Appendix 1

Treasury Management Strategy Statement 2019/20 (Updated October 2019)

Introduction

The Chartered Institute of Public Finance and Accountancy (CIPFA) *Treasury Management in the Public Services: Code of Practice* (the Treasury Code) requires the Council to approve a treasury management strategy before the start of each financial year, and review it mid-year.

In addition, the Ministry of Housing, Communities and Local Government (MHCLG) revised guidance on Local Authority Investments and Minimum Revenue Provision (MRP) in February 2019. The guidance requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the MHCLG Guidance.

The Council has invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

Revised strategy: In accordance with the MHCLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

External Context

Economic background: UK Consumer Price Inflation (CPIH) fell to 1.7% year/year in August 2019 from 2.0% in July, weaker than the consensus forecast of 1.9% and below the Bank of England's target. The most recent labour market data for the three months to July 2019 showed the unemployment rate edged back down to 3.8% while the employment rate remained at 76.1%, the joint highest since records began in 1971. Nominal annual wage growth measured by the 3-month average excluding bonuses was 3.8% and 4.0% including bonuses. Adjusting for inflation, real wages were up 1.9% excluding bonuses and 2.1% including.

The Quarterly National Accounts for Q2 GDP confirmed the UK economy contracted by 0.2% following the 0.5% gain in Q1 which was distorted by stockpiling ahead of Brexit. Only the services sector registered an increase in growth, a very modest 0.1%, with both production and construction falling and the former registering its largest drop since Q4 2012. Business investment fell by 0.4% (revised from -0.5% in the first estimate) as Brexit uncertainties impacted on business planning and decision-making.

Politics, both home and abroad, continued to be a big driver of financial markets over the last quarter. Boris Johnson won the Conservative Party leadership contest and has committed to leaving the EU on 31st October regardless of whether a deal is reached with the EU. Mr Johnson prorogued Parliament which led some MPs to put forward a bill requiring him to seek a Brexit extension if no deal is in place by 19th October. The move was successful and, having been approved by the House of Lords, was passed into law. The Supreme Court subsequently ruled Mr Johnson's suspension of Parliament unlawful.

Tensions continued between the US and China with no trade agreement in sight and both countries imposing further tariffs on each other's goods. The US Federal Reserve cut its target Federal Funds rates by 0.25% in September to a range of 1.75% - 2%, a pre-emptive move to maintain economic growth amid escalating concerns over the trade war and a weaker economic environment leading to more pronounced global slowdown. The euro area Purchasing Manager Indices (PMIs) pointed to a deepening slowdown in the Eurozone. These elevated concerns have caused key government yield curves to invert, something seen by many commentators as a predictor of a global recession. Market expectations are for further interest rate cuts from the Fed and in September the European Central Bank reduced its deposit rate to -0.5% and announced the recommencement of quantitative easing from 1st November.

The Bank of England maintained Bank Rate at 0.75% and in its August Inflation Report noted the deterioration in global activity and sentiment and confirmed that monetary policy decisions related to Brexit could be in either direction depending on whether or not a deal is ultimately reached by 31st October.

Financial markets: After rallying early in 2019, financial markets have been adopting a more risk-off approach in the following period as equities saw greater volatility and bonds rallied (prices up, yields down) in a flight to quality and anticipation of more monetary stimulus from central banks. The Dow Jones, FTSE 100 and FTSE 250 are broadly back at the same levels seen in March/April.

Gilt yields remained volatile over the period on the back of ongoing economic and political uncertainty. From a yield of 0.63% at the end of June, the 5-year benchmark gilt yield fell to 0.32% by the end of September. There were falls in the 10-year and 20-year gilts over the same period, with the former dropping from 0.83% to 0.55% and the latter falling from 1.35% to 0.88%. 1-month, 3-month and 12-month LIBID (London Interbank Bid) rates averaged 0.65%, 0.75% and 1.00% respectively over the period.

Recent activity in the bond markets and PWLB interest rates highlight that weaker economic growth remains a global risk. The US yield curve remains inverted with 10-year Treasury yields lower than US 3-month bills. History has shown that a recession hasn't been far behind a yield curve inversion. Following the sale of 10-year Bunds at -0.24% in June, yields on German government securities continue to remain negative in the secondary market with 2 and 5-year securities currently both trading around -0.77%.

