Treasury Management Strategy Report 2019/20

INTRODUCTION

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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

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

Reporting Requirements

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

Governance and Audit Committee – As part of the committees terms of reference the above reports are presented to them for consideration and scrutinity during the year. The Committee also have delegated authority to approve in year ammendments to the Treasury Management Strategy.

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

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

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

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.

Treasury Management Strategy for 2019/20

The strategy for 2019/20 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, MHCLG MRP Guidance, the CIPFA Treasury Management Code and MHCLG Investment Guidance.

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 responsibe for scrutiny. Training has been undertaken by members of Governance and Audit and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

Treasury management consultants

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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.

SECTION 1 - THE CAPITAL PRUDENTIAL INDICATORS 2019/20 to 2021/22

Introduction

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

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	2018/19 Outturn £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
Non-HRA	19.873	14.214	1.683	1.841
HRA	5.727	16.489	15.113	13.796
Total	25.600	30.703	16.796	15.637

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	2018/19 Outturn £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
Capital Expenditure:				
Non-HRA	19.873	14.214	1.683	1.841
HRA	5.727	16.489	15.113	13.796
Financed by:				
Capital receipts	1.488	5.770	1.600	600
Capital grants	2.602	862	797	797
Reserves	13.511	14.071	14.399	11.465
Net financing need for the year	7.999	10.000	0.000	2.775

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 Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, 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 borrowing need in line with each asset life.

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

The Council is asked to approve the CFR projections below:

	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
Capital Financing Requirement				
Closing CFR – Non Housing	11.701	21.393	20.891	20.395
Closing CFR - Housing	102.848	99.626	96.404	95.957
Total CFR	114.549	121.019	117.295	116.352
Opening CFR	109.926	114.549	121.019	117.295
Movement in CFR	4.623	6.470	(3.724)	(0.943)

	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
Movement in CFR represented by				
Net financing need for the year	7.999	10.000	0.000	2.775
Repayment of HRA Borrowing	(3.222)	(3.222)	(3.222)	(3.222)
Less MRP/VRP and other financing movements	(0.154)	(0.308)	(0.502)	(0.496)
Movement in CFR	(3.376)	(3.530)	(3.724)	(0.943)

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	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
General Fund balances	14.826	11.874	12.251	12.323
Capital reserves – General Fund	2.955	1.905	1.755	1.755
Capital reserves – HRA	18.039	9.137	4.517	3.549
HRA reserve	2.571	2.059	1.610	1.610
Major Repairs Reserve	12.646	13.307	11.446	9.648
Total Core Funds	**51.037**	**38.282**	**31.579**	**28.885**
Working Capital - GF*	2.588	2.523	2.523	2.523
Working Capital - HRA*	3.059	3.301	2.679	3.927
Expected Investments	**56.684**	**44.106**	**36.781**	**35.335**

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

SECTION 2 – Borrowing

An underpinning principle of the local authority financial system is that all capital expenditure has to be financed either from capital receipts, capital grants (or other contributions) or eventually from revenue income. The broad aim of prudent provision is to require local authorities to put aside revenue over time to cover their Capital Financing Requirements. In doing so, local authorities should align the period over which they charge MRP to one that is commensurate with the period over which their capital expenditure provides benefits.

All future capital acquisitions that are financed through prudential borrowing will be required to demonstrate affordability but the extent that MRP is accounted for will be determined on a case by case basis and be in accordance with the four options sets out in the statutory guidance. It is expected that that calculation method adopted will be the asset life method which allows the MRP provision to be based on the estimated useful life of the asset.

During the year it is anticipated that there will be a requirement to undertake borrowing to fund capital expenditure and this will impact on the prudential indicators that are presented in the current version of the Treasury Management Strategy. This will require approval to amend the relevant prudential indicators and these will be presented as part of the business case for the relevant proposal. It is proposed that changes to the Treasury Management strategy during the year are considered and approved by Cabinet and Governance and Audit Committee as necessary.

In October 2018 the Housing Revenue Account borrowing cap was abolished which had previously limited the borrowing the Council could undertake for the HRA to £135m in total. The removal of the cap means that future borrowing decisions need to be assessed within the prudential framework mindful of ongoing affordability.

