Agenda Item

WARRINGTON BOROUGH COUNCIL

COUNCIL
24 February 2020

Report of	**Lynton Green, Director of Corporate Services (Section 151 Officer)/Deputy Chief Executive**	
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Ward Members:	**All**	

TITLE OF REPORT: 2020/21 TREASURY MANAGEMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 This report sets out the Council's proposed Treasury Management Strategy for 2020/21. The report was reported to the Audit and Corporate Governance Committee on 6 February 2020 and scrutinised by them. It is now presented to Council for approval.

2. BACKGROUND

2.1 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 activities is to ensure that cash flow is adequately planned, with sufficient cash being available when it is required to meet payment obligations. Surplus monies are invested, in reliance upon the statutory investment power, in counterparties or instruments approved by the Council as being commensurate with their risk appetite, with a view to ensuring that adequate liquidity takes precedence over investment return.

2.2 Treasury Management activity also incorporates financing the Council's capital expenditure that flows from its approved capital spending plans, whether through the use of available resources, or through external borrowing. This element of activity seeks to balance aggregate borrowing needs over the longer term with planned movements in the Council's Capital Financing Requirement through arranging long and short term borrowing within a balanced risk portfolio approach. It may also be appropriate for certain loans taken out to be restructured in the future where variations in interest rate levels cause this to represent an appropriate risk balancing measure.

2.3 The contribution the treasury management function makes to the authority is critical, as balancing the debt and investment operation ensures liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash

balances generally result from reserves and balance, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

2.4 Whilst any commercial initiatives or loans to third parties may impact on the treasury management function, these activities are referred to by CIPFA as "non-treasury management activities" and thereby considered separately from the more normal form of day to day treasury management activities.

2.5 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.*"

2.6 Revised reporting is recommended for the 2020/21 reporting cycle following revisions by the Ministry for Housing, Communities and Local Government (MHCLG) to the Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and CIPFA Treasury Management Code. The primary reporting changes recommended include the inclusion within the Prudential Code of a capital strategy, to provide a longer-term focus to the capital plans, and enhanced reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is reported to the Council separately.

2.7 The Treasury Management Strategy is drawn from the Council's Treasury Policy Statement and covers investments, borrowing, the outlook for interest rates, the management of associated risks, prudential indicators and the policy to be adopted on the Minimum Revenue Provision (MRP).

2.8 The Council's 2020/21 Treasury Management Strategy is attached at Appendix 1. Whilst endeavours are made to limit the technical content of the Strategy, it is by its nature necessary to include technical aspects. Additional explanations are therefore contained within the glossary of terms in Annexe A with a view to helping Members' understanding of certain technical terms contained in the Strategy.

3 CONFIDENTIAL OR EXEMPT

Not confidential.

4 FINANCIAL CONSIDERATIONS

N/A

5. RISK ASSESSMENT

5.1 The Council would be putting its financial standing at risk, as well as failing to meet the requirements of the Local Government Act 2003, should it not comply with the main thrust of recommended approaches.

5.2 The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy.

6. EQUALITY AND DIVERSITY/EQUALITY IMPACT ASSESSMENT

6.1 The Finance Service undertakes an Equality Impact Assessment (EIA) in its wider functions. Service changes that emerge from proposals contained in the treasury management strategy are subject to EI Assessments.

7. CONSULTATION

Not applicable.

8. REASONS FOR RECOMMENDATIONS

8.1 To ensure the Council's Treasury Management Strategy reflects the manner in which it has had regard to the revised 2017 CIPFA Treasury Management Code of Practice and MHCLG Investment Guidance.

9. RECOMMENDATIONS

9.1 Council approves the 2020/21 Treasury Management Strategy.

10. BACKGROUND PAPER

10.1 Treasury Management working papers.

Contacts for Background Papers:

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11. CLEARANCE DETAILS

	Name	Consulted		Date Consulted
		Yes	No	
SMT			✓	
Director of Corporate Services (Section 151 Officer) / Deputy Chief Executive	**Lynton Green**	✓		24.1.20
Director of Legal Services	**Matthew Cumberbatch**	✓		24.1.20

APPENDIX 1

2020/21 COUNCIL'S TREASURY MANAGEMENT STRATEGY

1. INTRODUCTION

1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code (for "affordability" purposes) and the CIPFA Treasury Management Code of Practice where it is setting set prudential indicators for the next three years to ensure that its capital investment plans are affordable, prudent and sustainable.

1.2 The Council is recommended therefore to set out its Treasury Management Strategy and an Annual Investment Strategy (as recommended by Investment Guidance). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 Each of these Strategies has had regard to the Ministry for Housing, Communities and Local Government (MHCLG) Guidance on Local Government Investments ("the Guidance"), the latest form of which became operative from 1 April 2018.

1.4 The combined Strategy also includes the Council's 2020/21 Minimum Revenue Provision Strategy, which is compiled after having regard to Guidance issued under S.21 (1)(A).

1.5 The CIPFA Code of Practice on Treasury Management (revised in December 2017) has been adopted by the Council. The Investment Guidance has been amended and is detailed in section 9 of this report.

1.6 The primary recommendations of the Treasury Management Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement, which set out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives:

- Reporting Requirements – the Council is recommended to receive and approve, as a minimum, three associated reports each year, which should incorporate appropriate Policies, together with estimates and actuals of associated activities.

    - **Prudential and Treasury Indicators and Treasury Strategy** – the first, and most important report covers:

        1. The capital plans (including prudential indictors);

        2. A Minimum Revenue Provision (MRP) Policy (how residual capital expenditure is charged to revenue over time);

3. The Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and

4. 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 treasury management activity, amending prudential indicators as necessary, and whether any policies require revision. In addition, the Council will receive quarterly update reports.

