

**TREASURY MANAGEMENT STRATEGY STATEMENT,  
MINIMUM REVENUE PROVISION POLICY STATEMENT  
AND ANNUAL INVESTMENT STRATEGY FOR 2018-19**

Meeting	<b>Governance and Audit Committee – 6 Dec 2017</b>
Report Author	<b>Tim Willis, Director of Corporate Resources &amp; Section 151 Officer</b>
Portfolio Holder	<b>Councillor John Townend, Portfolio Holder for Financial Services and Estates</b>
Status	<b>For Decision</b>
Classification:	<b>Unrestricted</b>

**Executive Summary:**

This report and annexes includes the proposed Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy for 2018/19.

**Recommendation(s):**

That the Governance and Audit Committee approves this report and annexes and recommends that it is approved by Cabinet and Council.

**CORPORATE IMPLICATIONS**

<b>Financial and Value for Money</b>	The financial implications are highlighted in this report and annexes.
<b>Legal</b>	Section 151 of the 1972 Local Government Act requires a suitably qualified named officer to keep control of the Council's finances. For this Council, this is the Director of Corporate Resources, Tim Willis, and this report and annexes is helping to carry out that function.
<b>Corporate</b>	Failure to undertake this process will impact on the Council's compliance with the Treasury Management Code of Practice.

<b>Equalities Act 2010 &amp; Public Sector Equality Duty</b>	<p>There are no equity and equalities implications arising directly from this report and annexes, but the Council needs to retain a strong focus and understanding on issues of diversity amongst the local community and ensure service delivery matches these.</p> <p>It is important to be aware of the Council's responsibility under the Public Sector Equality Duty (PSED) and show evidence that due consideration had been given to the equalities impact that may be brought upon communities by the decisions made by Council.</p>
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<b>CORPORATE PRIORITIES (tick those relevant)✓</b>	
A clean and welcoming Environment	
Promoting inward investment and job creation	
Supporting neighbourhoods	

<b>CORPORATE VALUES (tick those relevant)✓</b>	
Delivering value for money	✓
Supporting the Workforce	
Promoting open communications	

## 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.

CIPFA defines treasury management as:

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

## 1.2 Reporting requirements

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

**Prudential and treasury indicators and treasury strategy** (this report and annexes) - 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.

### Scrutiny

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

## 1.3 Treasury Management Strategy for 2018-19

The strategy for 2018-19 covers two main areas:

### Capital issues

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

### Treasury management issues

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

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG 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. Training was last undertaken by members on 21 September 2015 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

## **1.5 External service providers**

The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors. During the current planning period Capita Asset Services is likely to be sold to The Link Group. The services provided will not change under the new ownership.

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.

The Council uses the ICD Portal to invest or redeem trades in its Money Market Funds (MMFs). The portal provides advanced reporting tools so that the authority can assess its exposure to certain banks or countries.

Some investments via the ICD portal are made via JP Morgan who act as a clearing house for seven of the ten MMFs the Council currently uses. The clearing house allows the authority to make several investments in different MMFs but only requires one payment to the clearing house, therefore saving the authority costs in CHAPS fees.

## **2 THE CAPITAL PRUDENTIAL INDICATORS 2018-19 – 2020-21**

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.

### **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 £m	2016-17 Actual	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
General Fund	8.087	14.768	4.689	3.988	11.682
HRA	5.156	21.882	4.484	3.695	3.188
<b>Total</b>	<b>13.243</b>	<b>36.650</b>	<b>9.173</b>	<b>7.683</b>	<b>14.870</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.

Capital expenditure £m	2016-17 Actual	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
General Fund	8.087	14.768	4.689	3.988	11.682
HRA	5.156	21.882	4.484	3.695	3.188
<b>Total</b>	<b>13.243</b>	<b>36.650</b>	<b>9.173</b>	<b>7.683</b>	<b>14.870</b>
<b>Financed by:</b>					
Capital receipts - GF	2.345	3.224	0.941	0.453	0.830
Capital receipts - HRA	0.336	2.444	0.000	0.000	0.000
Capital grants - GF	4.812	5.554	3.425	3.010	5.597
Capital grants - HRA	1.394	2.233	0.000	0.000	0.000
Reserves - GF	0.374	0.212	0.073	0.000	0.000
Reserves - HRA	2.850	9.244	4.184	3.395	2.888
Revenue - GF	0.000	0.296	0.000	0.025	0.050
Revenue - HRA	0.439	1.056	0.300	0.300	0.300
<b>Net financing need for the year</b>	<b>0.693</b>	<b>12.387</b>	<b>0.250</b>	<b>0.500</b>	<b>5.205</b>

Other long term liabilities: The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

## 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 its 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 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. 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 had £3.264m of long term liabilities (excluding pensions) as at 31 March 2017.