Debt and Investment Projections

The capital expenditure plans set out in Section 1 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. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

The Councils forecast treasury portfolio position at 31 March 2019, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
External Debt				
Existing Debt at 1 April	102.321	107.099	113.877	110.655
Expected change in debt	7.999	10.000	0.000	2.775
HRA Settlement	(3.222)	(3.222)	(3.222)	(3.222)
Debt at 31 March	**107.099**	**113.877**	**110.655**	**110.209**
Closing CFR	114.549	121.019	117.295	116.352
Under / (over) borrowing	7.450	7.142	6.640	6.143
Total Investments at 31 March				
Expected Investments	**56.684**	**44.106**	**36.781**	**35.335**
Net Debt	**50.415**	**69.771**	**73.874**	**74.874**

Within the 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 CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes

The Section 151 or Deputy Section 151 officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report

Treasury Indicators: Limits to Borrowing Activity

The operational boundary and authorised limit have been increased to reflect the potential borrowing requirements that may be considered in order to facilitate the delivery of the regeneration projects and the lending to the Local Authority controlled company. Any capital schemes that have borrowing implications will be fully evaluated to identify the overall impact on the prudential indicators.

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**.**

Operational Boundary	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/22 Estimated £m
Debt (non HRA)	20.000	30.000	30.000	30.000
HRA Reform	108.765	108.765	108.765	108.765
Other long term liabilities	0.000	0.000	0.000	0.000
Total	**109.765**	**138.765**	**138.765**	**138.765**

The operational boundary will be reviewed on an individual project basis as required.

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

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 no control has yet been exercised.

The Council is asked to approve the following authorised limit:

Authorised limit	2018/19 Revised £m	2019/20 Estimated £m	2020/21 Estimated £m	2021/2022 Estimated £m
Debt (non HRA)	38.000	48.000	48.000	48.000
HRA Reform	108.765	108.765	108.765	108.765
Other long term liabilities	0.000	0.000	0.000	0.000
Total	**146.765**	**156.765**	**156.765**	**156.765**

Prospects for Interest Rates

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

Annual Average %	Bank Rate	PWLB Borrowing Rates (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2019	0.75	2.10	3.00	2.60
Jun 2019	1.00	2.20	3.10	2.80
Sep 2019	1.00	2.20	3.10	2.90
Dec 2019	1.00	2.30	3.10	2.90
Mar 2020	1.25	2.30	3.20	3.00
Jun 2020	1.25	2.40	3.30	3.10
Sep 2020	1.25	2.50	3.30	3.10
Dec 2020	1.50	2.50	3.40	3.20
Mar 2021	1.50	2.60	3.40	3.20
Jun 2021	1.75	2.60	3.50	3.30
Sep 2021	1.75	2.70	3.50	3.30
Dec 2021	1.75	2.80	3.60	3.40
Mar 2022	2.00	2.80	3.60	3.40

The forecast for Investment rates are based on a central assumption that there is a Brexit deal is agreed. If there is an agreement the bank rate could again continue to increase in May 2019 but this will end by February 2020. However in the case of a no deal Brexit then there is the potentail for cuts in the Bank Rate.

Borrowing Strategy 2019/20 – 2020/21

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.

When the Council is considering undertaking borrowing to fund the capital programme, projects or to fund future debt maturities a clear business case must be developed.

The business case will need to take in to consideration, the revenue consequences of the borrowing including interest payable, MRP and any future income to be generated from the project. Borrowing can then be undertaken where there is a clear business case and affordability is demonstrated

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Section 151 or Deputy Section 151 will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

The uncertainty over future interest rate increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy.

The option of postponing borrowing and running down investment balances will also be considered. This would reduce counterparty risk and hedge against the expected fall in investments returns.

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 the 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 Section 151 or Deputy Section 151 may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed interest rates will be economically beneficial or meet budgetary constraints. Whilst the Section 151 or Deputy Section 151 will adopt a cautious approach to any such borrowing, where there is a clear business case for doing so borrowing may be undertaken to fund the approved capital programme or to fund future debt maturities.

