

# **Treasury Management Strategy Statement**

## **Minimum Revenue Provision Policy Statement and**

## **Annual Investment Strategy**

### **2017/18**

#### **1 Introduction**

##### **Background**

- 1.1 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.
- 1.2 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.
- 1.3 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."

##### **Reporting requirements**

- 1.4 The Council is required to produce three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are all required to be scrutinised and reviewed. This role is undertaken by the Council's Scrutiny Panel and Governance and Audit Committee.
- 1.5 **Prudential and Treasury Indicators and Treasury Strategy** (This report) – The first, and most important report is recommended to Full Council following consideration by the Scrutiny Panel. It 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).
- 1.6 **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.
- 1.7 **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.

- 1.8 Members will also be kept informed of any other significant matters that may occur as part of the quarterly Capital Monitoring reports to Scrutiny Panel and Audit and Governance Committee.

### **Training**

- 1.9 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management or scrutiny receive adequate training in treasury management. Training has previously been undertaken by members and further training will be arranged as required. The training needs of treasury management officers are periodically reviewed.

### **Treasury Management Strategy for 2017/18**

- 1.10 The strategy for 2017/18 covers the following Capital and Treasury Management issues:

- the capital plans and the prudential and treasury indicators;
- the Minimum Revenue Provision (MRP) Policy;
- the current treasury position;
- the economic background and prospects for interest rates;
- the borrowing strategy;
- the investment policy and strategy, and credit worthiness policy;
- the policy on use of external service providers.

- 1.11 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.

### **Treasury management consultants**

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

## 2 **The Capital Prudential Indicators 2017/18 – 2019/20**

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

### **Capital Expenditure**

- 2.2 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:

<b>Capital Expenditure £'000</b>	<b>2015/16 Actual</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
General Fund	6,401	14,417	10,974	18,520	1,632
HRA	13,663	11,199	11,288	11,860	10,898
<b>Total</b>	<b>20,064</b>	<b>25,616</b>	<b>22,262</b>	<b>30,380</b>	<b>12,530</b>

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

<b>Capital Expenditure £'000</b>	<b>2015/16 Actual</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
Total Expenditure	20,064	25,616	22,262	30,380	12,530
<b>Financed by:</b>					
Capital receipts	1,318	9,782	7,786	17,787	2,132
Capital grants	3,238	3,068	1,399	1,137	0
Reserves	11,172	7,750	7,239	5,381	5,305
Revenue	646	3,902	3,814	3,433	2,527
Finance leases	877	78	0	0	0
<b>Net financing need</b>	<b>2,813</b>	<b>1,036</b>	<b>2,024</b>	<b>2,642</b>	<b>2,566</b>

### **The Capital Financing Requirement**

- 2.4 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.
- 2.5 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's life.
- 2.6 The CFR includes any other long term liabilities (e.g. finance leases) brought onto the balance sheet. Whilst this increases 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 £3.3m of such schemes within the CFR as at 31 March 2016. The Council is asked to approve the CFR projections below:

£'000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
CFR – general fund	25,630	24,520	23,342	23,415	22,251
CFR - housing	127,933	128,969	130,993	132,320	134,886
<b>Total CFR</b>	<b>153,563</b>	<b>153,489</b>	<b>154,335</b>	<b>155,735</b>	<b>157,137</b>
<b>Movement in CFR</b>	2,395	(74)	846	1,400	1,402
<b>Movement in CFR represented by:</b>					
Net financing need	2,813	1,036	2,024	2,642	2,566
Assets acquired under finance leases	877	78	0	0	0
Less MRP	1,295	1,188	1,178	1,242	1,164
<b>Movement in CFR</b>	<b>2,395</b>	<b>(74)</b>	<b>846</b>	<b>1,400</b>	<b>1,402</b>

### **Minimum revenue provision (MRP) Policy Statement**

- 2.7 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments (VRP) if required.
- 2.8 CLG Regulations have been issued which require the 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:
- 2.9 For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will allow for the borrowing need (CFR) to be repaid on an equal instalment basis over a period of 50 years with effect from the 2016/17 financial year. This has the benefits of reducing the amount payable for the first 17 years, introducing a consistent level of charge, and ensuring that this element of MRP is eventually completely repaid.
- 2.10 From 1 April 2008 for all unsupported borrowing (including finance leases) the MRP policy will be the Asset Life Method (option 3) – MRP will be based on the estimated life of the assets, in accordance with the regulations. This provides for a reduction in the borrowing need over approximately the asset's life. Repayments included in finance leases are applied as MRP.
- 2.11 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.
- 2.12 The Accountancy team will keep the Council's MRP Policy under review to ensure that it remains fit for purpose in relation to its borrowing requirements.