Credit background: Credit Default Swap (CDS) spreads rose and then fell again during the quarter, continuing to remain low in historical terms. After rising to almost 120bps in May, the spread on non-ringfenced bank NatWest Markets plc fell back to around 80bps by the end of September, while for the ringfenced entity, National Westminster Bank plc, the spread remained around 40bps. The other main UK banks, as yet not separated into ringfenced and non-ringfenced from a CDS perspective, traded between 34 and 76bps at the end of the period.

There were minimal credit rating changes during the period. Moody's upgraded The Co-operative Bank's long-term rating to B3 and Fitch upgraded Clydesdale Bank and Virgin Money to A-.

Economic background: The major external influence on the Council's treasury management strategy for 2019/20 continues to be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The EU Withdrawal Bill, which repeals the European Communities Act 1972 that took the UK into the EU and enables EU law to be transferred into UK law, narrowly made it through Parliament.

Very little progress was made in finalising negotiations with the EU (these have now been pushed into autumn 2018, with a UK-EU special summit on the Brexit deal expected in November). Nor was much progress made on future trading arrangements with non-EU countries, extending the period of uncertainty.

UK Consumer Price Inflation (CPI) index fell to 2.4% in June, a 12-month low. CPI ticked back up marginally to 2.5% in July. The Bank of England made no change to monetary policy at its meetings in May and June, however hawkish minutes and a 6-3 vote to maintain rates was followed by a unanimous decision for a rate rise of 0.25% in August, taking Bank Rate to 0.75%.

It is the view of the Council's treasury advisor that the UK economy still faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. Central bank actions and geopolitical risks, such as prospective trade wars, have and will continue to produce significant volatility in financial markets, including bond markets.

Financial markets: Gilt yields displayed marked volatility during the period, particularly following Italy's political crisis in late May when government bond yields saw sharp moves akin to those at the height of the European financial crisis with falls in yield in safe-haven UK, German and US government bonds. Over the period, despite the volatility, the yield on the 5-year benchmark gilt only rose slightly from 1.13% to 1.14%, the 10-year from 1.37% to 1.39% and the 20-year gilt from 1.74% to 1.85%. Money markets rates remained low: 1-month, 3-month and 12-month LIBID rates averaged 0.45%, 0.60% and 0.87% respectively over the period.

Credit background: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans.

The big four UK banks are progressing well with ringfencing. Barclays Bank plc and HSBC Bank plc have created new banks (Barclays Bank UK and HSBC UK Bank) and transferred ringfenced (retail) business lines into the new companies. Lloyds Bank plc has created Lloyds Bank Corporate Markets as a new non-ringfenced (investment) bank. RBS has renamed existing group entities and transferred accounts to leave NatWest Markets as the non-ringfenced bank and NatWest Bank, Royal Bank of Scotland and Ulster Bank as the ringfenced banks.

There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

Outlook for the remainder of 2019/20

The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased dramatically.

There appears no near-term resolution to the trade dispute between China and the US, a dispute that the US appears comfortable exacerbating further. With the 2020 presidential election a year away, Donald Trump is unlikely to change his stance.

Parliament appears to have frustrated UK Prime Minister Boris Johnson's desire to exit the EU on 31st October. The probability of a no-deal EU exit in the immediate term has decreased, although a no-deal Brexit cannot be entirely ruled out for 2019 and the risk of this event remains for 2020. The risk of a general election in the near term has, however, increased.

Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Our treasury advisor Arlingclose expects Bank Rate to remain at 0.75% for the foreseeable future but there remain substantial risks to this forecast, dependant on Brexit outcomes and the evolution of the global economy. Arlingclose also expects gilt yields to remain at low levels for the foreseeable future and judge the risks to be weighted to the downside and that volatility will continue to offer longer-term borrowing opportunities.

	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22
Official Bank Rate													
Upside risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Cas	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75
Downside risk	0.50	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75	0.75

Local Context

The Council's balance sheet summary and forecast for the current and future financial years is included in table 1.