- **An annual treasury report** – this provides details of a selection of actual prudential and treasury indicators and treasury operations compared with the estimates previously included within the strategy.

(iii) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(iv) Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council, the delegated body is the Audit and Corporate Governance Committee.

1.7 The CIPFA revised 2017 Prudential and Treasury Management Codes recommend that all local authorities prepare a Capital Strategy, to include provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contributes to the provision of services

- An overview of how the associated risks are managed

- The implications for future financial sustainability

The aim of this Capital Strategy is to ensure that all elected members of the Council fully understand the Council's overall long-term policy objectives arising from its Capital Strategy requirements, Governance procedures and risk appetite.

1.8 The Council has completed a Capital Strategy for 2020/21 which is due to be approved at Council on 24th February 2020.

1.9 The suggested Strategy for 2020/21 in respect of the following aspects of the Treasury Management function is based upon the views of treasury officers regarding interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor (Link Asset Services). The Strategy covers two main areas:

Capital Issues
- The capital expenditure plans and the associated prudential indicators
- The Minimum Revenue Provision (MRP) Policy.

Treasury Management issues
- The current treasury position
- Treasury indicators which limit the treasury risk arising from activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling opportunities
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers
- Future developments.

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

1.10 In particular, Section 32 of the Local Government Finance Act 1992 requires the Chief Finance Officer of the Authority to calculate and report upon its budget requirement for each financial year, and the adequacy of proposed financial reserves, to include the revenue costs which flow from capital financing decisions.

1.11 Section 3 of the Local Government Act 2003 requires that regard must be had to the Prudential Code in order to determine an Affordable Borrowing Limit, with the aim of determining and keeping under review how much money an authority can afford to borrow.

1.12 In general, this aims to limit increases in revenue expenditure arising from new capital expenditure where these represent:

- Increases in interest and debt liability charges (MRP) arising from new capital expenditure, or

- Any increases in running costs arising from new capital projects

are restricted to a level, which is affordable within the projected income of the Council for the foreseeable future.

1.13 **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. Both internal and external training courses are regularly provided to Members.

2. TREASURY LIMITS FOR 2020/21

2.1 It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England and Wales the Authorised Limit arising under the Prudential Code represents the legislative limit specified in the Act.

2.2 The Council must have regard to the Prudential Code when setting its Affordable Borrowing Limit (ABL). This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", its extent represents mainly the Council's underlying capital debt liability, whether or not this is fully financed from external borrowing at any moment in time (e.g. the Council may on occasion use its own resources to finance new capital debt liability, rather than investing the monies externally). This underlying capital debt liability may also include any "credit arrangements" entered into by the Council, such as arise from leases. The ABL is determined at least annually, on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4 Prudential and Treasury Indicators identified at Annexe 2 are relevant for the purposes of setting an integrated Treasury Management Strategy.

2.5 The Council is also recommended to indicate whether it has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (the Treasury Management Code). The original Treasury Management Code was adopted in 2004 at a full meeting of the Council, and the 2009 revised Treasury Management Code was adopted at a full meeting of the Council on 1 March 2010. The latest Amendments to the Code amended in 2017 are set out in section 9 of this report. Subject to any amendments by the Committee it will be forwarded to the Council for approval at its meeting of 24th February 2020.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position as at 31st December 2019 comprised of:

Current Portfolio Position	Principal £m	Total £m	Average Interest Rate %
Fixed Rate Funding			
- Public Works Loans Board	815.732		2.267
- Money Market	178.512		2.542
- Temporary Borrowing	170.210	1,164.455	1.015
Variable Rate Funding			
- Public Works Loans Board			
- Money Market	150.000	150.000	0.871
TOTAL BORROWING		**1,314.455**	2.190
Council Investments			
- Externally Managed	(20.577)		4.723
- Internally Managed	(14.049)		1.843
- Call Accounts	(228.864)	(263.490)	0.364
TOTAL INVESTMENTS		**(263.490)**	**1.628**
NET BORROWING		**1,050.965**	
Non-Treasury Investments			
- Group Entities	(310.600)		
- Loans to Housing Assoc. & Commercial	(137.727)		
- Investment Properties	(257.008)	**(705.336)**	
NET BORROWING (less Non-Treasury)		**345.629**	

BORROWING REQUIREMENT

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

3.3 The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

3.4 The table below sets out the Council's future borrowing requirement (current and previous year are shown for comparison) based on current commitments and plans.

2018/19 Actual £m	2019/20 Estimate £m	Capital Expenditure	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m	TOTAL 3 Years £m
230.686	519.822	Capital Expenditure	965.863	249.129	85.058	**1300.050**
		Financed By:				
21.762	19.408	Capital Grants & Reserves	16.051	0.112	0	**16.163**
4.488	4.295	Capital Receipts	4.459	4.025	4.563	**13.047**
0.744	0.298	Council Revenue Funding	9.002	0	0	**9.002**
8.858	11.351	External Funding	13.309	5.209	4.250	**22.768**
194.834	**484.470**	**Financing need for year**	**923.042**	**239.783**	**76.245**	**1239.070**

Please note: Leases estimated at £9m added to 2020/21 capital programme and funded via revenue as previous years, change due to IFRS16 accounting requirement.

4. PROSPECTS FOR INTEREST RATES

4.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

4.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but no solely, the treasury advisers.

4.3 The Council 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.

4.4 The Bank Rate is forecast to remain steady or increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

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

The overall balance of risk to economic growth in the UK is probably neutral. The balance of risk to increases in Bank Rate and shorter term PWLB rates, is probably also even, being mainly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how the Brexit Transition arrangements progress.