It would not look to borrow more than 24 months in advance of need.

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.

Debt Rescheduling

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

The reasons for any rescheduling to take place will include:

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

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

SECTION 3 - ANNUAL INVESTMENT STRATEGY

Investment Policy and Counterparty Selection Criteria

The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, then return. Annex 3 details the councils policy for non-treasury investments.

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

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

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

Investment instruments identified for use in the financial year are listed in Annex 2 under the 'specified' and 'non-specified' investment categories. Counterparty limits will be as set through the Council's treasury management practices-schedules.

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 and 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

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

*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

The Link Asset Services creditworthiness service uses a wider array of information 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 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 are monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services creditworthiness service.

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

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

The Treasury Management Officer will use the Link Credit Rating weekly listing as a tool for guidance, with the option to deviate from this guidance only when there are clear alternative options that are available to the Council. Any decision of this nature should be clearly documented for audit purposes.

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).

Investment returns expectations. Bank Rate is forecast to stay flat at 1.00% until quarter 4 2019 and not to rise above 1.50% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%
- 2021/22 1.75%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.50%
- 2021/22 1.75%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.50%

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

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

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

Maximum principal sums invested > 365 days			
	2019/20 £m	2020/21 £m	2021/22 £m
Principal sums invested > 365 days	13.000	11.000	10.000

Investment Risk Benchmarking

These benchmarks are simple guides to maximum risk, so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.022% historic risk of default when compared to the whole portfolio.

Liquidity – In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.25m

- Liquid short term deposits of at least £9m available with a week's notice.
- Weighted Average Life benchmark is not expected to exceed a maximum of 1 year.

Yield - Local measures of yield benchmarks are:

- Investments – Internal returns above the 7 day LIBID rate
- Investments – External fund managers - returns 110% above 7 day compounded LIBID.

And in addition that the security benchmark for each individual year is:

	1 year	2 years	3 years	4 years	5 years
Maximum	0.05%	0.15%	0.28%	0.42%	0.59%

Note: This benchmark is an average risk of default measure (potential loss on investments), and would not constitute an actual expectation of loss against a particular investment.

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.

<u>Management Practices for Non-Treasury Investments</u>

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury purposes, requires careful investment management. Such activities includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Council will ensure that all investments are covered in the investment strategy, and will set out, where relevant, the Council's risk appetite and specific policies and arrangements for non-treasury investments. It will be recognised that the risk appetite for these activities may differ from that for treasury management.

The Council will maintain a schedule setting out a summary of existing material investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure. Annex 3 provides further information on these types of investments.

Annex 1 – THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2021/22 AND MRP STATEMENT

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 revenue payments (VRP) if required.

MHCLG Regulations have been issued which 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. The Council is recommended to approve the following MRP Statement**.**

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing practice -** MRP will follow the existing practice outlined in former MHCLG Regulations.

This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 April 2008 for all new unsupported borrowing the preferred MRP method policy will be asset life method (as this option provides for a reduction in the borrowing need over approximately the assets life) which is in line with the MHCLG MRP guidance issued in 2018. Further details can be found at section 2 (borrowing).

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).

This policy will be regularly reviewed against the MHCLG MRP guidance and will be amended if necessary.

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:

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 Revised %	2019/20 Estimated %	2020/21 Estimated %	2021/22 Estimated %
Non-HRA	-1.79%	0.80%	0.97%	0.90%
HRA	15.81%	14.50%	14.87%	14.03%

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

Annex 2

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

MHCLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which are under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 23 June 2004 and will apply its principles to all investment activity. In accordance with the Code, the Section 151 or Deputy Section 151 has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual Investment Strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of the following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments the Council will use. These are high security, and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy Guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement**.**

Specified Investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are low risk assets where the possibility of loss of principal or investment income is small.
These would include sterling investments which would not be defined as capital expenditure with:

