

## **Treasury Management Strategy Statement**

Minimum Revenue Provision Policy  
Statement and Annual Investment Strategy  
2020-21

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## 1 INTRODUCTION

### 1.1 Background

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

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

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

CIPFA defines treasury management as:

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

Currently, this Council has not engaged in any commercial investments and has no non-treasury investments.

### 1.2 Reporting requirements

#### 1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require 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.

The Treasury Management Strategy has been developed alongside the Capital Strategy to ensure that the two documents are consistent.

### **1.2.2 Treasury Management reporting**

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

- a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:
  - the capital plans, (including prudential indicators);
  - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
  - an investment strategy, (the parameters on how investments are to be managed).
- b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- c. **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### **Scrutiny**

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Cabinet.

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

The strategy for 2020/21 covers two main areas:

#### **Capital issues**

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

## **Treasury management issues**

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

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

### **1.4 Training**

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. In September 2019 the Council's Treasury Consultants provided training to all Members as part of the new Member induction. Further training will be arranged as required. 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 the services of our 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.

## 2 THE CAPITAL PRUDENTIAL INDICATORS 2020/21 – 2022/23

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

### 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. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £'000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Corporate	93	108	17	93	13
People	849	497	237	237	237
Place	51	122	175	0	0
HRA	2,485	2,956	4,802	4,026	3,988
<b>TOTAL</b>	<b>3,478</b>	<b>3,683</b>	<b>5,231</b>	<b>4,356</b>	<b>4,238</b>

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure £'000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital receipts	484	418	2,771	2,074	1,533
Capital grants	409	503	237	237	237
Reserves	1,105	1,100	691	581	1,023
Repairs and Renewals Fund	92	174	67	34	13
Cash Backed depreciation	1,380	1,461	1,465	1,430	1,432
Contribution from third parties	0	27	0	0	0
Revenue	8	0	0	0	0
<b>Net financing need for the year</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</b>	<b>0</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 historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so it's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the

indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long-term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £0.1m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£'000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
<b>Capital Financing Requirement</b>					
CFR - non housing	101	89	77	65	54
CFR - housing	31,484	31,484	31,484	31,484	31,484
<b>Total CFR</b>	<b>31,585</b>	<b>31,573</b>	<b>31,561</b>	<b>31,549</b>	<b>31,538</b>
<b>Movement in CFR</b>	<b>-12</b>	<b>-12</b>	<b>-12</b>	<b>-12</b>	<b>-11</b>
<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	0	0	0	0	0
Less MRP/VRP and other financing movements	-12	-12	-12	-12	-11
<b>Movement in CFR</b>	<b>-12</b>	<b>-12</b>	<b>-12</b>	<b>-12</b>	<b>-11</b>

### 2.3 Core funds and expected investment balances

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

Year End Resources £'000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Fund balances/reserves	14,052	11,916	10,857	10,814	10,635
Capital Receipts	5,312	5,577	3,502	2,138	1,329
Provisions	1,553	1,494	1,554	1,554	1,554
Other	0	0	0	0	0
<b>Total Core Funds</b>	<b>20,917</b>	<b>18,987</b>	<b>15,913</b>	<b>14,506</b>	<b>13,518</b>
Working Capital*	1,174	1,174	1,174	1,174	1,174
Under borrowing	- 71	- 71	- 71	- 71	- 71
<b>Expected investments</b>	<b>22,020</b>	<b>20,090</b>	<b>17,016</b>	<b>15,609</b>	<b>14,621</b>

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

## 2.4 Minimum revenue provision (MRP) policy statement

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

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

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

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);

These options provide for a reduction in the borrowing need over approximately the asset's life. 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.

