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NORTH DEVON COUNCIL

REPORT TO:	**STRATEGY AND RESOURCES**
DATE:	**3rd FEBRUARY 2020**
TOPIC:	**TREASURY MANAGEMENT STRATEGY STATEMENT 2020/21**
REPORT BY:	**CHIEF FINANCIAL OFFICER**

1. INTRODUCTION

This report sets out the Council's strategy for Treasury Management, Minimum Revenue Provision (MRP) and Investments for the forthcoming financial year.

2. RECOMMENDATIONS

The Committee is asked to recommend to full Council that:

2.1 The Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Statement 2020/2021, including the Treasury Management and Prudential Indicators for 2020/21 to 2022/23, 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 of the treasury management reports by the Policy Development Committee before they are reported to the full Council.

4. TREASURY MANAGEMENT

4.1 Background

Part of the treasury management operation is to ensure that 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."

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

4.2. Reporting Requirements

The Council will receive and approve 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 Policy Development Committee.

4.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 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.

4.4 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.

4.5 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.

5 THE CAPITAL PRUDENTIAL INDICATORS 2020/21 – 2022/23

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.

5.1 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	**2018/19 Actual**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Chief Executive & Corporate	82	382	506	198	433
Corporate & Community	1,251	3,722	5,234	8,587	0
Environmental Health & Housing	1,722	2,063	1,801	979	979
Operational Services	911	474	876	976	1,290
Place	77	278	2,026	0	0
Resources	255	1,208	2,179	0	150
Total	**4,298**	**8,127**	**12,622**	**10,740**	**2,852**

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	**2018/19 Actual**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Capital Expenditure	**4,298**	**8,127**	**12,622**	**10,740**	**2,852**
Financed by:					
Capital receipts	494	200	600	150	150
Capital grants	2,538	5,350	7,285	1,984	979
Capital reserves	1,060	913	1,207	643	365
Net financing need for the year	**206**	**1,664**	**3,530**	**7,963**	**1,358**

5.2 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 it's 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 Council is asked to approve the CFR projections below:

£000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement					
Total CFR	**4,711**	**5,866**	**8,770**	**16,120**	**16,569**
Movement in CFR	**(298)**	**1,155**	**2,904**	**7,350**	**449**

Net financing need for the year above	**206**	**1,664**	**3,530**	**7,963**	**1,358**
Less MRP/VRP and other financing movements	(504)	(509)	(626)	(613)	(909)
Movement in CFR	**(298)**	**1,155**	**2,904**	**7,350**	**449**

5.3 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	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Fund balances / reserves	8,754	9,101	4,683	3,900	3,600
Provisions	990	600	550	500	500
Vehicle replacement fund	26	170	304	0	0
Total core funds	**9,770**	**9,871**	**5,537**	**4,400**	**4,100**
Working capital*	3,540	3,500	1,000	750	500
Total cash to invest	**13,310**	**13,371**	**6,537**	**5,150**	**4,600**
(Under)/over borrowing	**(3,461)**	**(4,616)**	**(3,270)**	**(3,120)**	**(2,069)**
Expected external investments	**9,849**	**8,755**	**3,267**	**2,030**	**2,531**

*Working capital balances shown are estimated year end

5.4 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.

%	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
General Fund	2.87	3.87	4.78	6.87	10.52

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

5.5 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. MRP will always start in the financial year after the asset becomes operational.

Leisure centre – An element of the funding for this project is future S106 income. When this income is received it will be used to reduce the Capital Financing Requirement, therefore no MRP will be required. Should any of this funding not be forthcoming then an MRP adjustment will be required at that time. Where affordable the Council will make additional voluntary revenue provisions to help pay off the debt early.

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 2020 the Council had made no voluntary revenue provision (VRP) overpayments.

6 BORROWING

The capital expenditure plans set out in Section 5 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.

6.1 Current Portfolio Position

The overall treasury management cash portfolio as at 31 March 2019 and for the position as at 31st December 2019 are shown below for both borrowing and investments.

Treasury Portfolio **£000**	**31/03/19** **Actual**	**31/12/19** **Actual**
Investment with banks	8,560	23,380
Total investments managed in-house	**8,560**	**23,380**
Borrowing with PWLB	1,250	1,250
Total external borrowing	**1,250**	**1,250**
Net treasury investments / (borrowing)	7,310	22,130

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

£000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
External Debt					
Debt at 1 April	2,000	1,250	1,250	5,500	13,000
Expected change in Debt	(750)	0	4,250	7,500	1,500
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	**1,250**	**1,250**	**5,500**	**13,000**	**14,500**
The Capital Financing Requirement	**4,711**	**5,866**	**8,770**	**16,120**	**16,569**
(Under) / over borrowing	**(3,461)**	**(4,616)**	**(3,270)**	**(3,120)**	**(2,069)**

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 2020/21 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.

