

Treasury Management Strategy 2018/19 to 2021/22

For Consideration by Budget and Performance Panel 06 February 2018

1 INTRODUCTION

1.1 Background

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

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

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

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

1.2 Reporting Requirements

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

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report 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).

A mid-year treasury management report – This will update Members with the progress of the treasury position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

In addition, Members will receive high level update reports for Quarters 1 and 3.

Scrutiny - The above reports are required to be adequately considered and scrutinised before being presented to Council. This is undertaken by Cabinet and the Budget and Performance Panel.

Capital Strategy – In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-10, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:-

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

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

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

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital Issues

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

Treasury Management Issues

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

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

1.4 Training

The CIPFA Code requires the Chief Officer (Resources) to ensure that Members with responsibility for treasury management receive adequate associated training. This especially applies to Members responsible for scrutiny. A training session will be arranged during 2018 accordingly with further training provided as required. The training needs of treasury management Officers are periodically reviewed.

1.5 Treasury Management Consultants

The Council uses Link Asset Services, 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 external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2021/22

The Council's capital expenditure plans are the key driver of treasury management activity. The plans are reflected in various prudential indicators, as determined under regulation, to assist Members in their overview of such capital expenditure planning.

2.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

The table below provides that summary, showing how the plans are being financed by capital or revenue resources. Any shortfall of resources results in an underlying borrowing or financing need.

| Capital expenditure | 2016/17 Actual £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|--|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| General Fund | 12.63 | 12.05 | 10.35 | 3.54 | 3.89 | 2.38 |
| Housing Revenue Account (HRA) | 4.08 | 4.20 | 4.42 | 4.33 | 4.16 | 4.16 |
| Total | 16.71 | 16.25 | 14.77 | 7.87 | 8.05 | |
| Financed by: | | | | | | |
| Capital receipts | -0.85 | -1.46 | -0.38 | -0.38 | -0.38 | -0.38 |
| Capital grants | -4.53 | -5.75 | -5.03 | -1.63 | -1.61 | -1.61 |
| Capital reserves | -4.62 | -4.57 | -4.67 | -4.31 | -3.85 | -3.84 |
| Revenue | -0.26 | -0.15 | 0.00 | 0.00 | 0.00 | 0.00 |
| Net financing need for the year | 6.45 | 4.32 | 4.69 | 1.55 | 2.21 | 0.71 |

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total amount of capital expenditure (including that from prior years) that has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying need to borrow. Any capital expenditure that is not wholly financed in-year will increase the CFR.

The CFR does not increase indefinitely. This is because the Minimum Revenue Provision (MRP), which is a statutory annual charge to revenue, broadly reduces the borrowing need in line with each asset's life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £38K of leases within the CFR.

| | 2016/17 Actual £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|--------------------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Capital Financing Requirement | | | | | | |
| General Fund** | 40.62 | 43.53 | 46.45 | 46.10 | 46.19 | 44.54 |
| HRA ** | 41.45 | 40.41 | 39.37 | 38.33 | 37.29 | 36.25 |
| Total CFR | 82.07 | 83.94 | 85.82 | 84.43 | 83.48 | 80.79 |
| Movement in CFR | 4.18 | 1.87 | 1.88 | -1.39 | -0.95 | -2.69 |

| Movement in CFR represented by | | | | | | |
|--|-------------|-------------|-------------|--------------|--------------|--------------|
| Net financing need for the year (above) | 6.45 | 4.32 | 4.69 | 1.55 | 2.21 | 0.71 |
| Less MRP/VRP and other financing movements | -2.27 | -2.45 | -2.81 | -2.94 | -3.16 | -3.40 |
| Movement in CFR | 4.18 | 1.87 | 1.88 | -1.39 | -0.95 | -2.69 |

2.3 Minimum Revenue Provision (MRP) Policy Statement

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

Government Regulations require 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 being made. In approving this Strategy, Council approves the following MRP Statement:

For capital expenditure incurred after 01 April 2008, MRP will be based on:

- Asset life method – MRP will be based on the estimated life of each asset created as a result of the related capital expenditure, in accordance with the

Regulations (this option must also be applied for any expenditure capitalised under a Capitalisation Direction).

This option provides for a reduction in the borrowing need over the approximate life of the asset concerned.

In line with Government guidance, the MRP in respect of capital expenditure incurred before 01 April 2008 will be charged over a period of 60 years.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in annual finance leases are applied as MRP.