### 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 2019, and the position as at 31<sup>st</sup> December 2019 are shown below for both borrowing and investments:

TREASURY PORTFOLIO				
	actual	actual	current	current
	31.3.19	31.3.19	31.12.19	31.12.19
Treasury investments	£000	%	£000	%
banks	14,000	68%	20,945	78%
building societies - unrated		0%		0%
building societies - rated		0%		0%
local authorities		0%		0%
DMADF (H.M.Treasury)		0%		0%
money market funds	4,710	23%	4,060	15%
certificates of deposit		0%		0%
<b>Total managed in house</b>	<b>18,710</b>	<b>90%</b>	<b>25,005</b>	<b>93%</b>
bond funds		0%		0%
property funds	2,000	10%	2,000	7%
<b>Total managed externally</b>	<b>2,000</b>	<b>10%</b>	<b>2,000</b>	<b>7%</b>
<b>Total treasury investments</b>	<b>20,710</b>	<b>100%</b>	<b>27,005</b>	<b>100%</b>
<b>Treasury external borrowing</b>				
local authorities		0%		0%
PWLB	31,413	100%	31,413	100%
LOBOs		0%		0%
<b>Total external borrowing</b>	<b>31,413</b>	<b>100%</b>	<b>31,413</b>	<b>100%</b>
<b>Net treasury investments / (borrow</b>	<b>-10,703</b>	<b>0</b>	<b>-4,408</b>	<b>0</b>

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



£'000	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
<b>External Debt</b>					
Debt at 1 April	31,413	31,413	31,413	31,413	31,413
Expected change in Debt	0	0	0	0	0
Other long-term liabilities (OLTL)	101	89	77	65	54
Expected change in OLTL	-12	-12	-12	-12	-11
<b>Actual gross debt at 31 March</b>	<b>31,514</b>	<b>31,502</b>	<b>31,490</b>	<b>31,478</b>	<b>31,467</b>
<b>The Capital Financing Requirement</b>	<b>31,585</b>	<b>31,573</b>	<b>31,561</b>	<b>31,549</b>	<b>31,538</b>
<b>Under / (over) borrowing</b>	<b>71</b>	<b>71</b>	<b>71</b>	<b>71</b>	<b>71</b>

Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Director for Corporate 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 this 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 £'000	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	36,413	36,413	36,413	36,413
Other long term liabilities	89	77	65	54
<b>Total</b>	<b>36,502</b>	<b>36,490</b>	<b>36,478</b>	<b>36,467</b>

#### IFRS 16 Leases

This standard replaces the current guidance in IAS 17 on leases. The standard provides a single lessee accounting model, requiring lessees to recognise assets and liabilities for all leases unless the lease term is 12 months or less or the underlying asset has a low value. Lessors continue to classify leases as operating or finance, with IFRS 16's approach to lessor accounting remaining substantially unchanged from the IAS 17 approach.

In December 2018, CIPFA/LASAAC announced its plans to delay implementation of IFRS 16 in the Code until 1 April 2020. The Authority will therefore adopt IFRS 16 from 1 April 2020. The impact of adopting IFRS 16 will be disclosed in the financial statements for the year ending 31 March 2021. This will require a change in the Authorised Limit and Operational Boundary which currently has a £5m headroom and will be subject to change once the full impact has been analysed.

### The authorised limit for external debt.

This is a 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. The Council is asked to approve the following authorised limit:

Authorised limit £'000	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	45,910	45,920	45,930	45,940
Other long term liabilities	90	80	70	60
Total	46,000	46,000	46,000	46,000

### 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 and narrative gives the advisor's central view.

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

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

EU on a trade deal within the short time to December 2020, as the prime minister has pledged.

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

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

During the first half of 2019-20 to 30 September, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. (*See paragraph 3.7 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9.10.19.*) There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth.

If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts; at various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

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

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

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

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

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

year time horizon will be heavily dependent on economic and political developments.

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local Council treasury management strategy and risk management. Now that the gap between longer term borrowing rates and investment rates has materially widened, and in the long term Bank Rate is not expected to rise above 2.5%. The Council will need to consider carefully its borrowing strategy in the future taking into account the PWLB rate changes.
- 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 reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. Should a need to borrow arise the Director for Corporate Services will monitor interest rates and risks in the financial markets, adopting a pragmatic approach to changing circumstances and will produce a full financial analysis which will include an assessment of when any long term borrowing should take place, taking into account the following risks:

- \* *if it was felt that there was a significant risk of a sharp FALL in borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.*
- \* *if it was felt that there was a significant risk of a much sharper RISE in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity, or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate*

funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

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

### **3.5 Policy on borrowing in advance of need**

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

The Council does not envisage a situation where it will need to borrow in advance, however if the circumstances dramatically change this will be reported to Full Council together with a revised policy.