The Council is asked to approve the CFR projections below:

£m	2016-17 Actual	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
<b>Capital Financing Requirement</b>					
CFR – General Fund	26.706	30.963	29.850	28.959	32.356
CFR – HRA	20.377	27.283	26.321	26.187	26.053
<b>Total CFR</b>	<b>47.083</b>	<b>58.246</b>	<b>56.171</b>	<b>55.146</b>	<b>58.409</b>
<b>Movement in CFR</b>	<b>(0.224)</b>	<b>11.163</b>	<b>(2.075)</b>	<b>(1.025)</b>	<b>3.263</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year (above)	0.693	12.387	0.250	0.500	5.205
Less HRA – loan repayments	0.000	0.000	(0.962)	(0.134)	(0.134)
Less GF – lease terminations	0.000	(0.294)	0.000	0.000	(0.347)
Less MRP/VRP and other financing movements	(0.917)	(0.930)	(1.363)	(1.391)	(1.461)
<b>Movement in CFR</b>	<b>(0.224)</b>	<b>11.163</b>	<b>(2.075)</b>	<b>(1.025)</b>	<b>3.263</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 £m	2016-17 Actual	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
Fund balances / reserves	17.164	14.361	12.261	11.241	8.439
Capital receipts	7.120	1.813	1.813	1.813	1.813
Earmarked reserves	11.706	6.523	6.237	5.993	6.064
<b>Total core funds</b>	<b>35.990</b>	<b>22.697</b>	<b>20.311</b>	<b>19.047</b>	<b>16.316</b>
Balances incl working capital*	14.148	17.832	17.296	18.246	20.907
(Under)/over borrowing	(12.150)	(24.529)	(12.607)	(12.293)	(12.223)
<b>Expected investments</b>	<b>37.988</b>	<b>16.000</b>	<b>25.000</b>	<b>25.000</b>	<b>25.000</b>

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

### 3 BORROWING

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

#### 3.1 Current portfolio position

The Council's treasury portfolio position at 1 April 2016, with forward projections 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.

£m	2016-17 Actual	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
<b>External Debt</b>					
Debt at 1 April	29.220	31.669	31.086	41.274	40.903
Expected change in Debt	2.449	(0.583)	10.188	(0.371)	4.019
Other long-term liabilities (OLTL) at 1 April	3.655	3.264	2.630	2.290	1.950
Expected change in OLTL	(0.391)	(0.633)	(0.340)	(0.340)	(0.686)
<b>Actual gross debt at 31 March</b>	<b>34.933</b>	<b>33.717</b>	<b>43.564</b>	<b>42.853</b>	<b>46.186</b>
The Capital Financing Requirement	47.083	58.246	56.171	55.146	58.409
<b>Under / (over) borrowing</b>	<b>12.150</b>	<b>24.529</b>	<b>12.607</b>	<b>12.293</b>	<b>12.223</b>

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 the CFR in the preceding year plus the estimates of any additional CFR for 2018-19 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 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.

#### 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 £m	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
Debt	50.000	55.000	55.000	55.000
Other long term liabilities (incl leases)*	12.000	22.000	22.000	22.000
Total	62.000	77.000	77.000	77.000

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

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

Authorised limit £m	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
Debt	55.000	60.000	60.000	60.000
Other long term liabilities (incl leases)*	15.000	27.000	27.000	27.000
Total	70.000	87.000	87.000	87.000

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

HRA Debt Limit £m	2017-18 Estimate	2018-19 Estimate	2019-20 Estimate	2020-21 Estimate
HRA debt cap	27.792	27.792	27.792	27.792
HRA CFR	27.283	26.321	26.187	26.053
HRA headroom	0.509	1.471	1.605	1.739

*\*Other long term liabilities (in both the Operational Boundary and Authorised Limit above) from 2018-19 includes an estimate for the recognition of leases under International Financial Reporting Standard 16 (IFRS 16). The impact of IFRS 16 has not been reflected elsewhere in this report, pending further information from CIPFA.*