6.2 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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	5,000	8,000	16,000	16,000
Other long term liabilities	250	250	250	250
Total	5,250	8,250	16,250	16,250

The authorised limit for external debt. This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal 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	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	22,000	22,000	22,000	22,000
Other long term liabilities	500	500	500	500
Total	22,500	22,500	22,500	22,500

6.3 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 their central view. For further economic information please see Appendix C.

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit and the outcome of the general election. In its meeting on 7 November, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then the MPC were likely to cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates. There has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was heading for a recession in 2020, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, conditions are ripe for low bond yields. While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc. This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. We have therefore seen over the last year, many bond yields up to ten years in the Eurozone actually turn negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been a precursor of a recession. The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of dismal ultra-low interest rates on cash deposits.

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (See paragraph 6.9 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

One potential danger that may be lurking in investor minds is that Japan has become mired in a twenty-year bog of failing to get economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the central bank and government. Investors could be fretting that this condition might become contagious to other western economies.

Another danger is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may end up doing more harm than good through prolonged use. Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or push them into riskier lending. Banks could also end up holding large amounts of their government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

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

In addition, PWLB rates are subject to ad hoc decisions by **H.M. Treasury** to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.

Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. 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 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. Now that the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%, in light of this change the authority will need to review the borrowing strategy for the Leisure Centre and consider keeping longer term borrowing to a minimum for the next three years, or until such time as the extra 100 bps margin is removed.
- While this authority may not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt there will be a cost of carry (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

6.4 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 2020/21 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

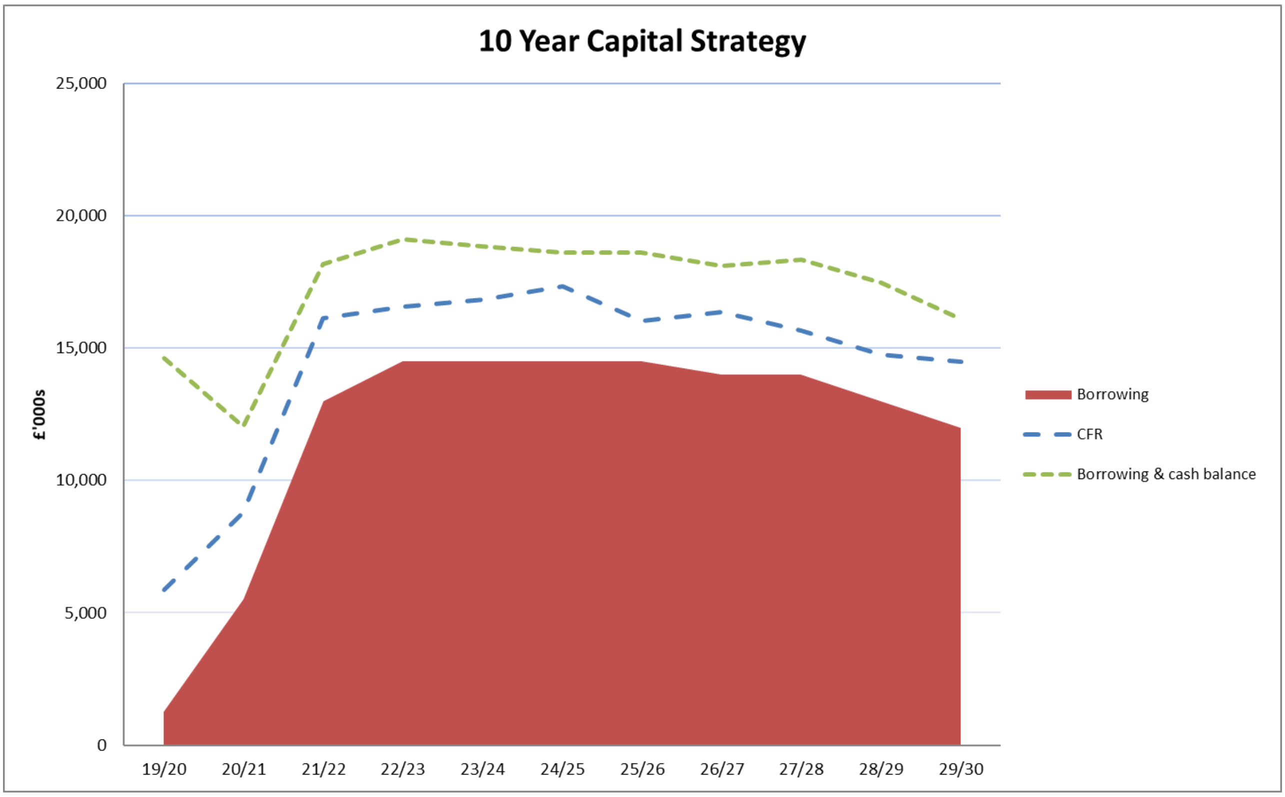
- *if it was felt that there was a significant risk of a sharp FALL in borrowing rates (*e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- *if it was felt that there was a significant risk of a much sharper RISE in borrowing 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 Lead Member for Resources and Commercialisation.