2.4 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 (e.g. asset sales). The following table provides estimates of the year end balances for each resource and anticipated year end cash flow balances from other day to day activities:

| Year End Resources | 2016/17 Actual £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|-----------------------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Fund balances / reserves | 23.99 | 21.50 | 20.74 | 20.32 | 20.72 | 21.43 |
| Capital receipts | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Provisions | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 | 0.50 |
| Total core funds | 24.49 | 22.00 | 21.24 | 20.82 | 21.22 | 21.93 |
| Working capital* | 22.70 | 22.70 | 22.70 | 22.70 | 22.70 | 22.70 |
| Under borrowing | -16.82 | -19.77 | -22.69 | -22.34 | -22.44 | -20.79 |
| Expected investments | 30.37 | 24.93 | 21.25 | 21.18 | 21.48 | 23.84 |

*Working capital balances shown are estimated year end; these may be higher mid-year

2.5 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

2.6 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.

| | 2016/17 Actual £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|--------------|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| General Fund | 13.9% | 15.8% | 17.7% | 17.7% | 17.2% | 17.5% |
| HRA | 21.6% | 21.8% | 21.5% | 20.9% | 20.3% | 19.4% |

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

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current Portfolio Position

The Council's treasury portfolio position at 31 March 2016 and forward projections are summarised below. The table shows the actual external debt from treasury management operations, against the underlying capital borrowing need (the Capital Financing Requirement or CFR), highlighting any over or under borrowing.

| | 2016/17 Actual £m | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|--|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| External Debt | | | | | | |
| Debt at 1 April | 66.29 | 65.25 | 64.17 | 63.13 | 62.09 | 61.05 |
| Expected change in Debt | -1.04 | -1.04 | -1.04 | -1.04 | -1.04 | -1.04 |
| Other long-term liabilities (OLTL) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Expected change in OLTL | 0.00 | -0.04 | 0.00 | 0.00 | 0.00 | 0.00 |
| Actual gross debt at 31 March | 65.25 | 64.17 | 63.13 | 62.09 | 61.05 | 60.01 |
| The Capital Financing Requirement | 82.07 | 83.94 | 85.82 | 84.43 | 83.48 | 80.79 |
| Under Borrowing | -16.82 | -19.77 | -22.69 | -22.34 | -22.44 | -20.79 |

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

3.2 Treasury 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 | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|-----------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Debt* | 83.94 | 85.82 | 84.43 | 83.48 | 80.79 |
| Other long term liabilities | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Total | 83.94 | 85.82 | 84.43 | 83.48 | 80.79 |

- *The term debt in this instance is CFR minus the effect of leases*

The Authorised Limit for External Debt

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

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

| Authorised Limit | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|-----------------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Debt | 99.00 | 101.00 | 99.00 | 98.00 | 96.00 |
| Other long term liabilities | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 |
| Total | 100.00 | 102.00 | 100.00 | 99.00 | 97.00 |

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

| HRA Debt Limit | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | 2020/21 Estimate £m | 2021/22 Estimate £m |
|---------------------|------------------------|------------------------|------------------------|------------------------|------------------------|
| HRA debt cap | 60.19 | 60.19 | 60.19 | 60.19 | 60.19 |
| HRA CFR | 40.41 | 39.37 | 38.33 | 37.29 | 36.25 |
| HRA headroom | 19.78 | 20.82 | 21.86 | 22.90 | 23.94 |

3.3 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.

| | Mar-18 | Mar-19 | Mar-20 | Mar-21 |
|----------------|--------|--------|--------|--------|
| Bank rate | 0.50% | 0.75% | 1.00% | 1.25% |
| 5yr PWLB rate | 1.60% | 1.80% | 2.10% | 2.30% |
| 10yr PWLB rate | 2.20% | 2.50% | 2.70% | 3.00% |
| 25yr PWLB rate | 2.90% | 3.10% | 3.40% | 3.60% |
| 50yr PWLB rate | 2.60% | 2.90% | 3.20% | 3.40% |

As expected, the Monetary Policy Committee, (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase the Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The forecast as above includes increases in the Bank rate of 0.25% in November 2018, November 2019 and August 2020.

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.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit.