Table A – Specified Investments

	Specified Investments Category	Limit
a	**A body of high credit quality,** this category includes the following – □ Any bank or building society using Link Creditworthiness service, following the suggested duration on the list up to a maximum of 365 days. □ Nationalised and Part nationalised banks can be included within specified investments as long as they remain part-nationalised	**£12m per institution** or a maximum of **45% of total investment** (whichever is the greatest), **£12m per corporate group**
b	**The UK Government** (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)	no amount limit
c	**UK local authorities, Parish Council or Community Council**	**£5m per LA, £10m all LAs**
d	**Pooled investment vehicles** (such as money market funds) that have been awarded a high credit rating by a credit rating agency. This category covers pooled investment vehicles, such as money market funds, rated *AAA* by Standard and Poor's, Moody's or Fitch rating agencies. MHCLG Investment Guidance specifies that Money Market Funds with high credit ratings are classified as Specified Investment. These funds are instant access investment. There is possibility that part of the investment may be exposed to counterparties the Council would not approve normally or invest directly. The counterparty risk is mitigated by that – • The Fund Managers diversify investment in a range of counterparties; • The Funds are instant access; • The Council only invests in funds rated AAA; • MHCLG Investment Guidance classifying such funds as Specified Investment.	**£5m** per fund,
e	**Ultra Short Dated Bond Funds** These are similar to normal money market funds but operate on a variable rate basis. The selection criteria will be on the same basis as the pooled investment vehicles with only funds with a credit score of 1.25 and rated *AAA* by Standard and Poor's, Moody's or Fitch rating agencies being used	**£5m** per fund,
f	**Corporate Bond Funds**	**£5m** per fund

Non-Specified Investments – Are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

Amounts invested with any one corporate group shall not exceed £5m (with the exception of Councils own bank).

Amounts invested in non-specified fixed term investments would normally not exceed 35% of the total Invested**.** The Section 151 or Deputy Section 151 has the discretion if required to exceed this, and the limits detailed below, should the rate of return on Investment be beneficial to the council. Any decision will be based on taking into account current and future market conditions as well as counterparty strength and rating. If these circumstances are required this will be reported back to the appropriate committee through the annual reporting cycle.

The table below is not an exhaustive list of all non-specified investments; further options are identified in the narrative section within the strategy.

Table B – Non-Specified Investments

	Non Specified Investment Category	**Limit**
a.	**Any institutions meeting the criteria set out for Specified Investments,** with a maturity of greater than 1 year following the suggested duration on the list up to a maximum of 3 years. (including forward deals in excess of one year from inception to repayment).	**£4m** maximum of **3-years** per institution
b.	**Councils Bank –** Should it fail to meet the basic credit criteria, monies will be restricted to instant access and will be minimised as far as is possible.	**£7m**
c.	**Top 10 building societies, by asset value –** The operation of some building societies does not require a credit rating, although in every other respect the security would match similarly sized societies with ratings. The Council may use such building societies that all placed within the top 10 by asset value.	**£2m** maximum of **3-years** per institution. **£20m for all top 10 building societies**
d.	**UK Local Authorities, Parish Council or Community Council**	**£5m per LA, £10m all LA's**
e.	**Property funds** The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using.	**£5m** per fund **No maximum duration period.**

Note: This Authority will seek further advice on the appropriateness and associated risks with investments in these categories.

Maximum limit per institution – The maximum limit for both specified and non-specified investments is a total of £12m per corporate group with a higher limit of £15m at the discretion of the section 151 (or deputy) where an institution is considered to be of a higher credit quality.

The monitoring of investment counterparties – The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principle and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Section 151 or Deputy Section 151, and if required new counterparties which meet the criteria will be added to the list.

Companies in which the Council has an Interest (Local Authority Controlled Company and Joint Ventures)

The Council has the ability to make equity investments and loans to a Local Authority Controlled Company and Joint Ventures. The criteria for equity investments and loans being made with a company will be that there is a clear business plan that demonstrates the affordability of the investment for the company.