Table 1: Balance sheet summary and forecast

	31/3/19 Actual £'000	31/3/20 Estimate £'000	31/3/21 Forecast £'000	31/3/22 Forecast £'000
Capital Financing Requirement (CFR)	39,361	61,730	84,100	104,600
Usable Capital Receipts	(22,798)	(9,868)	(6,368)	(3,868)
Balances & Reserves	(23,793)	(23,575)	(23,575)	(23,575)
Borrowing	(19,500)	(52,600)	(75,000)	(100,000)
Net Balance Sheet Position **	**(26,730)**	**(24,313)**	**(20,843)**	**(22,843)**

***excluding working capital.*

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council currently has external borrowing of £39.5m (30/09/2019) and has an increasing CFR due to the capital programme. It is anticipated that the borrowing requirement could rise to £150m-£200m over the forecast period, reflecting potential investment in commercial properties and town centre regeneration programmes. It should be noted that the Council has also agreed to progress with significant regeneration programmes. The financing approach agreed in the governance for these programmes is quite elastic meaning the CFR will be determined by supported business cases, the timing of spend, and the ability to raise capital resources through assets sales and external funding.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2019/20.

Borrowing Strategy

The Council held external short-term loan finance of £19.5m at 31 March 2019, and this has increased to £39.5m as at 30 September 2019. The balance sheet forecast in table 1 shows that the Council expects to borrow additional amounts in 2019/20. The Council may decide to borrow to pre-fund future years' requirements as well, providing this does not exceed the authorised limit for borrowing of £124 million.

PWLB borrowing rates indicates it may be appropriate to externalise some or all of the current CFR in the near future in order to secure favourable long term borrowing rates. The rates will continue to be monitored by the S151 Officer and advice sought from the Council's treasury management advisors.

Objectives: The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead of long-term.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal/short term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- Any institution approved for investments (see below)
- Any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Somerset County Council Pension Fund)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Council can readily access long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Full Council.

Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the last financial year, the Council's investment balance ranged between £35 million and £75 million. As capital expenditure plans are implemented the investment balances are likely to fall unless these are supported through external funding or borrowing.

Objectives: Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Council will further diversify into more secure and/or higher yielding asset classes during 2019/20. A proportion of the Council's surplus cash is currently invested in short-term unsecured bank deposits, certificates of deposit and money market funds. The financial strategy seeks to increase and maintain higher levels of investment income and we are therefore actively increasing funds held in strategic treasury investments.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown. There are no proposals to change the limits through the mid-year review of the strategy.

Table 2: Approved investment counterparties and limits

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3 m 5 years	£6 m 20 years	£6 m 50 years	£3 m 20 years	£3 m 20 years
AA+	£3 m 5 years	£6 m 10 years	£6 m 25 years	£3 m 10 years	£3 m 10 years
AA	£3 m 4 years	£6 m 5 years	£6 m 15 years	£3 m 5 years	£3 m 10 years

Credit rating	Banks unsecured	Banks secured	Government	Corporates	Registered Providers
AA-	£3 m 3 years	£6 m 4 years	£6 m 10 years	£3 m 4 years	£3 m 10 years
A+	£3 m 2 years	£6 m 3 years	£3 m 5 years	£3 m 3 years	£3 m 5 years
A	£3 m 13 months	£6 m 2 years	£3 m 5 years	£3m 2 years	£3 m 5 years
A-	£3 m 6 months	£6 m 13 months	£3 m 5 years	£3 m 13 months	£3 m 5 years
None	n/a	n/a	£6 m 25 years*	n/a	£3 m 5 years
Pooled funds and real estate investment trusts		£10m (nominal value) per fund			

This table must be read in conjunction with the notes below
*includes unrated UK Local Authorities

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £200,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Investment limits: The Council's revenue reserves available to cover investment losses were £4.6 million on 31st March 2019. The maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£20m per group
Any group of pooled funds under the same management	£20m per manager
Negotiable instruments held in a broker's nominee account	£30m per broker
Foreign countries	£12m per country
Registered providers and registered social landlords	£8m in total
Unsecured investments with building societies	£8m in total
Loans to unrated corporates	£4m in total
Money market funds	£20m in total
Real estate investment trusts	£10m in total

Liquidity management: The Council uses purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

Non Treasury Investments

The definition of investments in CIPFA's revised Treasury Management Code now covers all the financial assets of the Council as well as other non-financial assets which the Council holds primarily for financial return. This is replicated in MHCLG's Investment Guidance, in which the definition of investments is further broadened to also include all such assets held partially for financial return.