Link Asset Services' interest rate forecast

The following table gives their view:

	Bank Rate	PWLB Borrowing Rates			
		5 year	**10 year**	**25 year**	**50 year**
Mar-20	0.75%	2.40%	2.70%	3.30%	3.20%
Jun-20	0.75%	2.40%	2.70%	3.40%	3.30%
Sep-20	0.75%	2.50%	2.70%	3.40%	3.30%
Dec-20	0.75%	2.50%	2.80%	3.50%	3.40%
Mar-21	1.00%	2.60%	2.90%	3.60%	3.50%
Jun-21	1.00%	2.70%	3.00%	3.70%	3.60%
Sep-21	1.00%	2.80%	3.10%	3.70%	3.60%
Dec-21	1.00%	2.90%	3.20%	3.80%	3.70%
Mar-22	1.00%	2.90%	3.20%	3.90%	3.80%
Jun-22	1.25%	3.00%	3.30%	4.00%	3.90%
Sep-22	1.25%	3.10%	3.30%	4.00%	3.90%
Dec-22	1.25%	3.20%	3.40%	4.10%	4.00%
Mar-23	1.25%	3.20%	3.50%	4.10%	4.00%

4.5 The above forecasts have been based on confirmation of the Brexit Withdrawal Agreement, including agreement of satisfactory ongoing terms of trade between the UK and EU. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal within the short time to December 2020, as the Prime Minister has pledged.

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

4.7 **Bond yield / PWLB rates**: there has been much speculation during 2019 that the bond market has gone into a bubble, as evidenced by high bond prices and remarkably low yields. However, given the context that there have been heightened expectations that the US was

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

4.8 During the first half of 2019/20, gilt yields plunged and caused a near halving of longer term PWLB rates to completely unprecedented historic low levels. There is an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts. At various times this correlation has been strong but at other times weak. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

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

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

4.11 In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates. Such changes could be up or down. It is not clear whether H.M. Treasury would remove the extra 100 bps margin implemented on 09/10/19 should gilt yields rise up again by more than 100 bps.

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

4.13 **Investment and borrowing rates**

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019/20 but then jumped up by 100 bps on 09/10/19. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management. While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will most likely incur a revenue cost.

4.14 These assumptions have been used to determine the treasury management budget projections, included as part of the 2020/21 revenue budget and future year projections.

4.15 **Other forecasts** – the data below shows a variety of forecasts published by a number of institutions. The forecast includes Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources.

Capital Economics		**PWLB Borrowing Rates**			
	Bank Rate	**5 year**	**10 year**	**25 year**	**50 year**
Mar-20	0.75%	2.40%	2.60%	3.00%	3.00%
Jun-20	075%	2.50%	2.70%	3.10%	3.10%
Sep-20	0.75%	2.50%	2.80%	3.20%	3.20%
Dec-20	0.75%	2.60%	2.80%	3.20%	3.20%
Mar-21	0.75%	2.60%	2.80%	3.20%	3.20%
Jun-21	0.75%	2.60%	2.80%	3.20%	3.20%
Sep-21	0.75%	2.60%	2.80%	3.20%	3.20%
Dec-21	1.00%	2.80%	3.10%	3.40%	3.50%

5. ECONOMIC BACKGROUND

5.1 **UK : Brexit** – 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. This has now become law. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities:

- The need for an extension of negotiations, probably two years, or
- A no deal Brexit in December 2020

5.2 **GDP growth** has taken a hit from Brexit uncertainty during 2019; Q3 2019 surprised on the upside by coming in at +0.4% q/q, +1.1% y/y. However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is likely to tread water in 2020, with tepid growth around about 1% until there is more certainty after the trade deal deadline is passed.

5.3 The Bank of England produced a quarterly Inflation Report (now renamed the Monetary Policy Report), but there are a number of uncertainties of where the UK will be after the general election. The Bank made a change in their Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that was worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence the MPC views inflation as causing little concern in the near future.

5.4 The MPC December meeting repeated the previous month's vote of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. to review the economy in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that "domestic unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

5.5 If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax

cuts, increases in the annual expenditure budgets of governments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this directions and it made significant promises in its election manifesto to increase government spending by up to £20bn per annum (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget, probably in February 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

5.6 As for inflation, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5%. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

5.7 With regard to the labour market, growth in numbers employed has been quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000, which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

5.8 **USA** – President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. Growth in 2019 has been falling after a strong start in quarter 1 at 3.1% (annualised rate), to 2.0% in quarter 3 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter4. Fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 has weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

5.9 **The Federated Bank -** finished its series of increases in rates to 2.25-2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries, etc.). It then cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50-1.75%. At its September meeting it also said it was going to start buying Treasuries again, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn, whereas it had been reducing its balance sheet by $50bn per month

during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

5.10 Investor confidence has been badly rattled by the progressive ramping up on increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This trade war is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China. However, in November/December, progress has been made on agreeing a phase one deal between the US and China to roll back some of the tariffs, this gives some hope of resolving this dispute.

5.11 **Eurozone** – growth has been slowing from +1.8% during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, (+1.1% y/y) in quarter 3. There appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter2. Industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

5.12 **The European Central Bank (ECB)** – ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a third round of Target Long Term Repurchase Operations (TLTROs). This provides banks with cheap borrowing every three months from September 2019 until March 2021 that means, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of the bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum. At its meeting on 12/09/19 it cut its deposit rate further into negative territory, from -0.4% to 0.5% and announced a resumption of quantitative easing purchases of debt for an unlimited period. At its October meeting it said these purchases would start in November at €20bn per month – a relatively small amount compared to the previous buying programme. It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments would need to help stimulate growth by 'growth friendly' fiscal policy.

