

# Treasury Management Strategy 2020/21 to 2023/24

For Consideration by Council 26 February 2020

## 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 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.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure) and are separate from the day to day treasury management activities.

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

### Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2020-21, all local authorities to prepare an additional report, a capital strategy report, which will provide the following:

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

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

This capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

## **Treasury Management Reporting**

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.

### **1.3 Treasury Management Strategy for 2020/21**

The strategy for 2020/21 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 responsible officer to ensure that Members with responsibility for treasury management receive adequate associated training. This especially applies to Members responsible for scrutiny. A training session was held for members on 5 December 2019 supplemented by further internal briefings on 16 and 22 January 2020. The training needs of treasury management Officers are periodically reviewed.

## **1.5 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 external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

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

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments such as investment properties. The commercial type investments require specialist advisers. The Council used Carigiet Cowan Chartered Surveyors in relation to this activity.

## **2 CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2023/24**

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.

<b>Capital expenditure</b>	<b>2018/19 Actual £m</b>	<b>2019/20 Estimate £m</b>	<b>2020/21 Estimate £m</b>	<b>2021/22 Estimate £m</b>	<b>2022/23 Estimate £m</b>	<b>2023/24 Estimate £m</b>
General Fund	7.27	7.98	29.24	20.15	15.47	8.92
Housing Revenue Account (HRA)	3.99	4.77	4.12	4.21	4.23	4.06
Commercial activities/non-financial investments*	0.00	15.00	16.00	16.00	16.00	16.00
<b>Total</b>	<b>11.26</b>	<b>27.75</b>	<b>49.36</b>	<b>40.36</b>	<b>35.70</b>	<b>28.98</b>
<b>Financed by:</b>						
Capital receipts	(0.37)	(0.59)	(0.57)	(0.57)	(0.57)	(0.57)
Capital grants	(4.86)	(6.17)	(12.09)	(6.82)	(2.25)	(1.89)
Capital reserves	(4.43)	(4.86)	(4.51)	(4.10)	(4.06)	(3.86)
Revenue	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)	(0.00)
<b>Net financing need for the year</b>	<b>1.60</b>	<b>16.13</b>	<b>32.19</b>	<b>28.87</b>	<b>28.82</b>	<b>22.66</b>

*\* Commercial activities/non-financial investments related to areas such as capital expenditure on property investments*

The net financing need for commercial activities/non-financial investments included in the above table against expenditure is shown below:

<b>Commercial activities/non-financial</b>	<b>2018/19 Actual £m</b>	<b>2019/20 Estimate £m</b>	<b>2020/21 Estimate £m</b>	<b>2021/22 Estimate £m</b>	<b>2022/23 Estimate £m</b>	<b>2022/23 Estimate £m</b>
Capital Expenditure	0.00	15.00	16.00	16.00	16.00	16.00
Financing Costs	0.00	0.00	0.72	1.04	1.04	1.04
<b>Net financing need for the year</b>	<b>0.00</b>	<b>15.00</b>	<b>16.72</b>	<b>17.04</b>	<b>17.04</b>	<b>17.04</b>
Percentage of total net financing need %	<b>0.00</b>	<b>92.99</b>	<b>51.92</b>	<b>59.02</b>	<b>59.13</b>	<b>75.20</b>

## 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, which has not immediately been paid for through a revenue or capital resource, 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 no leases within the CFR.

Members are asked to approve the CFR projections below:

£m	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
<b>Capital Financing Requirement</b>						
CFR – Non Housing	43.55	43.33	57.67	68.00	77.91	81.25
CFR – Housing	39.34	38.29	37.25	36.21	35.17	34.13
CFR – Commercial activities/non-financial investments	0.00	15.00	30.75	46.19	61.62	77.06
<b>Total CFR</b>	<b>82.89</b>	<b>96.62</b>	<b>125.67</b>	<b>150.40</b>	<b>174.70</b>	<b>192.44</b>
<b>Movement in CFR</b>						
Non Housing	(0.06)	(0.22)	14.34	10.33	9.91	3.34
Housing	(1.06)	(1.04)	(1.04)	(1.04)	(1.04)	(1.04)
Commercial activities/non-financial investments	0.00	15.00	15.75	15.43	15.43	15.43
<b>Net Movement in CFR</b>	<b>(1.12)</b>	<b>13.74</b>	<b>29.05</b>	<b>24.72</b>	<b>24.30</b>	<b>17.73</b>