The value of the Council's existing non-treasury investments are listed in **Appendix 1A**.

The Council's commercial strategy seeks to build its investment property portfolio in order to increase income available to maintain services, in response to reductions in general grant funding from Government. Most if not all of the proposed investment will require financing to be raised through borrowing. This will require the Council to disregard the statutory guidance in respect of 'borrowing in advance of need', and report the rationale for this. The purpose was clearly set out in the Council's approved Commercial Strategy prior to the release of the latest Guidance, and this will be clarified further within the Capital Strategy that is brought to Members in February 2019.

Treasury Management Indicators

The Council measures and manages its exposure to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	30/9/19 Actual	**2019/20 Target**
Portfolio average credit rating	3.3	5.0

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	30/9/19 Actual	**2019/20 Target**
Total cash available within 3 months	£12.9m	£10m

Interest rate exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

Interest rate risk indicator	**30/9/19 Actual**	**2019/20 Limit**
Upper limit on one-year revenue impact of a 1% rise in interest rates	£0.17m	£0.20m
Upper limit on one-year revenue impact of a 1% fall in interest rates	£0.05m	£0.15m

The impact of a change in interest rates is calculated on the assumption that maturing loans and investment will be replaced at current rates.

Maturity structure of borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	30/9/19 Actual	**Upper**	**Lower**
Under 12 months	100%	100%	100%
12 months and within 24 months	0%	100%	100%
24 months and within 5 years	0%	100%	100%
5 years and within 10 years	0%	100%	100%
10 years and above	0%	100%	100%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

As the council doesn't have any fixed rated external borrowing at present the above upper and lower limits have been set to allow flexibility to borrow within any of the maturity bands.

Principal sums invested for periods longer than 365 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end were:

	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£50m	£30m	£25m

<u>Other Items</u>

There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

Policy on the use of financial derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Investment training: The needs of the Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

Investment advisers: The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is monitored by measuring:

- The timeliness of advice
- The returns from investments

- The accuracy of technical advice
- Regular market testing
- Regular internal meetings to discuss performance
- Direct access to a nominated advisor
- The quality and content of training courses

Investment of money borrowed in advance of need: The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £124 million. The maximum period between borrowing and expenditure is expected to be three years, although the Council is not required to link particular loans with particular items of expenditure.

Minimum revenue provision (MRP): MHCLG published updated Minimum Revenue Provision guidance in February 2018. This includes clarification regarding the application of the guidance in respect of investment properties. The 2019/20 MRP Policy Statement is included in **Appendix 1C**, to include specific provisions for investment properties.

<u>Financial Implications</u>

The budget for investment income in 2019/20 is £1,498,920, based on an average investment portfolio of £50 million at an interest rate of 1.86%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

The budget for minimum revenue provision (MRP) for debt repayment in 2019/20 is £372,950.

The interest received as at 30 September 2019 and the projected year-end position is included in **Appendix 1B**.

<u>Other Options Considered</u>

The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Section 151 Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller

Alternative	Impact on income and expenditure	Impact on risk management
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain

Appendix 1A – Existing Investment & Debt Portfolio Position

EXISTING PORTFOLIO PROJECTED FORWARD

	31/03/18 Actual £'000	31/03/19 Actual £'000	30/09/19 Actual £'000	31/03/20 Estimate £'000	31/03/21 Estimate £'000
External Debt:					
Total External Borrowing	0	19,500	39,500	50,000	75,000
Long-term liabilities					
• *Finance Leases**	138	138	138*	138*	138*
Total External Debt	**138**	**19,638**	**39,638**	**50,138**	**75,138**
Investments:					
• Short term Deposits	8,000	4,000	4,000	3,000	3,000
• Monies on call and Money Market Funds	2,230	480	1,160	1,000	1,000
• Long term Deposits	3,000	1,000	1,000	3,000	3,000
• Bonds/CDs	8,814	2,000	2,000	2,000	2,000
• Property Fund & Other pooled funds	13,000	23,250	23,250	25,000	30,000
Total treasury investments	**35,044**	**30,730**	**31,410**	**35,000**	**39,000**
Non-treasury investments:					
• Investment property	17,633	26,108	52,960	75,000	100,000
Total non-treasury investments	**17,633**	**26,108**	**52,960**	**75,000**	**100,000**
Total Investments	**52,677**	**56,838**	**84,370**	**110,000**	**139,000**
(Net Borrowing Position)/ Net Investment position	**52,539**	**37,200**	**44,732**	**59,862**	**63,862**

*Proposed changes to IFRS 16 (Leases) were sue to come into effect from 1 April 2019, the date has been revised to 1 April 2020. The revised IFRS 16 retains the concept of operating and finance leases for lessors, but adopts a new accounting model for lessees that will see most leases come onto the balance sheet.

This will have a significant impact upon local authorities' accounting and capital finance frameworks, work is ongoing to identify and implement the changes required. The figures included in the table do not take account the potential impact of the revised IFRS 16.

Appendix 1B – Half Year Interest position & Year end Projection

<u>INTEREST AS AT 30 SEPTEMBER 2019 & YEAR END PROJECTION</u>

	Income as at 30 Sept 19	2019/20 Projected
	£'000	**£'000**
Investments advised by Arlingclose:		
Money Market Funds (VNAV)	14	23
Diversified Income Fund (Investec)	94	224
Property Fund (CCLA)	136	270
Pooled Funds	385	771
Advised Investment Total	**629**	**1,288**
Internal Investments:		
Corporate Bonds	11	23
Floating Rate Notes (FRNs)	10	16
Fixed Term Deposits	16	62
Money Market Funds (CNAV) & Business Reserve Accounts	2	3
Internal Investments Total	**39**	**104**
Advised & Internal Investments Total	**668**	**1,392**
Other Interest:		
Miscellaneous Loans	675	1,452
Other Interest Total	**675**	**1,452**
Total Treasury Investment Income	**1,343**	**2,844**
Treasury Income Budget	**749**	**1,499**
Surplus	**594**	**1,345**

Appendix 1C

Minimum Revenue Provision Policy Statement 2019/20

1. Introduction

1.1. Where the Authority finances capital expenditure through borrowing it must put aside resources to repay it. This is usually undertaken by a charge to the annual revenue budget known as Minimum Revenue Provision (MRP).

1.2. It is also possible to use or ‘set aside’ capital receipts to repay capital borrowing. This may be in lieu of and/or additional to a charge to the revenue budget.

1.3. The Statutory Guidance on Minimum Revenue Provision was updated in February 2018, with the requirement that it is fully implemented from 2019/20 financial year. The latest edition provides specific guidance related to investment properties.

1.4. The broad aim of the guidance is to require local authorities to put aside revenue over time to cover their Capital Financing Requirement. 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.

1.5. The Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following policy only incorporates options recommended in the Guidance.

2. The Policy

2.1. For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an “Adjustment A” of £9,113,000.

2.2. For capital expenditure on operational assets incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset by either of the following methods:

a) In equal instalments
b) Using an annuity basis

2.3. For freehold land, MRP will be applied over 50 years, except where there is a structure on the land which the Council considers to have a life of more than 50 years where in such cases the longer life may also be applied to the land.

2.4. For capital expenditure not related to council assets but which has been capitalised by regulation or direction (e.g. capital grants to third parties) will be charged in equal instalments over a period of up to 25 years.

2.5. For assets acquired by finance leases, MRP will be determined as being equal to the element of the rent or charge that goes to write down the lease obligation.

2.6. For investment properties, MRP will be calculated over a period of no more than 50 years, and MRP may be calculated by either of the following methods:

a) In equal instalments
b) Using an annuity basis
c) Weighted to reflect projected net income cash flows over the expected life of investment (up to 50 years)

2.7. MRP will be charged from the start of the financial year after the expenditure is incurred.

2.8. The Section 151 Officer is responsible for calculating the Minimum Revenue Provision in line with the policy approved by Full Council.