### **Affordability Prudential Indicators**

- 2.13 The previous paragraphs 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:
- 2.14 **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.

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
%					
General Fund	8.06%	7.46%	7.85%	8.74%	8.84%
HRA	18.06%	18.58%	18.88%	19.24%	19.21%

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

2.16 **Incremental impact of capital investment decisions on council tax.** This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
£			
Council Tax - Band D	0	0	0

2.17 **Incremental impact of capital investment decisions on housing rent levels.** Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels. This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
£			
Weekly housing rents	0	0	0

### 3 **Treasury Management Strategy**

- 3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. 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.
- 3.2 The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External debt at 1 Apr	136,094	136,094	137,130	139,154	141,796
New borrowing	0	1,036	2,024	2,642	2,566
Other long-term liabilities	2,700	2,074	1,383	770	447
<b>Gross debt at 31 Mar</b>	<b>138,794</b>	<b>139,204</b>	<b>140,537</b>	<b>142,566</b>	<b>144,809</b>
CFR	153,563	153,489	154,335	155,735	157,137
<b>Under / (over) borrowing</b>	<b>14,769</b>	<b>14,285</b>	<b>13,798</b>	<b>13,169</b>	<b>12,328</b>
Investments at 31 Mar	37,406	36,370	34,346	31,704	29,138
<b>Net Debt</b>	<b>101,388</b>	<b>102,834</b>	<b>106,191</b>	<b>110,862</b>	<b>115,671</b>

- 3.3 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 2017/18 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.
- 3.4 The Chief Finance 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 report.

#### **Treasury Indicators: Limits to Borrowing Activity**

- 3.5 The **Operational Boundary** 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 £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	137,130	139,154	141,796	144,362
Other long term liabilities	2,074	1,383	770	447
<b>Total</b>	<b>139,204</b>	<b>140,537</b>	<b>142,566</b>	<b>144,809</b>

- 3.6 The **Authorised Limit** for external debt 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.

- 3.7 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. The Council is asked to approve the following Authorised Limit:

<b>Authorised limit £'000</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
Debt	166,515	168,252	170,465	172,390
Other long term liabilities	2,074	1,383	770	447
<b>Total</b>	<b>168,589</b>	<b>169,635</b>	<b>171,235</b>	<b>172,837</b>

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

<b>HRA Debt Limit £'000</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
HRA debt cap	140,275	140,275	140,275	140,275
HRA CFR	128,969	130,993	132,320	134,886
HRA headroom	11,306	9,282	7,955	5,389

  

<b>HRA Debt Ratios £'000</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
HRA debt	128,969	130,993	132,320	134,886
HRA revenues	30,181	29,807	29,355	29,534
Ratio of debt to revenues	4	4	5	5
Number of HRA dwellings	6,002	5,952	5,912	5,872
Debt per dwelling (£'000)	21	22	22	23

## 4 **Economic Outlook**

- 4.1 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. **Appendix A** draws together current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following table gives the Capita Asset Services central view:

	Bank Rate	PWLB Borrowing Rates			
		5 year	10 year	25 year	50 year
<b>Mar-17</b>	0.25%	1.60%	2.30%	2.90%	2.70%
<b>Jun-17</b>	0.25%	1.60%	2.30%	2.90%	2.70%
<b>Sep-17</b>	0.25%	1.60%	2.30%	2.90%	2.70%
<b>Dec-17</b>	0.25%	1.60%	2.30%	3.00%	2.80%
<b>Mar-18</b>	0.25%	1.70%	2.30%	3.00%	2.80%
<b>Jun-18</b>	0.25%	1.70%	2.40%	3.00%	2.80%
<b>Sep-18</b>	0.25%	1.70%	2.40%	3.10%	2.90%
<b>Dec-18</b>	0.25%	1.80%	2.40%	3.10%	2.90%
<b>Mar-19</b>	0.25%	1.80%	2.50%	3.20%	3.00%
<b>Jun-19</b>	0.50%	1.90%	2.50%	3.20%	3.00%
<b>Sep-19</b>	0.50%	1.90%	2.60%	3.30%	3.10%
<b>Dec-19</b>	0.75%	2.00%	2.60%	3.30%	3.10%
<b>Mar-20</b>	0.75%	2.00%	2.70%	3.40%	3.20%

- 4.2 The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip in economic growth. During the two-year period when the UK is negotiating the terms for withdrawal from the EU, it is unlikely that the MPC will do anything to dampen growth prospects, which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in until quarter 2 2019, after those negotiations are expected to have been concluded. However, if strong domestically generated inflation were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.
- 4.3 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments. The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.
- 4.4 PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could



continue to occur for the foreseeable future. The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently.