<b>Movement in CFR represented by</b>						
Net financing need for the year (above) re Non Housing	1.60	16.13	32.20	28.87	28.82	22.66
Less MRP/VRP and other financing movements	(2.72)	(2.39)	(3.15)	(4.14)	(4.52)	(4.93)
<b>Net Movement in CFR</b>	<b>(1.12)</b>	<b>13.74</b>	<b>29.05</b>	<b>24.73</b>	<b>24.30</b>	<b>17.73</b>

.A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures and details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

## 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 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 being made. In approving this Strategy, Council approves the following MRP Statement:

From 1 April 2008 for all unsupported borrowing the MRP will be:

- **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.

**MRP Overpayments** – A change introduced by the revised Government MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision, 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 31 March 2019 the total VRP overpayments were £7.28m

## 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:

<b>Year End Resources</b>	<b>2018/19 Actual £m</b>	<b>2019/20 Estimate £m</b>	<b>2020/21 Estimate £m</b>	<b>2021/22 Estimate £m</b>	<b>2022/23 Estimate £m</b>	<b>2023/24 Estimate £m</b>
Fund balances / reserves	33.33	30.67	28.09	27.79	27.71	28.06
Capital receipts	0.00	0.00	0.00	0.00	0.00	0.00
Provisions	4.04	4.04	4.04	4.04	4.04	4.04
<b>Total core funds</b>	<b>37.37</b>	<b>34.71</b>	<b>32.13</b>	<b>31.83</b>	<b>31.75</b>	<b>32.10</b>
Working capital*	9.18	9.18	9.18	9.18	9.18	9.18
Under borrowing	(19.72)	(34.50)	(31.59)	(32.35)	(31.69)	(30.46)
<b>Expected investments</b>	<b>26.83</b>	<b>9.39</b>	<b>9.72</b>	<b>8.66</b>	<b>9.24</b>	<b>10.82</b>

\*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. Members are asked to approve the following indicators:

## 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.

	<b>2018/19 Actual %</b>	<b>2019/20 Estimate %</b>	<b>2020/21 Estimate %</b>	<b>2021/22 Estimate %</b>	<b>2022/23 Estimate %</b>	<b>2023/24 Estimate %</b>
General Fund	17.04	16.53	20.11	26.31	30.05	32.88
HRA	21.26	20.88	19.96	19.11	18.31	17.56
Commercial activities/non-financial investments	0.00	0.00	64.27	79.09	83.24	86.02

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

	2018/19 Actual £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
<b>External Debt</b>						
Debt at 1 April	64.21	63.17	62.13	94.09	118.05	143.01
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	0.00	33.00	25.00	26.00	20.00
<b>Actual gross debt at 31 March</b>	<b>63.17</b>	<b>62.13</b>	<b>94.09</b>	<b>118.05</b>	<b>143.01</b>	<b>161.97</b>
<b>The Capital Financing Requirement</b>	<b>82.89</b>	<b>96.62</b>	<b>125.68</b>	<b>150.40</b>	<b>174.70</b>	<b>192.43</b>
<b>Under Borrowing</b>	<b>(19.72)</b>	<b>(34.50)</b>	<b>(31.59)</b>	<b>(32.35)</b>	<b>(31.69)</b>	<b>(30.46)</b>

Within the above figures the level of debt relating to commercial activities/non financial investment is:

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate	2023/24 Estimate
<b>External Debt for commercial activities / non-financial investments</b>						
Actual debt at 31 March £m	0.00	0.00	16.00	32.00	48.00	64.00
Percentage of total external debt %	0.00	0.00	17.01	27.11	33.57	39.52

