societies	Short-term F1, Long-term A-	In-house
Term deposits – local authorities	--	In-house
Term deposits – UK part nationalised banks	Short-term F1, Long-term A-	In-house
UK Government support to the banking sector	UK Sovereign Rating	In-house
Debt Management Agency Deposit Facility (DMADF)– UK Government	UK Sovereign Rating	In-house
Money Market Funds	AAA	In-house

1.3 The original list of banks covered when the support package was initially announced was:

- Abbey (now part of Santander)
- Barclays
- HBOS (now part of Lloyds Group)
- Lloyds TSB
- HSBC
- Nationwide Building Society
- RBS
- Standard Chartered

1.4 Banks eligible for support under the UK bail-out package and which have issued debt guaranteed by the Government are eligible for a continuing Government guarantee when debt issues originally issued and guaranteed by the Government mature and are refinanced. However, no other institutions can make use of this support as it closed to new issues and entrants on 28.2.10. The banks which have used this explicit guarantee are as follows:

- Bank of Scotland
- Barclays
- Clydesdale
- Coventry Building Society
- Investec bank
- Nationwide Building Society
- Rothschild Continuation Finance plc
- Standard Life bank
- Tesco Personal Finance plc
- Royal Bank of Scotland
- West Bromwich Building Society
- Yorkshire Building Society

1.5 Accounting treatment of investments – the accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, Treasury Officers in consultation with Link Asset Services will review the accounting implications of any new transactions before they are undertaken.

Non-specified Investments

Maturities of ANY period (not applicable for 2019-20 Investment Strategy)

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits with unrated counterparties	Market Capitalisation above £500 million	In-house	Nil - no longer applicable	Nil – no longer applicable

Maturities in excess of 1 year (not applicable for 2019-20 Investment Strategy)

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Term deposits – banks	Short-term F1, Long-term A+	In-house	Nil - no longer applicable	Nil - no longer applicable
Term deposits – local authorities	--	In-house	Nil - no longer applicable	Nil - no longer applicable

Appendix 3

Approved Organisations for on-lending of Surplus Funds

Note – the organisations listed below currently meet the specified criteria as per the Investment Policy of the above report, section 26.31 refers.

UK Banks (Maximum Investment Period of up to 1 year)

	Approved Investment Limit (max)	Proposed Investment Limit (max)	Current Investment Limit **
Santander UK plc	£15 million	£15 million	Nil
Barclays Bank plc	£15 million	£15 million	£7.5 million
Clydesdale Bank (trading as Yorkshire Bank)	£15 million	£15 million	Nil
HSBC Bank plc	£15 million	£15 million	£15 million
Lloyds Banking Group inc: * Lloyds TSB Bank plc Bank of Scotland plc	£20 million	£20 million	£10 million
Royal Bank of Scotland Group inc: * Royal Bank of Scotland NatWest Bank plc Ulster Bank Ltd	£20 million	£20 million	£2.5 million

Note * - The higher limits are based on Lloyds and RBS being part-nationalised therefore carrying additional UK Government security (section 26.31 refers).

Note **: The current investment limits above reflect the action taken as per the creditworthiness criteria included in the Investment Policy stated at paragraph 26.31 in the above report. Current investment limits have been reduced due the previous wholescale downgrade of ratings of some of the above organisations.

UK Building Societies (Maximum Investment Period of up to 1 year)

	Approved Investment Limit (max)	Proposed Investment Limit (max)	Current Investment Limit **
Nationwide Building Society	£15 million	£15 million	£7.5 million
Coventry Building Society	£15 million	£15 million	£7.5 million
Leeds Building Society	£15 million	£15 million	£5 million
Skipton Building Society	£15 million	£15 million	£5 million
Yorkshire Building Society	£15 million	£15 million	£5 million

Other (Maximum Investment Period of up to 1 year)

	Approved Investment Limit (max)	Proposed Investment Limit (max)	Current Investment Limit
Any Local Authority	£15 million (each)	£15 million (each)	£15 million (each)
Debt Management Agency Deposit Facility (DMADF) ***	Unlimited	Unlimited	Unlimited
Money Market Funds	£15 million (each)	£15 million (each)	£15 million (each)

Note *** - The unlimited investment limit for the DMADF is based on the current uncertainties within the banking sector, and if further bank failures occur, this account would provide for the security of the Council's cash surpluses.