### 3.3 Capita's economic and interest rate forecast (issued by Capita on 23 October 2017)

The Council has appointed Capita 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 Capita's central view.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
<b>Bank rate</b>	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
<b>5yr PWLB rate</b>	1.50%	1.60%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
<b>10yr PWLB rate</b>	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
<b>25yr PWLB rate</b>	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%
<b>50yr PWLB rate</b>	2.70%	2.70%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%

Capita Asset Services undertook its last review of interest rate forecasts on 9 August after the quarterly Bank of England Inflation Report. There was no change in the Monetary Policy Committee's (MPC) policy at that meeting. However, the MPC meeting of 14 September revealed a sharp change in sentiment whereby a majority of MPC members said they would be voting for an increase in Bank Rate "over the coming months". (However, two new members of the MPC start in November who both appear likely to side with the doves on the committee; so this does complicate the outlook for the vote in November.) It is, therefore, possible that there will be an increase from 0.25% to 0.5% at the November MPC meeting but, if not, then at the February 2018 meeting. If that happens, the question will then be as to whether the MPC will stop at just withdrawing the emergency Bank Rate cut of 0.25% in August 2016, after the result of the EU withdrawal referendum, or whether they will embark on a series of further, but gentle, increases in Bank Rate during 2018 and onwards.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Federal Reserve (Fed.) has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert

some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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 and emerging market developments. Such volatility could occur at any time during the forecast period.

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

The overall balance of risks to economic recovery in the UK is currently to the downside but huge variables over the coming few years include just what final form Brexit will take, when finally agreed with the EU, and when.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea., but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. This could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its initial pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in the Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

#### Investment and borrowing rates

- Investment returns are likely to remain low during 2018-19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### 3.4 Borrowing strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's 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 2018-19 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be

postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position 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 has some flexibility to borrow funds this year for use in future years. The Section 151 Officer may do this under delegated power where, for instance, a sharp rise in interest rates is expected, and so borrowing early at fixed rates will be economically beneficial or meet budgetary constraints. Whilst the Section 151 Officer 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.

Borrowing in advance will be made within the constraints that:

- The authority would not look to borrow more than 18 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.

### **3.6 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.

All rescheduling will be reported to Cabinet at the earliest meeting following its action.

### **3.7 Municipal Bond Agency**

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

## **4 ANNUAL INVESTMENT STRATEGY**

### **4.1 Investment policy**

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

In accordance with the above guidance from the CLG 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 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.

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' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

## 4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Capita Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria may be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA-
 and have, as a minimum, the following credit rating from at least one of Fitch, Moody's and Standard and Poors (where rated):
  - i. Short term – F1 (or equivalent)
  - ii. Long term – A (or equivalent)
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland Group. This bank can be included provided it continues to be part nationalised or it meets the above criteria.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.

- Bank subsidiary and treasury operations - The Council will use these where the parent bank has the necessary ratings outlined above.
- Building societies: The Council will use all societies which meet the ratings/criteria for banks outlined above.
- Pooled investment vehicles (including money market funds, enhanced money market funds and bond funds) – AAA
- UK Government (including gilts, treasury bills and the DMADF)
- Local authorities, parish councils, community councils, companies controlled by the Council (either alone or with other public sector organisations) etc
- Supranational institutions

A limit of £5m will be applied to the use of investments with a maturity of over 364 days.

**Use of additional information other than credit ratings.** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

**Time and monetary limits applying to investments.** The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long Term Rating (or equivalent)*	Money Limit	Time Limit
<b>Higher quality</b>	<b>AA-</b>	<b>£6m per institution</b>	<b>370 days</b>
<b>Medium quality</b>	<b>A</b>	<b>£5m per institution</b>	<b>370 days</b>
<b>Part nationalised</b>	<b>N/A</b>	<b>£7m per institution</b>	<b>370 days</b>
<b>Debt Management Account Deposit Facility</b>	<b>UK sovereign rating</b>	<b>unlimited</b>	<b>6 months</b>
<b>Pooled investment vehicles (including money market funds, enhanced money market funds and bond funds)</b>	<b>AAA</b>	<b>£6m per fund</b>	<b>370 days</b>
<b>Local authorities, parish councils, community councils, companies controlled by the Council (either alone or with other public sector organisations), Supranational institutions etc</b>	<b>N/A</b>	<b>£4m per institution</b>	<b>5 years</b>

*\*The institution must have this minimum credit rating from at least one of Fitch, Moody's, and Standard and Poors (where rated).*

The proposed criteria for specified and non-specified investments are shown in Annex 2 for approval.