5.13 There were no policy changes in the December meeting, which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy. This makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

5.14 On the political front – Austria, Spain and Italy have been in the throes of forming coalition governments with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of German state elections has put further pressure on the frail German CDU/SDP coalition government and on the current leadership of the CDU. The results of the Spanish general election in November have not helped the prospects of forming a stable coalition.

5.15 **China** – economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus, medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

5.16 **Japan** – has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

5.17 **World Growth** – until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, this rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support, (i.e. subsidies), to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair completion that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to suing economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a reversal of world globalisation and a decoupling of western countries from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.

5.18 The trade war between the US and China is a major concern to financial markets due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth. This confirms investor sentiment that the outlook for growth during the year ahead is weak.

5.19 **Interest Rate Forecasts** – the interest rate forecasts provided by Link Asset Services are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. On this basis, while GDP growth is likely to be subdued in 2019 and 2020 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement on the detailed terms of a trade deal is likely to lead to a boost to the rate of growth in subsequent years. This could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an orderly non-agreement exit in December 2020, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there were a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

5.20 **The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably eve, but dependent on a successful outcome of negotiations on a trade deal.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

5.21 One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy,

(i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** – takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipate.
- **Eurozone sovereign debt crisis** – a resurgence of this. In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government. This has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- **European banks** – weak capitalisation of some banks, particularly Italian banks.
- **German minority government** – in the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The CDU has done badly in recent state elections but the SPD has done particularly badly and this has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.
- **Other minority EU governments** – Austria, Finland, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** – now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was potential for a rerun of the 2008 financial crisis, but this time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on some $19trn of corporate debt in major western economies, if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers, etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grate so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England

also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.

- **Geopolitical risks** – for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

5.23 **Upside risks to current forecasts for UK gilt yields and PWLB rates:**

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- **Bank of England** - is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than currently expected.
- **UK inflation** – whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

6. BORROWING STRATEGY

6.1 The capital expenditure plans provide details of the anticipated 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 facilitate 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.

6.2 In general, the Council will borrow for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position, in that it is investing some of its own resources internally. This means that the underlying capital debt liability (primarily signified by the Capital Financing Requirement), has not been fully funded through external borrowing. This strategy is considered to be prudent, as investment returns are low, whilst counterparty risk is also limited under this approach.

6.3 The Council's treasury portfolio position at 31 March 2020, with forward projections is summarised below and detailed in table 3.3. The actual external borrowing (under treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlights an underlying need to borrow £484.470m in 2019/2020, £923.042m in 2020/21, £239.783m in 2021/22 and £76.245m 2022/23. There is a large requirement in the early years. This is due to the impact of new capital schemes in the programme and the need to replace some existing short term loans which were taken to benefit from the then existing market conditions.

6.4 A key aim of the Treasury Management Strategy is to minimise the cost of the Council's external borrowing (portfolio), through seeking to spread the period for which loans are raised so as to avoid any undue fluctuation on interest costs arising from replacement loans.

6.5 Currently the average rate of interest on the Council's loan portfolio is 2.19%, which is considered to be a beneficially low rate. The achievement of such low average rate demonstrates how the Council benefits from the best value for money in terms of its borrowing. This is the result of a number of years proactively managing the portfolio on loans through restructuring and taking advantage of the best possible interest rates available. The proposed treasury management strategy aims to continue this successful approach.

6.6 The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- UK Local Authorities
- Municipal Bond Agency
- Any institution approved for investments including high quality supranational banks
- European Banks Green Sustainable Bond Issuances
- World Wide Banks Green Sustainable Bond Issuances
- UK public and private sector pension funds
- Any other financial institution approved by the Prudential Regulation Authority, which is part of the Bank of England and is responsible for the regulation and supervision of banks, building societies, credit unions, insurers and major investment firms
- Capital market bond investors either over the counter or through electronic trading platforms

6.7 The PWLB rate forecasts are given in the table below.

	PWLB Borrowing Rates			
	5 year	**10 year**	**25 year**	**50 year**
Mar-20	2.40%	2.70%	3.30%	3.20%
Jun-20	2.40%	2.70%	3.40%	3.30%
Sep-20	2.50%	2.70%	3.40%	3.30%
Dec-20	2.50%	2.80%	3.50%	3.40%
Mar-21	2.60%	2.90%	3.60%	3.50%
Jun-21	2.70%	3.00%	3.70%	3.60%
Sep-21	2.80%	3.10%	3.70%	3.60%
Dec-21	2.90%	3.20%	3.80%	3.70%
Mar-22	2.90%	3.20%	3.90%	3.80%
Jun-22	3.00%	3.30%	4.00%	3.90%
Sep-22	3.10%	3.30%	4.00%	3.90%
Dec-22	3.20%	3.40%	4.10%	4.00%
Mar-23	3.20%	3.50%	4.10%	4.00%

6.8 These forecasts are based around an expectation that there will normally be variations of +/-25bp during each quarter around these average forecasts in the normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.

6.9 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates. The Council will also evaluate the option of borrowing further from the bond markets during 2020/21. Borrowing from the bond market will take place if it offers greater value for money than borrowing from the PWLB.

6.10 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 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 still lower than they are projected to be in the next few years.

6.11 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. The Council's policy for 2020/21 will be to balance investments to obtain returns within the council's risk appetite. However, an assessment of the opportunity for borrowing will be made on the cost of borrowing long-term, within forward approved Capital Financing Requirement estimates, and will be consider carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

6.12 Any decisions will be reported to the Audit and Corporate Governance Committee at the next available opportunity.

7. DEBT RESCHEDULING

7.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded, since 20 October 2010 and 9 October 2019 (new borrowing rates), by a considerable further widening of the difference between new borrowing and repayment rates) has meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the large premiums, which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings may still be achievable through using other local authority loans and market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

7.2 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).