Investment and borrowing rates

- *Investment returns are likely to remain low during 2018/19 but be on a gently rising trend over the next few years;*
- *Borrowing interest increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank rate increases. Since then borrowing rates have eased back again somewhat. Apart from that there has been little general trend in rates during the current financial year. 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 to refinance maturing debt;*
- *There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.*

3.4 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's provisions, reserves, balances and working capital 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 2018/19 treasury operations. The Chief Officer (Resources), under delegated powers 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 any long term borrowings would be postponed, and potential rescheduling from fixed rate funding into short term borrowing would 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 start date and 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 would be re-appraised. Most likely, if need be, fixed rate funding would be drawn if interest rates were lower than projected to be in the next few years.*

Any decisions will be reported to Cabinet at the next available opportunity.

3.5 Treasury Management Limits on Activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates.
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

| | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/2022 |
|--|--------------|--------------|--------------|--------------|--------------|
| Interest rate exposures | | | | | |
| | Upper | Upper | Upper | Upper | Upper |
| Limits on fixed interest rates based on net debt | 100% | 100% | 100% | 100% | 100% |
| Limits on variable interest rates based on net debt | 30% | 30% | 30% | 30% | 30% |

| Maturity structure of fixed interest rate borrowing 2018/19 | £m | |
|--|-----------|--------|
| Under 12 months | 1.04 | 1.62% |
| 12 months and within 24 months | 1.04 | 1.62% |
| 24 months and within 5 years | 3.12 | 4.87% |
| 5 years and within 10 years | 5.21 | 8.11% |
| 10 years and within 15 years | 5.21 | 8.11% |
| 15 years and within 25 years | 9.37 | 14.60% |
| 25 years and within 50 years | 39.22 | 61.08% |

3.6 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, allowing for

authorised increases, 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.

3.7 Debt Rescheduling

As short term borrowing rates are expected to 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.

Any rescheduling will be reported to Cabinet at the earliest meeting following any action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment Policy

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

In accordance with the above guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties that also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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 this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

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 process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in **Annex A2** under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices, applying the creditworthiness policy set out below.

4.2 Creditworthiness Policy

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

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

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:

- **Yellow (Y)** up to but less than 1 year
- **Dark pink (Pi1)** liquid - Ultra-Short Dated Bond Funds with a credit score of 1.25
- **Light pink (Pi2)** liquid – Ultra-Short Dated Bond Funds with a credit score of 1.5
- **Purple (P)** up to but less than 1 year
- **Blue (B)** up to but less than 1 year (only applies to nationalised or part-nationalised UK Banks)
- **Orange (O)** up to but less than 1 year
- **Red (R)** 6 months
- **Green (G)** 100 days
- **No colour (N/C)** not to be used

| | | | | | | | | |
|---|------|-----|---|---|---|---|---|-----|
| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7 |

| | Colour (and long term rating where applicable) | Money Limit | Time Limit |
|---|--|----------------------|------------|
| Banks /UK Govt. backed instruments* | yellow | £12m | ≤1 year |
| Banks | purple | £6m | ≤1 year |
| Banks | orange | £6m | ≤1 year |
| Banks – part nationalised | blue | £12m | ≤1 year |
| Banks | red | £6m | ≤6 mths |
| Banks | green | £3m | ≤100 days |
| Banks | No colour | Not to be used | |
| Limit 3 category – Council’s banker (for non-specified investments) | n/a | £500K | 1 day |
| DMADF | AAA | unlimited | ≤6 months |
| Local authorities** | n/a | £12m | ≤1 year |
| | Fund rating | Money and/or % Limit | Time Limit |
| Money Market Funds CNAV | AAA | £6m | liquid |
| Money Market Funds LVNAV | AAA | £6m | liquid |
| Money Market Funds VNAV | AAA | £6m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | Dark pink / AAA | £6m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.5 | Light pink / AAA | £6m | liquid |

* the yellow colour category includes UK Government debt, or its equivalent, collateralised deposits where the collateral is UK Government debt –see [Annex A2](#).

** Under UK Statute the loans to any Council have priority and first call over the revenues of the authority, which under-writes any concerns over the ability of a local authority to repay its debt. As the UK Government also acts as a lender of last resort, the ranking of UK local authorities is usually considered equivalent to that of the UK Government. As the UK Government has a long term rating of AA+, this is usually applied to local authorities and as such all local authorities have equal rating.

