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NORTH DEVON COUNCIL

REPORT TO:	**EXECUTIVE**
Date:	**4th February 2019**
TOPIC:	**TREASURY MANAGEMENT STRATEGY STATEMENT 2019/20**
REPORT BY:	**CHIEF FINANCIAL OFFICER**

1. INTRODUCTION

This report has been prepared in compliance with CIPFA's Code of Practice and covers the following:

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

2. RECOMMENDATIONS

The Executive is asked to recommend to the full Council that:

2.1 The Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Statement 2019/2020, including the Treasury Management and Prudential Indicators for 2019/20 to 2021/22, be approved.

3. REASONS FOR RECOMMENDATIONS

3.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 (SI 2003/3146) requires the Council to have regard to the Treasury Management Code.

3.2 Under section 3(5) of the Local Government Act 2003 the Council is required to have regard to the Prudential Code when setting limits to the level of its affordable borrowing.

3.3 This Council is also required under the Code to give prior scrutiny to the treasury management reports by the Overview and Scrutiny Committee before they are reported to the full Council.

4. CONSTITUTIONAL CONTEXT

Article and paragraph	Referred or delegated power?	A key decision?	In the Forward Plan?
Part 4 Financial Procedure Rules (Article 13.8) Article 4.4	Delegated	No	Yes

5. TREASURY MANAGEMENT

5.1 Background

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

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

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

CIPFA defines treasury management as:

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

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

This authority has not engaged in any material commercial investments or non-treasury investments.

5.2. Reporting Requirements

Capital Strategy

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

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

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

Treasury Management Reporting

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

a) **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

b) **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c) **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

These reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Overview and Scrutiny Committee.

5.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

Capital Issues

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

Treasury management Issues

- the current treasury position;
- treasury indicators which 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
- the policy on use of external service providers.

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

5.4 Training

The CIPFA Code requires the Chief Finance Officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The training needs of treasury management officers are periodically reviewed.

5.5 Treasury Management Consultants

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all the available information, including, but solely, our treasury advisors.

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.

6 THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

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

6.1 Capital Expenditure.

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

Capital Expenditure **£000**	**2017/18** **Actual**	**2018/19** **Estimate**	**2019/20** **Estimate**	**2020/21** **Estimate**	**2021/22** **Estimate**
Chief Executive & Corporate	617	69	675	140	198
Corporate & Community	208	1,805	3,095	0	0
Environmental Health & Housing	592	1,710	2,602	1,200	1,200
Operational Services	864	911	1,209	116	976
Place	10	221	1,044	1,000	0
Resources	163	813	984	*150	*150
Total	**2,454**	**5,529**	**9,609**	**2,606**	**2,524**

**Projected figures 20/21 onwards, based on statutory responsibilities continuing.*

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.

Financing of Capital Expenditure **£000**	**2017/18** **Actual**	**2018/19** **Estimate**	**2019/20** **Estimate**	**2020/21** **Estimate**	**2021/22** **Estimate**
Capital Expenditure	**2,454**	**5,529**	**9,609**	**2,606**	**2,524**
Financed by:					
Capital receipts	1,527	373	650	150	150
Capital grants	710	3,139	6,074	2,200	1,200
Capital reserves	1,173	1,103	1,316	231	643
Net financing need for the year	**(956)**	**914**	**1,569**	**25**	**531**

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. Any capital expenditure in the table above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

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

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

The Council is asked to approve the CFR projections below:

£000	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Capital Financing Requirement					
Total CFR	**5,009**	**5,419**	**6,440**	**5,786**	**5,700**
Movement in CFR	**(1,460)**	**410**	**1,021**	**(654)**	**(86)**

Net financing need for the year above	**(956)**	**914**	**1,569**	**25**	**531**
Less MRP/VRP and other financing movements	(504)	(504)	(548)	(679)	(617)
Movement in CFR	**(1,460)**	**410**	**1,021**	**(654)**	**(86)**

6.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day to day cash flow balances.

Year End Resources **£000**	**2017/18** **Actual**	**2018/19** **Estimate**	**2019/20** **Estimate**	**2020/21** **Estimate**	**2021/22** **Estimate**
Fund balances / reserves	7,728	7,315	4,100	3,500	3,350
Provisions	865	850	600	550	500
Vehicle replacement fund	520	0	144	278	0
Total core funds	**9,113**	**8,165**	**4,844**	**4,328**	**3,850**
Working capital*	4,631	1,000	500	500	500
Total cash to invest	**13,744**	**9,165**	**5,344**	**4,828**	**4,350**
(Under)/over borrowing	**(3,009)**	**(4,169)**	**(3,940)**	**(3,286)**	**(2,700)**
Expected external investments	**10,735**	**4,996**	**1,404**	**1,542**	**1,650**

*Working capital balances shown are estimated year end

6.4 Affordability Prudential Indicator

This prudential indicator is 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 indicator:

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
General Fund	3.48	3.80	4.19	5.20	4.51

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

6.5 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

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

Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).