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 Head of Financial Services 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	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt*	81.62	94.92	104.21	113.08	115.37
Other long term liabilities	0.00	0.00	0.00	0.00	0.00
Commercial activities/non-financial investments	15.00	30.75	46.19	61.62	77.06
<b>Total</b>	<b>96.62</b>	<b>125.67</b>	<b>150.40</b>	<b>174.70</b>	<b>192.43</b>

- 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 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. Council is asked to approve the following authorised limit:

Authorised Limit	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
Debt	97.00	110.00	119.00	128.00	130.00
Other long term liabilities	1.00	1.00	1.00	1.00	1.00
Commercial activities/non-financial investments	15.00	31.00	46.00	62.00	77.00
<b>Total</b>	<b>113.00</b>	<b>142.00</b>	<b>166.00</b>	<b>191.00</b>	<b>208.00</b>

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

HRA Debt Limit	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	2023/24 Estimate £m
HRA debt cap*	60.19	60.19	60.19	60.19	60.19
HRA CFR	38.29	37.25	36.21	35.17	34.13
<b>HRA headroom</b>	<b>21.90</b>	<b>22.94</b>	<b>23.98</b>	<b>25.02</b>	<b>26.07</b>

- **Abolition of the HRA debt cap.** In October 2018 prime Minister Theresa May announced a policy change of abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29.10.18

### 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-20	Mar-21	Mar-22	Mar-23
Bank Rate	0.75	0.75	1.00	1.25
3 Month LIBID	0.70	0.90	1.20	1.30
6 Month LIBID	0.80	1.00	1.40	1.50
12 Month LIBID	0.90	1.20	1.60	1.70
5yr PWLB rate	2.30	2.50	2.90	3.10
10yr PWLB rate	2.50	2.70	3.10	3.30
25yr PWLB rate	3.00	3.30	3.70	3.90
50yr PWLB rate	2.90	3.20	3.60	3.80

*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.*

*2019 was a weak year for UK economic growth as political and Brexit uncertainty depressed confidence. It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% during the year. However, during January 2020, financial markets were predicting a 50:50 chance of a cut in Bank Rate at the time of the 30 January MPC meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after that election, had depressed economic growth in quarter 4 of 2019. However, that downbeat news was backward looking; more recent economic statistics and forward looking business surveys, all pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and Brexit uncertainty. The MPC clearly decided to focus on the more recent forward-looking news, rather than the earlier*

downbeat news, and so left Bank Rate unchanged. Provided that the forward-looking surveys are borne out in practice in the coming months, and the March Budget delivers a fiscal boost, then it is expected that Bank Rate will be left unchanged until after the December trade deal deadline. However, the MPC is on alert that if the surveys prove optimistic and/or the Budget disappoints, then they may still take action and cut Bank Rate in order to stimulate growth.

Economic and interest rate forecasting remains difficult with so many external 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 and 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 100bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, the unexpected increase of 100bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. As Link Asset Services' long-term forecast for Bank Rate is 2.25%, and all PWLB certainty rates are close to or above 2.25%, there is little value in borrowing from the PWLB at present. Accordingly the Council will reassess its risk appetite in terms of either seeking cheaper alternative sources of borrowing or switching to short term borrowing in the money markets until such time as the Government might possibly reconsider the margins charged over gilt yields. Longer term borrowing could also be undertaken for the purposes of certainty where that is desirable.
- While this authority will not be able to avoid borrowing to finance £104m, 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.

### **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 2020/21 treasury operations. The Section 151 Officer, 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 borrowing rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing would be postponed.*
- *if it was felt that there was a significant risk of a much sharper RISE 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 would be re-appraised*

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

### 3.5 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 indicators and limits:

<b>Maturity structure of fixed interest rate borrowing 2019/20</b>	<b>£m</b>	<b>Current %</b>	<b>Lower %</b>	<b>Upper %</b>
Under 12 months	1.04	1.68	0	100
12 months and within 24 months	1.04	1.68	0	100
24 months and within 5 years	3.12	5.02	0	100
5 years and within 10 years	5.20	8.37	0	100
10 years and within 20 years	10.40	16.74	0	100
20 years and within 30 years	2.12	3.40	0	100
30 years and within 40 years	39.20	63.11	0	100
40 years and within 50 years	0.00	0.00	0	100

### 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

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

If rescheduling was done it would be reported to Cabinet at the earliest meeting following its action.

## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Investment Policy

The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy (a separate report).

Council's investment policy has regard to the following:

- MHCLG 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, liquidity second, then 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 the council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. The authority has defined the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in **annex B2** 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 more complex instruments which require greater consideration by members and officers before being authorised for use.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio. (see paragraph 4.3)
6. **Lending limits** (amounts and maturity), for each counterparty will be set through applying the matrix table in paragraph 4.2
7. **Transaction limits** are set for each type of investment in 4.2
8. The Council will set a limit for the amount of its investments which are invested for **longer than 365 days** (see paragraph 4.4)
9. Investments will only be placed with counterparties from countries with a specified minimum sovereign rating (see paragraph 4.3)
10. The Council has engaged **external consultants** (see paragraph 1.5), 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.
11. All investments will be denominated in **sterling**.
12. As a result of the change in accounting standards for 2020/21 under IFRS9, the 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

The Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

#### **Changes in risk management policy from last year.**

The above criteria are unchanged from last year

## **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	£1m	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 B2.*

*\*\* 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 to help support its decision making process.

### **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 2020. 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.

### 4.3 Country Limits

Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors

- a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 20% of the total investment portfolio.
- b) **Country limit.** 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 Investment Strategy

The proposed investment aspects of the strategy for treasury activities continues to provide for investing with other local authorities given that these, in effect, are as secure as investing with the Government but they offer greater returns, and from an Officer perspective, it makes sense to keep the benefits of such temporary cash investing/ borrowing wholly within the local authority family. Where this is not possible for liquidity reasons the Council is looking to place more emphasis on investment counterparties that are consistent with its own Priorities in particularly around climate change and ethical investments.

**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:** 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 1.25% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- |              |       |
|--------------|-------|
| • Q1 2020/21 | 0.75% |
| • Q1 2021/22 | 1.00% |
| • Q1 2022/23 | 1.25% |

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

- 2019/20 0.75%
- 2020/21 0.75%
- 2021/22 1.00%
- 2022/23 1.25%
- 2023/24 1.50%
- 2024/25 1.75%

The overall balance of risks to economic growth in the UK is probably relatively even due to the weight of all the uncertainties over post-Brexit trade arrangements and the impact of an expansionary government spending policy (as expected in the Budget on 11 March).

The balance of risks to increases or decreases in Bank Rate and shorter term PWLB rates are also broadly even..

**Investment treasury indicator and limit** - 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 an investment, and are based on the availability of funds after each year-end. Council is asked to approve the following treasury indicator and limit:

Maximum principal sums invested > 365 days					
	2019/20	2020/21	2021/22	2022/23	2023/24
Principal sums invested > 365 days	Nil	Nil	Nil	Nil	Nil

#### 4.5 End of year investment report

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

## 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.
- **Link Asset Services** – Link 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
<b>DMADF – UK Government</b>	N/A	<b>100%</b>	<b>N/A</b>	<b>6 months</b>
UK Government gilts	UK sovereign rating	100%	<b>N/A</b>	1 year
UK Government Treasury bills	UK sovereign rating	100%	<b>N/A</b>	1 year
Bonds issued by multilateral development banks	AAA	100%	<b>N/A</b>	6 months
Money Market Funds CNAV	AAA	100%	<b>N/A</b>	Liquid
Money Market Funds LVNAV	AAA	100%	<b>N/A</b>	Liquid
Money Market Funds VNAV	AAA	100%	<b>N/A</b>	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	AAA	100%	<b>N/A</b>	Liquid
Ultra-Short Dated Bond Funds with a credit score of 1.5	AAA	100%	<b>N/A</b>	Liquid
Local authorities	N/A	100%	<b>N/A</b>	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).

## 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