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

### **3.6 Debt rescheduling**

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

If rescheduling was done, it will be reported to Council at the earliest meeting following its action.

### **3.7 Approved Sources of Long and Short term Borrowing**

The Council will review the most appropriate level and method of borrowing, preparing a financial evaluation of any affordability and impact of any borrowing that may be undertaken.

The main source of borrowing is likely to be PWLB but other funding sources such as the Municipal bond agency, other local authorities or the loans market itself (banks and building societies)

## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Investment policy – management of risk

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

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

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

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

1. Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
2. **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "**credit default swaps**" and overlay that information on top of the credit ratings.
3. **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
4. This Council has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in appendix 5.3 under the categories of 'specified' and 'non-specified' investments.
  - **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
  - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once

an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.

5. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments as being 25% 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 paragraph 4.2.
8. This 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. This 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 Council 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 2019/20 under IFRS 9, this Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18.) As a result it is not expected that there will be any impact on the General Fund at this time however a provision has been set up to help mitigate any future impact as previously reported to Council.

However, this Council will also pursue **value for money** in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 4.5). 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 applies 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 & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

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

- Yellow            5 years \*
- Dark pink       5 years for Ultra-Short Dated Bond Funds with a credit score of 1.25
- Light pink       5 years for Ultra-Short Dated Bond Funds with a credit score of 1.5
- Purple            2 years
- Blue             1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange          1 year
- Red              6 months
- Green            100 days
- No colour        not to be used

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

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

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

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

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

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour

An institution with any colour coding from blue or orange (up to 1year) to green (up to 100 days) can be used for fixed term investments for up to 1 year in duration.

\* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt –see appendix 5.3.

### UK banks – ring fencing

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

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

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

### 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 25% of the total investment portfolio.
- b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a **minimum sovereign credit rating of AA-** from Fitch (*or equivalent*). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.
- c) **Other limits.** In addition:
  - no more than 50% will be placed with any non-UK country at any time;
  - limits in place above will apply to a group of companies;
  - sector limits will be monitored regularly for appropriateness.

### 4.4 Investment strategy

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

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

#### **Investment returns expectations.**

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

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

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

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

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

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

<b>Upper limit for principal sums invested for longer than 365 days</b>			
<b>£m</b>	<b>2019/20</b>	<b>2020/21</b>	<b>2021/22</b>
Principal sums invested for longer than 365 days	£10m	£10m	£10m
Current investments as at 31.12.19 in excess of 1 year maturing in each year	£0m	£0m	£0m

For its cash flow generated balances, the Council will seek to utilise its money market funds and notice account in order to benefit from the compounding of interest.

### **Sustainable and Ethical Investments**

The Council recognises the importance of supporting sustainability and ethical investments and will ask the financial organisations to provide their ethical statements if they first meet their criteria for risk outlined in TMP1 and will consider Environmental, Social or Governance (ESG) specific products if they meet your risk criteria.

#### **4.5 Investment risk benchmarking**

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

#### **4.6 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.

#### **4.7 External fund managers**

£2m of the Council's funds is externally managed on a discretionary / pooled basis by CCLA. In addition to this, the Council uses Money Market Funds of which there was £4.06m invested as at 31<sup>st</sup> December 2019.

The Council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund manager. In order to aid this assessment, the Council is provided with a suite of regular reporting from its manager. For the property fund, this includes receipt of monthly updates and quarterly statements on fund performance and annual meetings with the external fund manager to review CCLA performance in the current market

Money Market Funds are used as short term cashflow investments, of which all are made are at the decision of the treasury officer in accordance with the treasury strategy. Statements are received on a regular basis.