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

Typically the minimum credit ratings criteria (built in) that the Council use will be a Short Term rating of F1 and a Long Term rating of A- (Fitch, or equivalents). 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 daily. The Council is alerted to changes to ratings of all three agencies through its use of the 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 weekly basis. 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, the Council will also use to some limited extent market data and market information, information on sovereign support for banks and the credit ratings of that supporting government.

4.3 Country Limits

The Council has determined that it will only use approved counterparties from other countries with a minimum sovereign credit rating of AAA (**Fitch**) or equivalent from each of the credit rating agencies. This list will be added to, or deducted from, by Officers should ratings change in accordance with this policy.

4.4 Other Investment Matters

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 (iup to 12 months).

Investment Returns Expectations: Bank Rate is forecast to stay flat at 0.50% until Quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- | | | | |
|-----------|-------|-----------|-------|
| • 2017/18 | 0.50% | • 2019/20 | 1.00% |
| • 2018/19 | 0.75% | • 2020/21 | 1.25% |

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

4.5 Investment Treasury Indicator and Limit

This determines the total principal funds that can be 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 any investment, and are based on the availability of funds after each year-end. Council is asked to approve the treasury indicator and limit: -

| Maximum principal sums invested > 364 & 365 days | | | | | |
|--|----------------|----------------|----------------|----------------|----------------|
| | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
| Principal sums invested > 364 & 365 days | Nil | Nil | Nil | Nil | Nil |

This takes account of the proposed change in the CIPFA Treasury Code from a 364 day limit to 365 days

Treasury Management Glossary of Terms

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of the loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.
- **Call account** – instant access deposit account.
- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.
- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's, and Moody's. They currently analyse credit worthiness under four headings (but see changes referred to in the strategy):
 - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
 - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
 - **Individual/Financial Strength Rating** – a measure of an institution's soundness on a stand-alone basis based on its structure, past performance and credit profile.
 - **Legal Support Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.
- **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal, therefore the interest due with each payment reduces as the principal is eroded, and so the total amount reduces with each instalment.
- **Gilts** – the name given to bonds issued by the U K Government. Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like

shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt.

E.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45. The yield on that gilt is calculated as $8\%/1.45 = 5.5\%$.

See also PWLB.

- **LIBID** – The London Inter-Bank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time.
- **LIBOR** – The London Inter-Bank Offer Rate, the rate at which banks with surplus funds are offering to lend them to other banks, again published at 11am each day.
- **Liquidity** – Relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **Maturity** – Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.
- **Money Market Fund (MMF)** – Type of investment where the Council purchases a share of a cash fund that makes short term deposits with a broad range of high quality counterparties. These are highly regulated in terms of average length of deposit and counterparty quality, to ensure AAA rated status. As from 21 July 2018 there will be three structural options for existing money market funds – Public Debt Constant Net Asset Value (CNAV), Low Volatility Net Asset Value (LVNAV) and Variable Net Asset Value (VNAV)
- **Policy and Strategy Documents** – documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.
- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.
- **Capita Asset Services** – Capita Asset Services are the City Council's Treasury Management advisors. They provide advice on borrowing strategy, investment strategy, and vetting of investment counterparties, in addition to ad hoc guidance throughout the year.
- **Yield** – see Gilts

Members may also wish to make reference to *The Councillor's Guide to Local Government Finance*.

ANNEX B2

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 | Max % of counterparty limit - *Specified | Max % of counterparty limit – **Non - Specified | Max. maturity period |
|---|---------------------------------------|--|---|----------------------|
| DMADF – UK Government | N/A | 100% | N/A | 6 months |
| UK Government gilts | UK sovereign rating | 100% | N/A | 1 year |
| UK Government Treasury bills | UK sovereign rating | 100% | N/A | 1 year |
| Bonds issued by multilateral development banks | AAA | 100% | N/A | 6 months |
| Money Market Funds CNAV | AAA | 100% | N/A | Liquid |
| Money Market Funds LVNAV | AAA | 100% | N/A | Liquid |
| Money Market Funds VNAV | AAA | 100% | N/A | Liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | AAA | 100% | N/A | Liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.5 | AAA | 100% | N/A | Liquid |
| Local authorities | N/A | 100% | N/A | 1 year |
| Term deposits with banks and building societies | Yellow | 100% | 20% | Up to 1 year |
| | Purple | 100% | 20% | Up to 1 year |
| | Blue | 100% | N/A | Up to 1 year |
| | Orange | 100% | 20% | Up to 1 year |
| | Red | 100% | 20% | Up to 6 Months |
| | Green | 100% | 20% | Up to 100 days |
| | No Colour | 0% | 0% | Not for use |
| Certificates of Deposit and corporate bonds with banks and building societies | Yellow | 20% | 0% | Up to 1 year |
| | Purple | 20% | 0% | Up to 1 year |
| | Blue | 20% | 0% | Up to 1 year |
| | Orange | 20% | 0% | Up to 1 year |
| | Red | 0% | 0% | Up to 6 Months |
| | Green | 0% | 0% | Up to 100 days |
| | No Colour | 0% | 0% | Not for use |