### 4.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

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

In addition:

- no more than £5m will be placed with any non-UK country at any time (this limit applies to each non-UK country individually and not to non-UK countries in total);
- limits in place above will apply to a group of companies;

The above restrictions do not apply to pooled investment vehicles (including money market funds, enhanced money market funds and bond funds). The Council only invests in sterling denominated pooled investment vehicles.

### 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).

**Capita's Investment returns expectations (issued by Capita on 23 October 2017).** Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

2017-18	0.25%
2018-19	0.25%
2019-20	0.75%
2020-21	1.00%

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

2017-18	0.25%
2018-19	0.25%
2019-20	0.50%
2020-21	0.75%
2021-22	1.00%
2022-23	1.50%
2023-24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently skewed to the upside after the September MPC meeting shocked financial markets with a sharp change to hawkish warnings that Bank Rate was likely to go up 'in the coming months'. However, it is currently unclear as to whether these words reflect a desire to only do a one off withdrawal of the emergency rate cut of 0.25% in August 2016, probably then followed by a long pause before any further increases, or whether this implies an imminent start to a progressive gentle series of increases in Bank Rate during 2018 and then onwards.

**Investment treasury indicator and limit** - total principal funds invested for greater than 364 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: -

<b>Maximum principal sums invested &gt; 364 days</b>			
<b>£m</b>	<b>2018-19</b>	<b>2019-20</b>	<b>2020-21</b>
Principal sums invested > 364 days	£5m	£5m	£5m

For its cash flow generated balances, the Council will seek to utilise its instant access and notice accounts, pooled investment vehicles and term deposits in order to benefit from the compounding of interest.

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

These benchmarks are simple guides to maximum risk, so they 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:

- 0.05% historic risk of default when compared to the whole portfolio (excluding unrated investments).

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

- Bank overdraft - £0.5m
- Liquid short term deposits of at least £10m available with a week's notice.
- Weighted average life benchmark is expected to be 0.5 years, with a maximum of 5 years.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate

And in addition that the security benchmark for each individual year is (excluding unrated investments):

	1 year	2 years	3 years	4 years	5 years
<b>Maximum</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>	<b>0.05%</b>

Note: This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

#### **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 Use of external fund managers**

It is the Council's policy not to use external fund managers for any part of its investment portfolio.

### **5 OPTIONS**

That the Governance and Audit Committee:

- a) Approves this report and annexes, including each of the key elements of this report and annexes listed below, and recommends that it is approved by Cabinet and Council.
  - The Capital Plans, Prudential Indicators and Limits for 2018-19 to 2020-21, including the Authorised Limit Prudential Indicator.
  - The Minimum Revenue Provision (MRP) Policy.
  - The Treasury Management Strategy for 2018-19 to 2020-21 and the Treasury Indicators.
  - The Investment Strategy for 2018-19 contained in the Treasury Management Strategy, including the detailed criteria.
- b) Does not approve this report and annexes and does not recommend that it is approved by Cabinet and Council (advising the reason(s) why); thereby not complying with the Treasury Management Code of Practice.

### **6 NEXT STEPS**

Under the Treasury Management Code of Practice it is required that the Governance and Audit Committee, Cabinet and Council approve this report and annexes.

This report and annexes is to go to Cabinet and then Council for approval. The next Cabinet meeting is on 16 January 2018.

### **7 DISCLAIMER**

This report (including its annexes) is a technical document focussing on public sector investments and borrowings and, as such, readers should not use the information contained within the report to inform personal investment or borrowing decisions. Neither Thanet District Council nor any of its officers or employees

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Reporting to:	Madeline Homer, Chief Executive

### Annex List

Annex 1	The Capital Prudential and Treasury Indicators 2018-19 – 2020-21 and MRP Statement
Annex 2	Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
Annex 3	Guidance on Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy (TMSS)

### Corporate Consultation Undertaken

Finance	Ramesh Prashar, Head of Financial Services
Legal	Tim Howes, Director of Corporate Governance & Monitoring Officer