7.3 The reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;

(b) Help fulfil the borrowing strategy outlined above;

(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.4 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.

7.5 All rescheduling will be reported to the Audit and Corporate Governance Committee at the earliest meeting following this action.

7.6 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 intends to make use of this new source of borrowing as and when appropriate.

8. TREASURY POLICY STATEMENT

8.1 Treasury management within this Council is undertaken having regard to the CIPFA Code of Practice for Treasury Management in the Public Services ("the TM Code"). This Code has been reviewed and updated following recent developments in the marketplace and the introduction of the Localism Act 2011 for English local authorities.

8.2 The Council has complied with the recommendations of the TM Code and has formally adopted the key recommendations as described within Section 4 of the TM Code.

8.3 In accordance with the TM Code, the Council defines treasury management activities as:

"The management of the council'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."

8.4 'Investments' in the definition above are described within the latest Investment Guidance covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily or partially for financial returns, such as investment property portfolios. This form of recommendation may include investments which are not managed as part of normal treasury management or other activities not carried out in reliance upon the investment power granted by Section 12, Local Government Act 2003. The Council may consider the implications of such other types of activity in accordance with the principles recommended within the Investment Guidance, notwithstanding that this Guidance is restricted to investment Activities carried out in reliance upon the above mentioned S.12.

8.5 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

8.6 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

8.7 The Council will create and maintain, as the cornerstone for effective treasury management:

- A Treasury Policy Statement, setting out the policies, objectives and approach to risk management of its treasury management activities
- Suitable Treasury Management Practices (TMPs) setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (reported to the Audit & Corporate Governance Committee annually)

- Treasury management Prudential Indicators as determined by the recommendations of the CIPFA Prudential Code;
- The content of the policy statement and TMPs will follow the recommendations contained in Sections 6 and 7 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.
- The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, an annual report after its close and an half year review report.
- The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit & Corporate Governance Committee, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's Treasury Management Strategy and the TM Code, who is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

2020/21 COUNCIL'S ANNUAL INVESTMENT STRATEGY

9. INTRODUCTION

9.1 The aim of the Council's Investment strategy is to:

- Maintain the principal amount of sums invested;
- Maintain policy flexibility.

9.2 The Council's Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments made in reliance upon S.12, depending on the prevailing interest rates at the time, and taking into account the risks shown in the forecast above.

9.3 The Council invests surplus cash balances only with certain approved organisations, as security of funds is of primary importance. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

10. INVESTMENT POLICY – Management of Risk

10.1 The MHCLG and CIPFA have suggested an extension of the meaning of 'investments' to include both financial and non-financial investments. The Council is aware, however, of the limits placed by legislation manner and extent of Guidance that may be given by the Secretary of State with regard to investments made in reliance upon S.12. This report does therefore deal solely with financial investments, (as managed by the treasury management team). Non-financial investments are not generally made in reliance upon this power, essentially the purchase of income yielding assets, and are covered in the Capital Strategy, that is reported to Council separately.

10.2 The Council will have regard to:

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

10.3 The Council's investment priorities are:
(a) The security of capital
(b) The liquidity of its investments
(c) Yield
(d) Social Impact

10.4 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

10.5 Council has reviewed its classification with financial institutions under MIFID II requirements. A schedule has been included with the Treasury Management Practices

document of those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

10.6 In accordance with guidance from MHCLG and CIPFA, which places a high priority on the management of risk, the Council has stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list, which also enable diversification and thus avoidance of concentration risk.

10.7 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 and monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is integrated into the credit methodology provided by the advisors, Link Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

10.8 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.

10.9 The aim of the strategy is to generate a list of highly creditworthy counterparties, which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

10.10 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Statement.

11. SPECIFIED INVESTMENTS (MATURITIES UP TO ONE YEAR) AND COUNTERPARTY LIMITS

11.1 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable. The maximum limit will be applied to each account (i.e. bank, local authority, bond, etc.)

1. Specified Investments (limit per counterparty)	Maximum Group Limit
UK Government	Unlimited
Local Authorities	Unlimited
Money Market Funds CNAV	£50.0m
Money Market Funds LVNAV	£50.0m
Money Market Funds VNAV	£20.0m
Pooled Fund Institution with a min rating of AAA/A1	£50.0m
Institutions with a minimum rating of AAA/A1	£50.0m
Institutions with a minimum rating of AA-/A2	£30.0m
Institutions with a minimum rating of A-/A3	£20.0m
Institutions with a minimum rating of BBB/A3	£15.0m
Building Societies – assets greater than £5,000 million	£5.0m
Building Societies – assets greater than £1,000 million	£2.5m
Building Societies – assets greater than £ 250 million	£1.0m

All investments with maturities up to maximum 1 year, high credit criteria:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
Debt Management Agency Deposit Facility	UK sovereign rating	£50m	1 year
Term deposits – local authorities and other public institutions	UK sovereign rating	£20m	1 year
Term deposits – banks and building societies*	UK sovereign rating	£20m	1 year

11.2 Term deposits with nationalised banks, banks and building societies

	Minimum 'High' Credit Criteria	Maximum Limit	Maximum Maturity Period
UK part nationalised banks	UK sovereign rating	£20m	1 year
Banks part nationalised by high credit rated (sovereign rating) countries	Sovereign rating A	£20m	1 year

*The countries approved for investing with their banks: Australia, Canada, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, Finland, USA, Abu Dhabi (UAE), Hong Kong, France, UK, Belgium, and Qatar.