- 4.5 Borrowing interest rates were on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically low levels after the referendum and then even further after the MPC meeting of 4th August, when a new package of quantitative easing purchasing of gilts was announced. 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 later times when the Council may not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

## **5 Borrowing Strategy**

- 5.1 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.
- 5.2 At 31 March 2016 the Council's Capital Financing Requirement was £153.5m and, net of finance lease liabilities, the underlying borrowing requirement was £150.3m. The Council's external borrowing totalled £136.1m, which meant under-borrowing totalled £14.2m.
- 5.3 There would be a cost of carry to any new long-term borrowing that causes an increase in cash balances, as this position will incur a revenue loss between borrowing costs and investment returns. However, against this, the long term saving resulting from borrowing at very low rates should be considered. Assuming current rates increase in accordance with the above forecast, if borrowing were delayed for two years it would lead to the cost of borrowing being significantly higher over the life of a 50 year loan.
- 5.4 Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Chief Financial 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 borrowing 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 with the likely action that fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- 5.5 Any decisions will be reported to the Scrutiny Panel or Governance and Audit Committee at the next available opportunity.

### **Treasury Management Limits on Activity**

- 5.6 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:
- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
  - Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
  - Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

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

<b>Interest rate Exposures £'000</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
Upper limit on fixed interest rates based on net debt	106,200	110,900	115,700
Upper limit on variable interest rates based on net debt	53,100	55,400	57,800

  

<b>Maturity Structure of fixed interest rate borrowing</b>	<b>Lower</b>	<b>Upper</b>
Under 12 months	0%	15%
12 months to 2 years	0%	15%
2 years to 5 years	0%	15%
5 years to 10 years	0%	15%
10 years to 20 years	0%	30%
20 years to 30 years	0%	30%
30 years to 40 years	0%	40%
40 years to 50 years	0%	40%
Over 50 years	0%	10%

#### **Policy on Borrowing in Advance of Need**

5.8 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. 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**

5.9 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).

5.10 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.

5.11 Any rescheduling will be reported to the Scrutiny Panel or the Governance and Audit Committee at the earliest meeting following its action.

#### **Municipal Bond Agency**

5.12 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the

borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). The Council will consider making use of this new source of borrowing as and when appropriate.

#### **HRA borrowing**

- 5.13 As part of the HRA reform arrangements in April 2012, the Council decided to follow the 'two pool' approach to allocating existing debt, taking into account those loans that were originally raised for a specific purpose. This assumed that the HRA would be 'fully borrowed', however the HRA is now in a position where it may need to borrow to fund the Housing Investment Programme.
- 5.14 As the Council is maintaining an under-borrowed position, the HRA will be recharged for the cost of any new borrowing requirement based on the average balance of unfinanced HRA borrowing during the year, using the PWLB variable rate as at 31 March of the previous year. In an environment of low investment returns and relatively stable borrowing rates, this provides a recharge that is beneficial to both the HRA and General Fund, and can be reasonably forecast from early on in the financial year. This approach will be reviewed annually in conjunction with the TMSS and projected investment returns.

## **6 Annual Investment Strategy**

### **Investment Policy**

- 6.1 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 and then return.
- 6.2 In accordance with the above guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties 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.
- 6.3 Ratings will not be the sole determinant of the quality of an institution, and 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.
- 6.4 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.
- 6.5 Investment instruments identified for use in the financial year are listed in **Appendix B**, which includes Counterparty, time and monetary limits. These will cover both 'Specified' and 'Non-Specified' Investments.
- 6.6 Specified Investments are sterling denominated 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 considered low risk assets where the possibility of loss of principal or investment income is small. Non-Specified Investments are those that do not meet the specified investment criteria. A limit of £20m will be applied to the use of Non-Specified investments (this will partially be driven by the long term investment limits).