Registered Social Landlords (RSL's)

- This scheme would lend amounts up to £5m per investment to Registered Social Landlords for the purpose of providing housing within the District.
- Repayment terms of up to 10 years would be offered.
- Can be deemed as a service investment as opposed to a Treasury Investment.
- Individual Housing Associations do not have credit ratings therefore it is proposed that we use our external treasury advisers to undertake due diligence checks to assess borrowers' ability to make good the repayment of the loan.
- Loans would be secured by means of a legal charge over the borrowers assets. Related legal costs and loan set up fees would be charged to the borrower.
- Interest rates charged would be set at PWLB/market rates available at the time the loan is agreed. This will provide an investment return and ensure that no gratuitous benefit is included which would have soft loan or state aid implications.
- For accounting purposes loans would be treated as capital expenditure and financed from internal borrowing. This will increase the Capital Financing Requirement (CFR) by the amount of the loan and then this will be written down upon repayment of the principal.
- This approach means that there may not be a requirement to make a Minimum Revenue Provision (MRP) contribution, depending on the circumstances.
- Any activity of this type would only take place after detailed due diligence work be been undertaken.

Use of External Fund Managers – The Council is not restricted to placing funds with cash managers, and will manage funds in house, use fund managers, or brokers if it is appropriate to do so.
The fund managers will use both specified and non-specified investment categories, and are contractually committed to keep to the Council's investment strategy.

Currently the Council has an agreement with King & Shaxson, Tradition UK and Sterling International. The fund managers are required to adhere to the following:

- All investments restricted to sterling denominated instruments;
- Amounts invested with any one institution or Corporate Group should not exceed the limits specified in Table A and Table B.
- Portfolio management is measured against the return provided by the 3 month sterling LIBID, or in accordance with the measures specified in the contract.

The performance of investment managed by Fund Managers is reviewed at least quarterly by the Section 151 or Deputy Section 151.

Annex 3 Investments that are not part of treasury management activities

It is recognised that the Council may make investments for policy reasons outside of normal treasury management activity. These may include:

- 'service investments' held clearly and explicitly in the course of the provision, and for purposes of operational services, including regeneration

- 'commercial investments' which are taken for mainly financial reasons. These may include investments arising as part of business structures, such as shares and loans in subsidiaries or investments explicitly taken with the aim of making a financial surplus for the organisation. Commercial investments also include non-financial assets which are held primarily for financial investment, such as investment properties.

Commercial investments for financial benefit rather than service outcomes are sometimes entered into outside of normal treasury activity so need more careful financial risk assessment. Where such investments do not give priority for security and liquidity over yield, whether because of the nature of the assets themselves or for valid service reasons, it is recommended that the decision should be explicit, the additional risks set out clearly and the impact on financial sustainability identified and reported.

Due diligence processes need to ensure effective scrutiny of the proposed investments, identification of risk to both capital and revenue returns, any external underwriting of those risks and the potential impact on the financial sustainability of the organisation if those risks occur. Where necessary independent and expert advice will be required to ensure that due diligence is suitably robust.

A register of investments and financial guarantees will be maintained and regularly reviewed as part of performance reporting arrangements, including periodic reassessment of the probability of financial guarantees being called upon. This register should be reconciled to the financial instruments disclosures within the statement of accounts.

The council has produced the following strategy for non-treasury investments.

Non-Treasury Investment Strategy

1. This Investment Strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the Government in January 2018, and focuses on the Council's provisions for lending to its own subsidiaries (service investments) and commercial property investment income.

Service Investments: Loans

2. The Council can lend money to its own subsidiaries to support local public services and stimulate local economic growth. The Council has approval to provide a loan of £1.68m to Gravitas Housing Ltd, £0.5m loan to DeliverSK and will also be providing a loan of £0.45m to EnvironmentSK for investment in assets.

3. The Council can also lend up to £5m per investment to Registered Social Landlord's for the purpose of providing housing within the District with repayment

terms of up to 10 years offered. These loans would be considered to be a service investment.

4. The main risk when making this type of loan is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure remains proportionate to the size of the Council, each application will be assessed alongside a robust business case and quarterly financial performance reports will be required to be provided.

5. Accounting standards require the Council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the Council has appropriate credit control arrangements in place to minimise any loss in overdue repayments.