11.3 Other instruments

	Minimum 'High' Credit Criteria	**Max Individual Investment**	**Maximum Total Investment**	**Max Maturity Period**
Collateralised deposit	UK sovereign rating	£5m	£5m	1 year
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	1 year
UK Government Gilts	UK sovereign rating	£10m	£50m	1 year
Bonds issued by multilateral development banks	Long term AA	£10m	£20m	1 year
Treasury Bills	UK sovereign rating	£5m	£20m	1 year

Collective Investment Schemes structures as Open Ended Investment Companies (OEICs)			
Government Liquidity Funds	Long term AA	£10m	1 year
Money Market Funds	Variable CNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable LNNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable VNAV Long Term AAA	£20m per fund	1 year
Enhanced Cash Funds	Long Term AA	£5m	1 year
Bonds Funds	Long Term AA	£5m	1 year / rolling
Gilt Funds	Long Term AA	£5m	1 year
Bond Funds	B- and unrated debt issuers	£20m per fund	1 year / rolling
Managed Account Bond Funds	B- and unrated	£30m per fund	1 year / rolling

12. NON-SPECIFIED INVESTMENTS (MATURITIES OVER ONE YEAR)

12.1 These are any investments which do not meet the specified investment criteria. The investments may be for periods in excess of one year, and/or more complex instruments which require greater consideration by members and officers before being authorised.

12.2 A maximum of 90% may be held in aggregate in non-specified investments. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Term deposits with nationalised banks and building societies:			
	Minimum 'High' Credit Criteria	**Maximum Limit**	**Maximum Maturity Period**
UK part nationalised banks	UK sovereign rating	£20m	5 year
Banks part nationalised by high credit rated (sovereign rating) countries UK and non UK*	Sovereign rating A	£20m	5 year

12.3 Maturities of any period:

	Minimum 'High' Credit Criteria	Maximum Individual Investment	Maximum Group Limit	Maximum Maturity Period
Structured deposits	In accordance with Link's Credit Worthiness Criteria	£5m	£20m	5 years
Banks and Building Societies term deposits with unrated counterparties : any maturity	The top twenty building societies by total assets with a minimum asset size of £1bn and the following credit rating Fitch (or its equivalent):			
	Long term rating AA-, short term rating F2	£1m	£5m	5 years
	Non rated	£0.5m	£1m	1 year
Challenger Banks term deposits with unrated counterparties : any maturity	The non-rated bank must have a minimum asset level of £200m,	£5m	£20m	1 year
Municipal Bonds	UK sovereign rating	£10m	£10m	10 years
Commercial paper	Short-term F2, Long term A	£5m	£5m	5 years
Corporate Bonds Corporate Bond Funds / Gilt Funds	Short-term F2, Long term A	£20m	£20m	10 years
Floating Rate Notes	Long term A	£1m	£5m	5 years
Covered Bonds	Long term AA-	£20m	£50m	10 years
Un-rated bonds	Long term B-	£50m	£50m	10 years
Churches, Charities and Local Authorities (CCLA) Property Fund		£20m	£20m	10 years

12.4 Maturities in excess of 1 year

	Minimum 'High' Credit Criteria	**Maximum Individual Limit**	**Maximum Group Limit**	**Maximum Maturity Period**
Term deposits – local authorities and other public institutions		£5m	£50m	5 years
Term deposits – banks and building societies		£1m	£5m	5 years
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	5 years
UK Government Gilts	UK sovereign rating	£5m	£50m	5 years
Bonds issued by multilateral development banks	AA	£5m	£20m	5 years
Corporate bonds	Short term F2 Long Term A-	£10m	£20m	10 years
Green Energy Bonds	Internal and External Due Diligence	£50m	£50m	5 years
Collateralised Term Deposit	Local Authority	£5m	£20m	5 years
Sovereign bond issues (i.e. other than the UK government)	AA	£5m	£20m	5 years
Property Bonds	External Due Diligence	£20m	£50m	5 years
LiveWire Community Energy	Internal Due Diligence	£1m	£1m	20 years
Funding Circle	Internal and External Due Diligence	£10m	£10m	5 years
Asset Backed Securities	Internal and External Due Diligence	£20m	£100m	10 years
Asset Backed Pooled Funds	Internal and External Due Diligence	£50m	£50m	10 years

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Bond Funds	AA	£5m	£10m	10 years
Gilt Funds	AA	£5m	£10m	5 years
Forest Financial Instrument	Internal and External Due Diligence	£20m	£50m	30 years
Public Sector Social Impact Fund	Unrated	£100m	£100m	10 years
Bond Funds	B- and unrated debt issuers	£50m	£50m	5 years
Managed Account Bond Funds	B- and unrated	£50m	£50m	5 years
Loan Rates	Unrated	£50m	£50m	10 years
Technology Enhanced Oil	Internal and External Due Diligence	£10m	£10m	5 years

12.5 As a result of the change in accounting standards for 2019/20 under IFRS 9, the Council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18)

12.6 **OTHER NON-SPECIFIED INVESTMENTS**

- Fixed term deposits with variable rate and variable maturities
- Local Authority Partnership Purchase Scheme (LAPP)
- Forest Financial Instruments
- Limited Liability Partnerships

13 CREDITWORTHINESS POLICY

13.1 This Council uses the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

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

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

13.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset Services weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

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

**The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

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

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

13.6 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link creditworthiness service:

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately;
- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap (CDS) against the iTraxx (CDS product brand name) benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

13.7 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on any external support for banks and the credit ratings of that government support.

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

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

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

14. COUNTRY LIMITS

14.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them). The list will be added to, or deducted from by officers should ratings change in accordance with this policy.