## **5 APPENDICES**

1. Prudential and treasury indicators
2. Interest rate forecasts
3. Treasury management practice 1 – credit and counterparty risk management
4. Treasury management scheme of delegation
5. The treasury management role of the section 151 officer

## 5.1 CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2020/21 – 2022/23

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

### 5.1.1 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. The Council is asked to approve the following indicators:

#### a. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Non-HRA	- 3.70	- 2.61	- 3.78	- 3.37	- 2.96
HRA	30.50	33.05	32.59	31.65	31.03

#### b. HRA ratios

	2018/19 Actuals	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
HRA debt £'000	31,413	31,413	31,413	31,413	31,413
Number of HRA dwellings	1,816	1,819	1,805	1,801	1,796
Debt per dwelling £'000	17.30	17.27	17.40	17.44	17.49

### 5.1.2 Maturity structure of borrowing

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

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

<b>Maturity structure of fixed interest rate borrowing 2020/21</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%
10 years to 20 years	0%	50%
20 years to 30 years	0%	50%
30 years to 40 years	0%	50%
40 years to 50 years	0%	50%
<b>Maturity structure of variable interest rate borrowing 2020/21</b>		
	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 years to 5 years	0%	50%
5 years to 10 years	0%	50%
10 years to 20 years	0%	50%
20 years to 30 years	0%	50%
30 years to 40 years	0%	50%
40 years to 50 years	0%	50%



## 5.2 INTEREST RATE FORECASTS 2020 – 2023

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1<sup>st</sup> November 2012.

Link Asset Services Interest Rate View													
	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00
Bank Rate													
Link Asset Services	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	25.00%	1.25%
Capital Economics	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	-	-	-	-	-
5yr PWLB Rate													
Link Asset Services	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	2.40%	2.50%	2.50%	2.60%	-	-	-	2.80%	-	-	-	-	-
10yr PWLB Rate													
Link Asset Services	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	2.60%	2.70%	2.80%	2.80%	-	-	-	3.10%	-	-	-	-	-
25yr PWLB Rate													
Link Asset Services	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	3.00%	3.10%	3.20%	3.20%	-	-	-	3.40%	-	-	-	-	-
50yr PWLB Rate													
Link Asset Services	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	3.00%	3.10%	3.20%	3.20%	-	-	-	3.50%	-	-	-	-	-

### 5.3 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

**SPECIFIED INVESTMENTS:** All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable. *(If a deposit is made for say 2 years, it starts as being a non-specified investment and remains as a non-specified investment even when it’s time to maturity falls under 12 months.)*

**NON-SPECIFIED INVESTMENTS:** These are any investments, which do not meet the specified investment criteria. A maximum of £10 million will be held in aggregate in non-specified investment.

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

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

	Minimum credit criteria / colour band	£ limit per institution	Max. maturity period
DMA DF – UK Government	N/A	unlimited	6 months
UK Government gilts	UK sovereign rating	£2m	12 months
UK Government Treasury bills	UK sovereign rating	£2m	12 months
Money Market Funds CNAV	AAA	£3m per fund	Liquid
Money Market Funds LNAV	AAA	£3m per fund	Liquid
Money Market Funds VNAV	AAA	£3m per fund	Liquid
Ultra-Short Dated Bond Funds	Selection process to determine most appropriate	£3m per fund	Liquid
Local authorities	N/A	100%	12 months
	N/A	£2m- non specified	5 years

	<b>Minimum credit criteria / colour band</b>	<b>£ limit per institution</b>	<b>Max. maturity period</b>
Term deposits with housing associations	Blue Orange Red Green	£3m per institution	12 months
Term deposits with banks and building societies	Blue Orange Red Green	£6m per institution £9m per banking group	12 months
CDs or corporate bonds with banks and building societies	Blue Orange Red Green	£3m- non specified per banking group	12 months
CDs or corporate bonds with banks and building societies	Blue Orange Red Green	£6m per institution £9m per banking group	12 months
Property Funds (longer term investment option)	N/A	£5m	Minimum 5 years
Multi asset funds (longer term investment option)	Via selection process	£5m	Minimum 3 years
Council's own bank	N/A	Unlimited	Overnight

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

## **5.4 TREASURY MANAGEMENT SCHEME OF DELEGATION**

### **(i) Council**

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

### **(ii) Cabinet**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

### **(iii) Director for Corporate Services**

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

## **5.5 TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER**

### **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the updated code is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management).

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the Council
- ensure that the Council has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the Council does not undertake a level of investing which exposes the Council to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an Council
- ensuring that the Council has adequate expertise, either in house or externally provided, to carry out the above