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

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

MRP Overpayments

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

7 BORROWING

The capital expenditure plans set out in section 6 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

7.1 Current Portfolio Position

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

Treasury Portfolio **£000**	**31/03/18** **Actual**	**31/12/18** **Actual**
Investment with banks	9,560	17,530
Total investments managed in-house	**9,560**	**17,530**
Borrowing with PWLB	2,000	1,250
Total external borrowing	**2,000**	**1,250**
Net treasury investments / (borrowing)	7,560	16,280

The Council's forward projections for borrowing 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.

£000	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt					
Debt at 1 April	2,000	2,000	1,250	2,500	2,500
Expected change in Debt	0	(750)	1,250	0	500
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual gross debt at 31 March	**2,000**	**1,250**	**2,500**	**2,500**	**3,000**
The Capital Financing Requirement	**5,009**	**5,419**	**6,440**	**5,786**	**5,700**
(Under) / over borrowing	**(3,009)**	**(4,169)**	**(3,940)**	**(3,286)**	**(2,700)**

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

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

7.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary £000	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Debt	5,000	5,500	6,000	6,000
Other long term liabilities	250	250	250	250
Total	5,250	5,750	6,250	6,250

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

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £000	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Debt	10,000	10,500	11,000	11,000
Other long term liabilities	500	500	500	500
Total	10,500	11,000	11,500	11,500

7.3 Prospects for Interest Rates

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

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

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth 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. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

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

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

Investment and borrowing rates

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

Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked 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;

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.

7.4 Borrowing Strategy

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

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

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

Any decisions will be reported to the Leader and Executive Portfolio Members.

It is anticipated that additional external borrowing of £1.25m will be required during 2019/20 to support the approved capital programme taking total projected external borrowing to £2.5m by March 2020. This still prudently assumes using £3.9m of internal borrowing from reserves and cash balances to fund the £6.4m Capital Financing Requirement.

The strategy projects further external borrowing of £0.5m in 2021/22 taking total borrowing to £3m. However any substantial increase in capital expenditure and/or decrease in the reserve balances within the forthcoming years may result in the need for additional external borrowing to ensure the Council holds sufficient cash balances to meet its day to day commitments. For further details on the long term borrowing strategy please refer to the Council's ten year capital strategy on this agenda.

7.5 Maturity structure of borrowing

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

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

Maturity Structure of fixed interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	50%
Maturity Structure of variable interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	60%
12 months to 2 years	0%	60%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years and above	0%	50%

7.6 Control of interest rate exposures

The Council is asked to approve the following local indicator to reduce the impact of any adverse movement in interest rates, whilst not impairing opportunities to reduce costs / improve performance.

Interest rate Exposures	2019/20 £000	2020/21 £000	2021/22 £000
Limit on fixed interest rates: • **Debt only** • **Investments only**	100% 100%	100% 100%	100% 100%
Limit on variable interest rates: • **Debt only** • **Investments only**	30% 100%	30% 100%	30% 100%

Paragraphs 7.3, 7.4, 7.5 and 8.4 provide further details on the controls in place to limit and manage interest rate exposure in line with financial requirements, borrowing maturities and interest rate forecasts.

7.7 Policy on borrowing in advance of need

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

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

7.8 Debt rescheduling

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

The reasons for any rescheduling to take place will include:

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

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

All rescheduling will be reported to the Leader and Executive Portfolio Members.

7.9 Municipal Bond Agency

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

8 ANNUAL INVESTMENT STRATEGY

8.1 Investment Policy – management of risk

The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

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

The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The

key ratings used to monitor counterparties are the short term and long-term ratings.

2. **Other information**: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.

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

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. Appendix 1 list the instruments under the categories of 'specified' and 'non-specified' investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 8.2.

6. **Transaction limits** are set for each type of investment in Appendix 1.

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 8.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 8.3).

9. This authority has engaged **external consultants**, (see paragraph 5.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in **sterling**.

11. As a result of the change in accounting standards for 2018/19 under **IFRS 9**, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.)

However, this authority will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 8.5). Regular monitoring of investment performance will be carried out during the year.

Changes in risk management policy from last year.

The above criteria is largely unchanged from last year.

8.2 Creditworthiness policy

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

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

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

- Dark pink 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.25

- Light pink 5 years for Ultra-Short Dated Bond Fund with a credit score of 1.5
- Yellow 5 years (UK Government debt)
- Purple 2 years
- 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

The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of F1 and a long term rating 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.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services'creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Council will be advised of information in movements in Credit Default Swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

	Colour (and long term rating where applicable)	Money Limit	Time Limit
Banks	**yellow**	**£1m**	**5 yrs**
Banks	**purple**	**£1m**	**2 yrs**
Banks	**orange**	**£3m**	**1 yr**
Banks – part nationalised	**blue**	**£4m**	**1 yr**
Banks	**red**	**£3m**	**6 mths**
Banks	**green**	**£3m**	**100 days**
Banks	**No colour**	**Not to be used**	
Other institutions limit	**-**	**£2m**	**1yr**
DMADF	**UK sovereign rating**	**Unlimited**	**6 months**
Local authorities	**n/a**	**£2m**	**1yr**
	Fund rating	**Money Limit**	**Time Limit**
Money market funds	**AAA**	**£3m**	**liquid**
Ultra-Short Dated Bond Fund with a credit score of 1.25	**Dark pink / AAA**	**£2m**	**liquid**
5 years for Ultra-Short Dated Bond Fund with a credit score of 1.5	**Light pink / AAA**	**£1m**	**liquid**

No limit will be set on placing funds with the Council's own bank due to the volatility / fluctuations in day to day cash flows.