15. INVESTMENT STRATEGY

15.1 Prudence will drive the Council's investment strategy in 2019/20 due to the volatility and uncertainty that exists in the world's financial markets. Investments will generally be of a short term nature. In order to minimise risk, the Council will look to diversify its investment portfolio by investing in other investment vehicles such as money market funds and property funds. The driving force of our strategy will be maintaining the security of capital. The Council will use a combination of credit ratings, sovereign ratings, internal and external due diligence and guarantees to assess the credit quality of financial institutions before placing investments.

16. INTEREST RATE OUTLOOK

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

- 2019/20 0.75%
- 2020/21 0.75%
- 2021/22 1.00%
- 2022/23 1.00%

16.2 There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

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

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

16.4 The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.

16.5 The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.

16.6 In the event that a Brexit deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

16.7 For 2020/21 the Council will budget for an investment return of 0.75% on investments placed during the financial year.

17. LIQUIDITY OF INVESTMENTS

17.1 The maximum period of investment of treasury balance will be ten years.

17.2 There will be no more than £150m of core treasury funds committed for a period over 5 years.

18. FINANCIAL DERIVATIVES

18.1 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), whilst not resulting in a totally conclusive situation.

18.2 The Authority 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 Authority 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.

19. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

19.1 The Council uses Link Asset Services (previously named Capita Asset Services) as its external treasury management advisers.

19.2 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. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

19.3 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 tendered for the service in 2019 for a three year period.

19.4 The Council fully appreciates the importance of monitoring the activity and resultant performance of its appointed external fund manager. In order to aid this assessment, the Council is provided with a suite of regular reporting from its manager. This includes quarterly/semi-annual and annual reports, statements, access to online fund reporting sites, etc.

19.5 In addition to formal reports, the Council also meets with representatives of the fund manager on (quarterly, semi-annual, annual) basis. These meetings allow for additional scrutiny of the manager's activity as well as discussions on the outlook for the fund as well as wider markets.

20. TREASURY MANAGEMENT SCHEME OF DELEGATION

20.1 The scheme of delegation is in the Council's Treasury Management Practices statement which will be reported to the Audit and Corporate Governance Committee on an annual basis.

20.2 The Council considers it essential, for the purposes of the effective control and monitoring of its Treasury Management activities, the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that the responsibilities of Treasury Management is always clear.

20.3 **Full Council**

- approval of annual treasury management strategy
- approval of the Mid-Year Review Report of Treasury Management
- approval of capital strategy
- monitoring of yearly Treasury Outturn Report

20.4 **Audit and Corporate Governance Committee**

- the body appointed by Council for the scrutiny of Treasury Management
- recommend the Council's Annual Treasury Management Strategy to Council
- recommend approval of amendments to the organisation's adopted clauses, treasury management policy and treasury management practices to Council
- receiving and reviewing regular monitoring reports and acting on recommendations
- recommending the yearly Mid-Year Review and Treasury Outturn Report to Council

20.5 **Section 151 Officer**

The Section 151 Officer (Deputy Chief Executive & Director of Corporate Services) and in their absence their appointed deputies is the delegated responsible officer by Full Council for the operation of the Council's overall borrowing and investment activities. The Section 151 Officer will implement and monitor the Treasury Management Strategy.

21. MINIMUM REVENUE PROVISION (MRP) STRATEGY

21.1 The Council is required to determine a prudent manner in which to charge its underlying capital debt liability to revenue (MRP), mainly in a manner that reflects generally the life of assets that have given rise to that debt liability. The requirement to make a prudent provision arises from S.21 (1A) of the Local Government Act 2003, which also requires local authorities to have regard to the MRP Guidance for the purpose of determining an annual prudent amount of MRP.

21.2 The Council has resolved to have regard to the Guidance when determining the amount of its annual MRP.

21.3 The major proportion of MRP for 2009/10 related to the more historic debt liability that was outstanding at the time the Guidance was adopted. The Council has approved a

variation of earlier statutory provisions which will result in the outstanding debt liability in this respect being charged more prudently over a 50 year period.

21.4 New capital expenditure for each subsequent year will in general be charged in accordance with Option 3 of the Guidance, which recommends that the annual charge should broadly equate to the anticipated life, or period of benefit, which is reflective of the nature of the expenditure. The annual charge will represent an equal annual instalment relative to the assessed life period.

21.5 The determination of which expenditure should be charged under Option 3, and the life periods considered to be applicable to these, will be carried out under delegated powers by the Section 151 Officer.

21.6 The use of this Option for certain schemes/expenditures will also result in there being no MRP charge until the year after that in which the expenditure or scheme results in the actual provision of service or similar benefits to the Authority. This will include, for example, ensuring that MRP is so delayed until the year after all expenditures on a scheme, project or other item of capital expenditure have been fully accrued under proper practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year.

21.7 Items of capital expenditure will only be considered to represent separate amounts in cases where two or more major components have substantially different useful economic lives. Assets will not be transferred into the asset register and fixed assets account until complete, in accordance with Accounting Code principles.

21.8 To the extent that expenditure does not create an asset, and is of a type that is subject to estimated life periods that are referred to in the Guidance, these recommended periods will generally be adopted by the Council. However, in the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no minimum revenue provision made in the first instance where it is considered prudent to adopt this approach. The Council will exercise this determination where they are satisfied that the capital debt liability will be met from the repayment of loans, or reimbursement of other forms of capital expenditure, whilst also ensuring that such decisions are kept under review when formulating each future year's prudent provision.