Appendix 4

Minimum Revenue Provision (Repayment of Debt) Policy Statement 2019-20

1. What is Minimum Revenue Provision?

1.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. In accordance with proper practice, the financing of such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual charge known as Minimum Revenue Provision (MRP), which is determined by the Council under guidance.

2. Statutory duty

2.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (as amended by Statutory Instrument 2008 no. 414 s4) lay down that:

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

3. Government guidance

3.1 Along with the above duty, the Government issued guidance which came into force on 31 March 2008 which requires that a Statement on the Council'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.

3.2 The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. Although it is up to each Council to determine for itself how to calculate its MRP, the guidance suggests four methodologies, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that:

- Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

- It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

4. Method

4.1 The Policy to be adopted for 2019/20 incorporates the following methods;

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

Calculating MRP in accordance with the annuity method over 60 years. The 60 year repayment period is considered a reasonable average assumption for the lives of the assets funded by capital expenditure. This method will ensure the debt is fully repaid after 60 years, which was not the case under the existing method.

4.1.2 For capital expenditure incurred from 1 April 2008 for all unsupported borrowing (excluding PFI and finance leases) the MRP Policy will be:

Asset Life Method – MRP will be calculated in accordance with the annuity method based on the estimated life of the asset, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction), using the annuity method. This method also ensures that the debt is fully repaid at the end of the estimated useful lives of each asset.

4.1.3 The specified rate of interest will be the average interest rate of the Council's debt as at the end of the year in which the annuity rate is to be applied.

Appendix 5

Summary of the Report Content

1. Background

1.1 The scope and content of the Treasury Management Strategy Statement report are in line with the requirements of the Treasury Management Code of Practice and the Prudential Code for Capital Finance, and therefore the report is more detailed than standard committee reports.

1.2 The scope and content of the Treasury Management Strategy Statement report is also consistent with previous reports submitted to Members, in line with the reporting requirements stated within the Strategy Statement, and is consistent with the Treasury Management reports of other Local Authorities.

1.3 Members are provided with 3 reports on an annual basis as follows:

- Treasury Strategy Statement (this report)
- A Mid-Year Treasury Management Report – update on progress of capital position and Prudential Indicators
- An Annual Treasury Management Report – actual Prudential Indicators and actual treasury operations as compared to estimates.

2. Main Content of Report and Key Areas for Consideration

2.1 The report covers the following key areas of Treasury Management:

- Investment Strategy
- Prudential and Treasury Indicators
- Minimum Revenue Provision Policy Statement

3. Investment Strategy

3.1 The Investment Strategy provides clear criteria as to creation of the Council's approved lending list and selection of counterparties to be included.

3.2 The criterion covers investment limits and duration of investment.

3.3 The Strategy covers the Council's creditworthiness policy, stating how the Council monitors the approved list of counterparties.

4. Prudential and Treasury Indicators

4.1 These indicators cover an assessment of the affordability of the Council's capital plans and the impact of these plans on the General Fund and HRA revenue budgets. They also set limits on the amount of borrowing the Council can undertake and the structure of the Council's debt portfolio in terms of type of debt held and maturity periods.

4.2 These indicators are set for the forthcoming financial year and subsequent 2 years, and are in line with the Council's Budget Report and Medium Term Financial Plan.

5. Minimum Revenue Provision Policy Statement

5.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year through a revenue charge – the minimum revenue provision (MRP). The provision (revenue charge) is in respect of capital expenditure financed from borrowing. The MRP statement provides the basis in which this is done.

5.2 There are options available to the Council in how the revenue charge is derived, so long as the there is a prudent provision. The options recommended for approval are based on the ones which have the least impact on the revenue budget in each year.

6. Options Available

6.1 Although the content and criteria stated in the Treasury Management Strategy are statutory requirements, there are some options available to the Council in how this is managed, in terms of the following:

- Investment Options – alternative investment products, counterparties, limits and durations.
- Prudential Indicators – alternative limits for certain indicators, i.e. debt maturity profile, interest rate exposure.
- Minimum Revenue Provision – alternative options for the revenue charge.