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

****NON-SPECIFIED INVESTMENTS:** These are any investments which do not meet the specified investment criteria. A maximum of up to 20% ** will be held in aggregate in relevant non-specified investments (as at the trade date of investing).

Definitions of Specified and Non Specified Investments

See the detailed Investment Strategy included in **Appendix B**, for the limits to be applied.

1. Specified Investments are defined as follows.

SPECIFIED INVESTMENTS

These are investments denominated in sterling of a maturity period of not more than 364 days (or of a longer period where the Council has the right to be repaid within 364 days if it wishes). These are low risk assets with high liquidity where the possibility of loss of principal or investment income is considered negligible. These include investments with:

- (i) The UK Government (such as the Debt Management Office, UK Treasury Bills or a Gilt with less than one year to maturity).
- (ii) Supranational bonds of less than one year's duration.
- (iii) A local authority, parish council or community council.
- (iv) An investment scheme that has been awarded a high credit rating by a credit rating agency.
- (v) A body with high credit quality (such as a bank or building society) as set out in table 4.2

For category (iv) this covers a money market fund AAA rated by Standard and Poor's, Moody's or Fitch rating agencies.

2. Non-specified Investments are defined as:

All types of investment not meeting the criteria for specified investments. The non-specified investments which may be used by the authority are set out below. Non specified investments not explicitly referred to below are excluded from the Treasury Management Strategy.

| Ref | Non Specified Investment Category | Limit |
|------|--|--------------|
| (i) | An investment with a non-UK bank, for a term of less than 1 year and in a product which falls within one of the criteria stated with the table in Annex B2 | Annex B2 |
| (ii) | The Council's own banker if it fails to meet the high credit quality criteria attached to other bandings. | Table in 4.2 |

Background information on credit ratings

Credit ratings are an important part of the Authority's investment strategy. The information below summarises some of the key features of credit ratings and why they are important.

What is a Credit Rating?

A credit rating is:

- An independent assessment of an organisation;
- It gauges the likelihood of getting money back on the terms it was invested;
- It is a statement of opinion, not statement of fact;
- They help to measure the risk associated with investing with a counterparty;

Who Provides / Uses Credit Ratings?

There are three main ratings agencies, all of which are used in the Authority's treasury strategy.

- Fitch
- Moody's Investor Services
- Standard & Poor's

The ratings supplied by these agencies are used by a broad range of institutions to help with investment decisions, these include:

- Local Authorities;
- Other non-financial institutional investors;
- Financial institutions;
- Regulators;
- Central Banks;

Rating Criteria

There are many different types of rating supplied by the agencies. The key ones used by the Authority are ratings to indicate the likelihood of getting money back on terms invested. These can be split into two main categories:

- 'Short Term' ratings for time horizons of 12 months or less. These may be considered as the most important for local authorities.
- 'Long Term' ratings for time horizons of over 12 months. These may be considered as less important in the current climate.

In addition, the agencies issue sovereign, individual and support ratings which will also feed into the investment strategy.

Rating Scales (Fitch, Moody's and Standard & Poor's)

The table below shows how some of the higher graded short and long term ratings compare across the agencies; the top line represents the highest grade possible. (There are other ratings that go much lower than those shown below, and ratings for other elements).

| Short Term | | | Long Term | | |
|------------|---------|------|-----------|---------|-----|
| Fitch | Moody's | S&P | Fitch | Moody's | S&P |
| F1+ | P-1 | A-1+ | AAA | Aaa | AAA |
| F1 | P-1 | A-1 | AA | Aa2 | AA |
| F2 | P-2 | A-2 | A | A2 | A |