6. Risk assessment: The Council will assess the risk of loss before entering into service loans by evaluating the business case submitted with each counterparty's application to determine how resilient the business is and that the provision of the loan will enable the business to grow and deliver the objectives set out on the business case. The loan will be monitored on a quarterly basis to minimise the risk of any potential loss. During the life of the loan any change in original assumptions will be monitored. The Council will use external advisors if felt appropriate by the Strategic Director - Resources. All loans will be subject to contract agreed by Head of Legal Services. All loans will be approved by Council or the Committee to which this approval has been delegated and will be monitored by the Strategic Director - Resources.

Service Investments: Shares

7. The Council has approval to invest in £1.12m of equity shares in Gravitas Housing Limited. This is the maximum limit that the Council is approved to invest in this type of investment. Any further equity investments in subsidiaries of the council will be included in a report to Council and the limit amended in the report.

8. Security: One of the risks of investing in shares is that they potentially fall in value meaning that the initial outlay may not be recovered. To manage this risk upper limits on the sum invested in subsidiaries will be set at the lowest investment level required to enable the subsidiary to operate.

9. Risk assessment: The Council will assess the risk of loss before entering into and whilst holding shares by going through an extensive process of risk analysis. The risk analysis will include an assessment of the market that the subsidiary will be active in including the nature and level of competition, how the market/customer needs will evolve over time, the barriers to entry and exit and any ongoing investment requirements. As the Council's primary reason for investing in shares may not be the financial return but for service benefits these will also be included in the assessment. This will ensure that that the council has a clear understanding of all of the benefits as well as the potential risks. The Council will use external advisors as thought appropriate by the Strategic Director - Resources.

10. Liquidity: This type of investment is fundamentally illiquid as the investment will be in a council owned subsidiary, in order to limit this the Council, will assess the maximum level of resources that can prudently be committed and ensure that this limit is not exceeded.

11. Non-specified Investments: Shares are the only investment type that the Council has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Council's required upper limits on non-specified investments. The Council has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

12. The Property Investment Policy outlines that the Council will invest in local commercial property with the intention of generating an income that will contribute towards funding the revenue budget. The Council has a range of investment properties which it leases to local businesses which in 2017/18 generated an income of £187k.

13. The table below lists the investment properties by major category and highlight's whether these have been purchased to provide commercial income to support the Council's budget following a reduction in Central Government support as this is the main concern of the new guidance.

Property Type	Value as at 31 March 2018 £m
General Fund Investment Property	4.828
Housing Revenue Account Investment Shops	0.249
Total	5.077

14. Security: In accordance with government guidance, the Council considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

15. Investment properties are revalued each year-end by external valuers, so the Council will consider annually whether the underlying assets provide security i.e. are not below their purchase cost. Should this be the case the Assistant Director of Growth will consider whether holding the assets is appropriate and bring any alternative actions to Council in an update to the Property Investment Policy for that year.

16. Risk assessment: The Council assesses the risk of loss before entering into and whilst holding property investments by:
    - assessing the relevant market sector including the level of competition,
    - the barriers to entry and exit and future market prospects;
    - using advisors if thought appropriate by the Strategic Director - Resources;
    - continually monitoring risk in the whole portfolio and any specific assets

17. Liquidity: Property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. The council takes this into consideration when assessing the cash balances that are required to meet its liabilities.

Proportionality

18. The Council receives income from investment properties which contribute towards achieving a balanced revenue budget. The table below shows the extent to which the expenditure planned to meet the service delivery objectives is dependent on achieving the expected income from these properties over the Medium Term Financial Strategy. Should it fail to achieve the expected income, the Council has reserves which could cover the loss of income in the short term whilst actions were identified to ensure the income shortfall is remedied in the medium term.

Proportionality of General Fund Investments £m	2017/18 Actual	2018/19 Forecast	2019/20 Indicative Budget	2020/21 Indicative Budget	2020/22 Indicative Budget
Gross service expenditure	32.553	33.342	32.502	32.094	32.885
Investment income	(0.171)	(0.327)	(0.333)	(0.333)	(0.333)
Proportion	0.53%	0.98%	1.02%	1.04%	1.01%

Proportionality of HRA Investments £m	2017/18 Actual	2018/19 Forecast	2019/20 Indicative Budget	2020/21 Indicative Budget	2020/22 Indicative Budget
Gross service expenditure	11.771	16.183	16.200	16.200	16.200
Investment income	(0.016)	(0.016)	(0.016)	(0.016)	(0.016)
Proportion	0.14%	0.10%	0.09%	0.09%	0.09%

Capacity and skills

19. Elected Members and statutory officers: The Council recognises that those elected Members and statutory officers involved in the investments decision making process must have appropriate capacity, skills and information to enable them to:

- take informed decisions as to whether to enter into a specific investment;
- assess individual business cases in the context of the strategic objectives and risk profile of the Council; and
- enable them to understand how new decisions have changed the overall risk exposure of the Council.