### **Creditworthiness policy**

- 6.7 The Council applies the creditworthiness service provided by Capita 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.
- 6.8 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 that indicate the relative creditworthiness of counterparties. These colour codes are used by the

Council to determine the duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow 5 years (UK Government debt or equivalent)
- Dark Pink 5 years Enhanced money market funds (1.25 credit score)
- Light Pink 5 years Enhanced money market funds (1.5 credit score)
- Purple 2 years
- Blue 1 year (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

- 6.9 The creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.
- 6.10 Typically the minimum credit ratings criteria the Council uses will be a Short Term rating (Fitch or equivalents) of F1, and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 6.11 All credit ratings will be monitored on a monthly basis. The Council is alerted to changes to ratings of all three agencies through its use of the creditworthiness service. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing.
- 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.
  - a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.
  - 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 daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.
- 6.12 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, and information on any external support for banks to help support its decision making process.

### Country limits

- 6.13 The Council will only use approved counterparties from countries with a minimum sovereign credit rating of AA-, based on the lowest available rating. However this

policy excludes UK counterparties. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix C**. This list will be amended by officers should ratings change in accordance with this policy.

- 6.14 In addition no more than £10m will be placed with any non-UK country at any time.

#### **Investment strategy**

- 6.15 The Council will manage all of its investments in-house. 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).
- 6.16 The Bank Rate is forecast to remain at 0.25% before starting to rise from quarter 2 of 2019, and not to rise above 0.75% by quarter 1 2020. Investment rates are likely to remain low during this period. The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:
- 2016/17 0.25%
  - 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%
- 6.17 The overall balance of risks to these forecasts is currently slightly to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.
- 6.18 For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

#### **Investment treasury indicator and limit**

- 6.19 The limit for the total principal funds invested for greater than 364 days is 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.

£'000	2017/18	2018/19	2019/20
Max. principal sums invested > 364 days	5,000	5,000	5,000

#### **End of year investment report**

- 6.20 At the end of the financial year, the Council will report on its investment activity to the Governance & Audit Committee as part of its Annual Treasury Report.

## Interest rate forecasts 2017 - 2020

## APPENDIX A

PWLB rates and forecast shown below take into account the 20 basis point certainty rate reduction effective as of 1 November 2012.

Capita Asset Services Interest Rate View													
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%
50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%



**Specified Investments** – All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

**Non-Specified Investments** – These are investments that do not meet the specified investment criteria. A limit of the lesser of £20m or 50% of the portfolio will be held in aggregate in non-specified investments.

A variety of investment instruments may be used that will fall into one of the above categories, subject to the credit quality of the institution. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Organisation	Min. Credit Criteria	Money Limit	Maturity Limit
Banks and Building Societies (including term deposits, CDs or corporate bonds)	Yellow	£7.5m	5 years
	Purple	£7.5m	2 years
	Orange	£7.5m	1 year
	Blue	£7.5m	1 year
	Red	£5.0m	6 months
	Green	£2.5m	100 days
	No colour	Not to be used	
UK Government Gilts	UK sovereign rating	£10m	1 year
UK Government Treasury Bills	UK sovereign rating	£10m	1 year
UK Local & Police Authorities	N/A	Unlimited	1 year
Debt Management Agency Deposit Facility	AAA	Unlimited	6 months
Money Market Funds	AAA	£10m	Liquid
Enhanced Money Market Funds	Dark Pink / Light Pink / AAA	£10m	Liquid
Bonds issued by Multilateral Development Banks	AAA	£3m	6 months
Property Funds	AAA	£5m	

**Notes:**

- Non U.K. country limit of £10m
- Limit in all Building Societies of £10m

The use of property funds can be deemed capital expenditure, and as such will be an application of capital resources. The Council will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.

The criteria in this appendix are intended to be the operational criteria in normal times. At times of heightened volatility, risk and concern in financial markets, this strategy may be amended by temporary operational criteria further limiting investments to counterparties of a higher creditworthiness and / or restricted time limits.

This list is based on those countries that have sovereign ratings of AA- or higher and also have banks operating in sterling markets, which have credit ratings of green or above in the Capita Asset Services credit worthiness service.

<b>AAA</b>	Australia
	Canada
	Denmark
	Germany
	Luxembourg
	Netherlands
	Norway
	Singapore
	Sweden
	Switzerland
<b>AA+</b>	Finland
	Hong Kong
	U.S.A.
<b>AA</b>	Abu Dhabi (UAE)
	France
	Qatar
	U.K.
<b>AA-</b>	Belgium