Group limits where a number of institutions are under one ownership is a maximum of £5m

UK banks – ring fencing

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

Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

8.3 Country limits

The Council has determined that it will mainly use approved counterparties from within the United Kingdom.

However, the Council may consider counterparties from outside the United Kingdom providing the country has a minimum sovereign credit rating of AA- from Fitch or equivalent.

8.4 Investment Strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

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

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

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

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

2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%

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

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

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

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

Upper limit for principal sums invested for longer than 365 days			
£m	**2019/20**	**2020/21**	**2021/22**
Principal sums invested for longer than 365 days	£1m	£1m	£1m

The Council currently has no investments in excess of one year.

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.

Investment risk benchmarking. The Chief Financial Officer will monitor the current and trend position of the treasury function and amend the operational strategy to manage risk, as interest rates and counterparty conditions change. Performance results will be reported through the Quarterly Performance and Financial Management, Mid-Year and Annual Treasury reports to Executive.

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID rate.

8.5 Non-Treasury Investments

The Council will adopt a low risk, immaterial, approach to non-treasury (commercial) investments in line with the investment categories and authorised limits set out in Appendix 2.

The Council will consider opportunities as they arise, within the Council boundary, such as light industrial investment.

9. RESOURCE IMPLICATIONS

As detailed in the report.

10. EQUALITY and HUMAN RIGHTS

An EINA has not been completed as the purpose of this report is to present the Council’s financial position only.

11. STATEMENT OF INTERNAL ADVICE

The author (below) confirms that advice has been taken from all appropriate Councillors and Officers.

12. STATEMENT OF CONFIDENTIALITY

This report contains no confidential information under the provisions of Schedule 12A of 1972 Act.

13. BACKGROUND PAPERS

The background papers are available for inspection and will be kept by the author of the report.

Executive Member: Councillor R Edgell and Councillor G Lane

Author: Jon Triggs, Head of Resources Date: 22nd January 2019

Reference: T:\Technical\Adam\Treasury Management\ TM & Annual Investment Strategy 2019.doc

APPENDIX 1: Treasury Management Practice (TMP1) – Credit and counterparty risk management

SPECIFIED INVESTMENTS: All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' quality criteria where applicable.

NON-SPECIFIED INVESTMENTS: These are any investments which do not meet the specified investment criteria and are therefore of greater potential risk. The Council will consider using this category only for investments that would come under Specified, except that the maturities are greater than 1 year.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

	Minimum credit criteria / colour band	**£ Limit per institution**	**Max maturity period**
Debt Management Account Deposit Facilities - **UK Government**	N/A	Unlimited	6 months
UK Government Gilts	UK sovereign rating	£2m	1 year
UK Government Treasury Bills	UK sovereign rating	£2m	1 year
Bonds issued by multilateral development banks	AAA	£2m	6 mths
Money Market Funds	AAA	£3m	Liquid

Local Authorities	N/A	£2m	1 year
Term deposit with Banks and Building Societies	Purple + Blue only Green +	£1m £4m £3m	2 years 1 year 1 year
CDs or corporate bonds with banks and building societies	Green +	£2m	1 year
Gilt funds	UK sovereign rating	£2m	1 year
Ultra-Short Dated Bond funds with a credit score of 1.25	AAA	£2m	Liquid
Ultra-Short Dated Bond funds with a credit score of 1.5	AAA	£2m	Liquid

(+) Above the minimum colour band given. The colour band will place its own maturity limit on the investment so only the maximum maturity period is given.

No limit will be set on placing funds with the Council's own bank due to the volatility / fluctuations in day to day cash flows.

APPENDIX 2: Investment management practice for non-treasury investments – Authorised limits

The approved schedule for non-treasury investments are as follows:

Category	Type	Limit per asset
Commercial Investment	**Inside ND area** Retail Industrial Offices Land Other	 £0.5m £1m £0.5m £0.5m £0.5m
	Outside ND area Retail Industrial Offices Other	 £0m £0m £0m £0m
	Subsidiaries	£0m
	Council owned companies	£0m
	Council owned industrial estates	£1m
Loans	Third Parties Employees Other	£0.25m £0.10m £0.05m
Loan Guarantees		£0m

**The above schedule does not include service investments items as these are covered by the capital programme and associated risk framework.*