The Council will ensure that the relevant officers and the Governance and Audit Committee have appropriate skills, providing training and advisor support where there is a skills gap.

20. Commercial deals: The Council will ensure that the Governance and Audit Committee Cabinet, and officers negotiating commercial deals are aware of the core principles of the prudential framework and of the regulatory regime within which local authorities operate.

21. Corporate governance: Any investment decisions will be scrutinised by the Corporate Management Team and Cabinet before final approval. The decisions will be reported in the mid-year and annual treasury management reports.

Investment Indicators

22. The Council has set the following quantitative indicators to allow elected Members and the public to assess its total risk exposure as a result of its investment decisions.

23. Total risk exposure: The first indicator shows the total exposure to potential investment losses.

Total Investment Exposure £m	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury Management Investments	64.785	56.684	44.106
Service Investment – Loans	0	0.730	2.630
Services Investment - Shares	0	1.120	1.120
Commercial Investments – GF Property	4.828	4.828	4.828
Commercial Investments – HRA Property	0.249	0.249	0.249
Total Investments	69.862	63.611	52.933
Commitments to Lend	0	0	0
Total Exposure	69.862	63.611	52.933

24. How investments are funded: Government guidance is that these indicators should include how investments are funded. The council has currently funded all investments with useable reserves. There is £18m included in the capital programme for borrowing which will be allocated to economic development and commercial investments. Once fund has been allocated indicators will be provided which will detail the level of commercial investments funded by borrowing.

25. Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested.

Investments net rate of return %	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Treasury Management Investments	0.90	0.95	1.20
Service Investment – Loans	0	0	PWLB + 2
Services Investment Shares	0	0	2
Commercial Investments – GF Property	8.07	6.76	6.89
Commercial Investments – HRA Property	6.82	6.51	6.51
All Investments	1.42	1.39	1.90

26. The MHCLG guidance lists other indicators and the Council has selected the indicators below as appropriate.

Total Investment Exposure	2017/18 Actual	2018/19 Forecast	2019/20 Forecast
Commercial income to net service expenditure ratio	1.0%	1.85%	2.09%
HRA - Commercial income to net service expenditure ratio	(0.12)%	(0.18)%	(0.20)%
Net Income Return Target	3 - 5%	3 - 5%	3 - 5%
Average vacancy levels	38%	8%	8%
Tenant over 5%	2	2	2
Weighted Average Unexpired Lease Term	12.1 years	10.8 years	9.8 years

Annex 4
Risk Management – The Council undertakes risk assessment for all fixed term deposits or greater than one month. The risk assessment uses the following template –

Risk assessment of new investment

Investment	**Institution**
Investment Product	Institution name
Principal Value	Eligibility
Term	Limit with this institution
Rate	Existing investment value
Rate %	Value inc new investment
Internal Reference	Is it within the limit?

Risk Assessment

Risk of the counterparty defaulting on investment

		Likelihood	
	Counterparty on our specified list: Instant access	1.4	
	Counterparty only on non specified list: Instant access	1.7	
	Counterparty on our specified list: <=364 days	2	Unlikely
	Counterparty on our specified list: <=3 months	1	Unlikely
	Counterparty only on non specified list: <=364 days	2.4	
	Counterparty only on non specified list: >364 days	3	Likely

	Impact of losing the investment	*Impact*	
	Total principal less than £700,000	1	Negligible
	Total principal between £700,000 and £1.4m	2	Minor
	Total principal between 1.4m and £3.5m	3	Major
	Total principal greater than £3.5m	4	Critical

Risk Score :

Risk assessed by:

Risk assessment date:

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