6.2 The options proposed are based on the Council investing surplus monies with low risk counterparties in line with the Council's low risk appetite. This provides the Council with adequate liquidity and security of funds before considering investment return.

7. Member Training

7.1 It is a requirement of the Code that all officers and members with the responsibility for treasury management receive adequate training. Members last attended a Treasury Management update session in November 2017.

7.2 The Council's Treasury advisors, Link Asset Services, Treasury Solutions, are also able to provide the required training as part of their advisory contract with the Council.

8. Conclusion

8.1 The Treasury Management Strategy Statement (including Prudential Indicators) is linked to and underpins the annual General Fund and HRA Revenue Budget Setting Report and Capital Strategy, and is therefore not subjective.

8.2 The other important element of the Treasury Management Strategy Statement is in relation to the borrowing and investment objectives which must be robust and satisfy the Council’s priorities and risk appetite.

Appendix 6

GLOSSARY OF TERMS

Base Rate	Minimum lending rate of a bank or financial institution in the UK determined by the Bank of England.
Basis Point	$1/100^{th}$ of 1%, i.e. 0.01%.
Call Account	Deposits/investments placed with a bank or other financial institutions which are available immediately, i.e. no advance notice is required.
Capital Expenditure	Expenditure on the acquisition of fixed assets which has a long term value to the Council (e.g. the purchase of land, erection of buildings), or expenditure that adds to the value of these assets and not just maintains their existing value.
Capital Financing Requirement (CFR)	The total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. This is the cumulative total of the Council's borrowing need.
Capital Grants	Monies provided to local authorities, usually from Government departments, for capital expenditure only.
Capital Receipts	These are proceeds from the sale of capital assets such as land or property. These receipts can be used to fund the capital programme but are not available to support the Revenue Budget.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender or borrower). In the Council's case this generally relates to a bank or building society.
Credit Default Swap	This provides protection (insurance) to a financial institution following a loan or investment against any potential default, i.e. protection against non-repayment of loan or investment.
Credit Outlook	A formal indication by a credit rating agency that it anticipates a change in a particular credit rating of a bank or other financial institution at some time in the foreseeable future.
Credit Rating	An assessment of the creditworthiness of a bank or other financial institution, made by a credit rating agency, i.e. Fitch, Moody's and Standard & Poor's.
Credit Rating Agency	Independent organisations that assess the credit quality of corporate and government debt. The main agencies are Moody's, Standard & Poor's and Fitch.
Credit Watch	Attached to a bank or other financial institution in which a downgrading or upgrading of the credit rating could be imminent.
Creditworthiness	A measure of the ability and the willingness of a bank or other financial institution to honour their financial obligations.

Debt Cap	A limit set on the council housing borrowing requirement for each local authority.
Debt Rescheduling	Refinancing of current debt/loans to generate revenue savings if rates are favourable.
Investment Instrument	Investment options available to local authorities, i.e. fixed term deposits, notice accounts.
Liquidity	The ability to convert an asset (investment) easily into cash quickly without affecting the asset's price or value.
Maturity	The end date of a loan, borrowing, investment or other form of capital financing.
Minimum Revenue Provision (MRP)	Local authorities are required each year to set aside some of their revenues as provision for debt repayment. The provision (revenue charge) is in respect of capital expenditure financed by borrowing.
Money Market	Consists of financial institutions (e.g. banks and building societies) and dealers in money and credit.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.
Non-Specified Investments	Anything that does not satisfy the specific investment criteria, i.e. investments with a term of greater than 1 year.
Notice Account	Deposits/investments placed with a bank or other financial institutions which are available at notice, i.e. 15/30 day notice to withdraw is required.
PFI	Private Finance Initiative – a Government initiative in which private sector companies usually design, build and operate a public facility for a set period of time, often 25 years.
Prudential and Treasury Indicators *(see below for description of each indicator)*	As required by The Prudential Code, requires local authorities to self-regulate the affordability, prudence and sustainability of their capital plans, buy setting estimates and limits, and publishing actuals, for a range of indicators.
Prudential Borrowing	Permissible borrowing within defined affordable limits.
Prudential Code (CIPFA)	Local Authorities determine their own programmes of capital investment in fixed assets that are central to the delivery of quality local public services. The Prudential Code has been developed as a professional code of practice to support them in taking these decisions. The Prudential Code underpins the overall system of capital finance. The objectives of the Prudential Code are to ensure, within a clear framework, that