It is anticipated that additional external borrowing of £4.25m will be required during 2020/21 to support the approved capital programme taking total projected external borrowing to £5.5m by March 2021. This still prudently assumes using £3.3m of internal borrowing from reserves and cash balances to fund the £8.8m Capital Financing Requirement.

The strategy projects further external borrowing of £7.5m in 2021/22 and £1.5m in 2022/23 taking total borrowing to £14.5m by March 2023. This increased borrowing reflects the large capital schemes in the approved capital programme such as the new Leisure Centre.

Any further substantial increases to capital expenditure and/or decreases 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. The graph below sets out the current borrowing strategy for the next ten years. For further details please refer to the Council's ten year capital strategy on this agenda.



In accordance with the Council's accounting policy, the borrowing interest incurred during the construction of the leisure centre will be capitalised, thereby increasing the CFR and allowing this cost to be covered by external borrowing.

6.5 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 2020/21		
	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%	90%

Maturity Structure of variable interest rate borrowing 2020/21		
	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%	90%

6.6 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	2020/21 £000	2021/22 £000	2022/23 £000
Limit on fixed interest rates:			
• **Debt only**	100%	100%	100%
• **Investments only**	100%	100%	100%
Limit on variable interest rates:			
• **Debt only**	30%	30%	30%
• **Investments only**	100%	100%	100%

Paragraphs 6.3, 6.4, 6.5 and 7.4 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.

6.7 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.

6.8 Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

If rescheduling was done, it will be reported to the Leader and Lead Member for Resources and Commercialisation.

6.9 New financial institutions as a source of borrowing

Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
- Municipal Bonds Agency (no issuance at present but there is potential)

The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

Given the relative scale of our external borrowing it is likely that the PWLB will remain the Council’s best option as a source of borrowing, despite this rate increase.

6.10 Approved Sources of Long and Short term Borrowing

Following the decision made by the PWLB on 9th October 2019, Members are asked to review and approve the following list of sources and types of funding:

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Market (LOBOs)	●	●
Stock issues	●	●
Local temporary	●	●
Local Bonds	●	
Local authority bills	●	●
Overdraft		●
Negotiable Bonds	●	●
Internal (capital receipts & revenue balances)	●	●
Commercial Paper	●	
Medium Term Notes	●	
Finance leases	●	●

7 ANNUAL INVESTMENT STRATEGY

7.1 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 financial 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 A 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 7.2.

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

7. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**, (see paragraph 7.4).

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**, (see paragraph 7.3).

9. This authority has engaged **external consultants**, (see paragraph 4.5), 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 2019/20 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.

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 7.4). 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.

7.2 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. 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, it 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 Eurpoean Financials 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	£1m	liquid
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.

7.3 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.

7.4 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. On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

Q1 2021 0.75%

Q1 2022 1.00%

Q1 2023 1.00%

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:

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%

The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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	**2020/21**	**2021/22**	**2022/23**
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.

7.5 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 B.

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

A commercialisation strategy will shortly be considered by Members which will review the Council’s approach to non-treasury investments.

8. RESOURCE IMPLICATIONS

As detailed in the report.

9. EQUALITIES ASSESSMENT

There are not any equalities implications anticipated as a result of this report, as the purpose of this report is to present the Council’s financial position only.

10. CONSTITUTIONAL CONTEXT

11.

Article and paragraph	Referred or delegated power?
Part 4 Financial Procedure Rules (Article 13.8) Article 4.4	Delegated

STATEMENT OF CONFIDENTIALITY

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

12. BACKGROUND PAPERS

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

13. STATEMENT OF INTERNAL ADVICE

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

Author: Jon Triggs, Head of Resources   Date: 15th January 2020

Reference: T:\Technical\Adam\Treasury Management\ TM & Annual Investment Strategy 2020.doc