	the capital investment plans of local authorities are affordable, prudent and sustainable.
PWLB	Public Works Loans Board – a statutory body operating within the Debt Management Office of the HM Treasury and is responsible for lending money to local authorities and other prescribed bodies.
Risk Appetite	The level of risk Local Authorities wish to take in the lending of surplus monies. The Council operates a low risk appetite, i.e. only investing with low risk counterparties, where the security and liquidity of cash are more important than yield (return).
Specified Investments	Investments that are made in sterling, do not exceed 364 days in term, do not involve the acquisition of share or loan capital, are made with the UK Government or a local authority, or with a financial institution and meet the minimum credit criteria.
Treasury Management Code of Practice (CIPFA)	Provides Local Authorities with standards and guidance to support and underpin their overall Treasury Management activities.
Yield (Return)	The return on an investor's capital investment. The higher the yield the higher the risk of the capital invested.

Prudential and Treasury Indicators	
Affordability of Capital Plans:	
Indicator 1 – Capital Expenditure	This details the Council's approved capital spending plans for the next 3 years and reports on the outturn from the previous financial year. These estimates are reporting decisions agreed previously in the Capital Programme report, and therefore there is no subjectivity to this indicator.
Indicator 2 - Ratio of Financing Costs to Net Review Stream	This shows the revenue costs (the capital financing costs less investment income earned) as a percentage of the total revenue budget. There is a separate calculation for the General Fund and the HRA. Again, these estimates have been agreed by Committee through the Revenue Budget setting report or in the Medium Term Financial Strategy.
Indicator 3 – Capital Financing Requirement (CFR)	The CFR measures the Council's overall borrowing requirement for capital purposes, i.e. that element of previous and proposed capital spending which has been/will be funded from borrowing. The Prudential Code requires that net external borrowing does not exceed the CFR.
Indicator 4 – Incremental Impact of Capital Investment Decisions on Council Tax and Housing Rents	This indicator seeks to demonstrate the additional costs, to be funded from the Council Tax and Housing Rent of the Council's capital spending plans, i.e. the capital plans to be funded from borrowing. These estimates are in line with the General Fund and HRA Revenue Budget setting reports.

Treasury Management	
Indicator 5 – Authorised Limit for External Debt	The Council is required to set external borrowing limits consistent with the Revenue Budget and Capital Programme. The Authorised Limit is based on a prudent limit, with additional headroom to allow for unusual cash movements.
Indicator 6 – Operational Boundary for External Debt	The Operational Boundary is based on the same estimates as the Authorised Limit, but does not include any additional headroom. The Operational Boundary is the current debt plus additional planned borrowing, plus 10% of next year's revenue budget for cash flow purposes.
Indicator 7 – Fixed and Variable Interest Rate Exposure	This indicator seeks to ensure that the Council limits its exposure to the risk of interest rate changes and the subsequent impact of such changes on the interest payments on loans (a revenue expense), by restricting the proportion of variable rate borrowing.
Indicator 8 – Upper and Lower Limits for the maturity structure of borrowings	This indicator also seeks to ensure the Council controls its exposure to the risk of interest rate changes by limiting the proportion of debt due to be repaid in any one year. Debt is ordinarily replaced on maturity and therefore it is important that the Council is not forced to replace a large proportion of loans at a time of relatively high interest rates (aimed at mitigating any potential impact on the revenue budget).
Indicator 9 – Upper Limit for the maturity structure of Investments	Under the Prudential Code councils are free to invest for periods of greater than 1 year. This indicator sets restrictions on the proportion of investments committed for longer periods in order to limit the risks associated with being unable to meet unexpected cash flows and/or being able to take advantage of future increases in interest rates.