21.9 A similar type of policy will apply in the case of the Golden Square Shopping Centre. However, instead of relying solely upon principal element of repayments to satisfy the MRP liability, the annual MRP charge that will in effect be made will equate to the principal amount that has been assessed by the Council's advisers, Price Waterhouse Coopers, to be included each year within the repayments received by the Authority under the lease. Rather than resulting in a fixed annual MRP charge over the period of the lease, the nominal amount of MRP charge each year will be regarded as met by the element of the lease rental which serves to write down the outstanding long term debtor created as a consequence of the lease having been granted. The deferred capital receipt created under this arrangement will be earmarked on a yearly basis to pay off the debt liability

over 200 years and will equate to the MRP charge. This approach mirrors that which is recommended within paragraph 20 of the MRP Guidance with regard to leases where the authority is a lessee.

21.10 Other finance leases and Private Finance Initiative (PFI) assets will have their MRP liability determined according to the life of the financial instrument, acting as a a proxy for asset life, or in accordance with the asset life where considered appropriate . MRP on these instruments may separately be considered under IFRS accounting principles where these do not conflict with capitalisation and statutory principles.

21.11 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts, either to reduce outstanding aggregate capital debt liability, or to offset what would otherwise be an annual amount of MRP.

21.12 For those types of capital expenditure incurred by the Council which are not capable of being related to an individual asset (e.g. capitalising revenue items), asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure, and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

21.13 With regard to loans granted by the Council, MRP will not generally be charged. Where MRP is made, it will be related to the underlying asset for which the loan is made towards.

21.14 The policy will be reviewed on an annual basis. If it is proposed to vary the terms of the original Policy Statement during any year, a revised statement should be put to members at that time.

21.15 Option 2 & 4 will be used for economic regeneration and investment schemes if thought to be prudent.

21.16 The Council will charge no MRP on its investment in Redwood Bank for a period of 5 years. This is because the Council wants to build up a sustainable profitable bank before taking any dividends per the business case agreed by the Executive Board on 12th January 2017. After year 5 MRP will be charged over 50 years by applying the annuity method. The major reason for forming the bank was for economic regeneration purposes and the Council sees it as a long term 50+ years investment that all generations of tax payers can benefit from.

21.17 Strategic Asset Investment Programme - The properties in this portfolio are held for investment and economic regeneration purposes and are managed on a fully commercial basis.

21.18 The purchase of these properties will be treated as capital expenditure and will increase the Capital Financing Requirement. The Council is holding these properties solely for investment and economic regeneration purposes and they are leased to business tenants

on commercial lease terms. This includes a range from small local growth SME's to global businesses.

21.19 The Council has the ability to sell this asset or a number of varied approaches to an exit strategy that could raise capital – for example joint venture, equity share, partial sale or additional lease. By sale or raising capital through an alternative route, this can be used to repay any outstanding debt liabilities related to the purchase. As such, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

21.20 The assets will be reviewed annually and if the asset value significantly decreases, a prudent MRP policy will commence on the amount of the fall in value of the asset.

21.21 The Council's borrowing in the Strategic Asset Investment programme is prudent and within the Council's affordable borrowing limit. The Council's Section 151 Officer is satisfied that the borrowing is prudent and that the risks relating to the repayment of loans or the value of the investment are deemed to be low thus there are no resource implications in following this approach.

ANNEXE A

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01% (or 0.0001 decimal form)
Base Rate	Minimum lending rate of a bank or financial institution in the UK
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement
CIPFA	Chartered Institute of Public Finance and Accountancy
CLG	Department for Communities and Local Government
CPI	Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative

	because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
EMU	European Monetary Union
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
EU	European Union
Fed.	Federal Reserve Bank of America – sets the central rates in the USA
Floating Rate Notes	Bonds on which the rate of interest is established periodically with reference to short-term interest rates
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
FSA	Financial Services Authority – body responsible for overseeing financial services.
Fiscal Policy	The Government policy on taxation and welfare payments.
GDP	Gross Domestic Product
GF	General Fund
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Gilt Funds	Pooled fund investing in bonds guaranteed by the UK government.
Government MMF	MMFs that invest solely in government securities, or reverse repurchase agreements backed by Government Securities.
HM Treasury	Her Majesty's Treasury
HRA	Housing Revenue Account
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
iTraxx	The brand name for the group of credit default swaps index products.
LOBO's	Lenders Option Borrowers Option loans
MHCLG	Ministry of Housing, Communities and Local Government
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF.
Monetary Policy committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two year's time from the date of the monthly meeting of the Committee. Their secondary target is to support

	the Government in maintaining high and stable levels of growth and employment.
MRP	Minimum Revenue Provision
MTFP	Medium Term Financial Plan
Open Ended Investment Companies	A diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PFI	Private Finance Initiative
PWLB	Public Works Loan Board
QE	Quantitative Easing
Reverse Gilt Repo	This is a transaction as seen from the point of view of the party which is buying the gilts. In this case, one party buys gilts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gilts on a specified future date, or at call, at a specified price.
Retail Price Index (RPI)	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
RPIX	As RPI but excluding mortgage interest rate movements.
RPIY	As RPI but excluding mortgage interest rate movements and changes in prices caused by changes in taxation.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
SORP	Statement of Recommended Practice
S151	Section 151 Officer
Term Deposit	A deposit held in a financial institution for a fixed term at a fixed rate.
Treasury Bill	Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.
UBS	Union Bank of Switzerland
US	United States
WARoR	Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate.
WAM	Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount.
WATT	Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount.
WA Risk	Weighted Average Credit Risk Number. Each institution is assigned a colour corresponding to a suggested duration using Sector's Suggested Credit Methodology.
Model WARoR	Model Weighted Average Rate of Return is the WARoR that the model produces by taking into account the risks inherent in the portfolio.

PRUDENTIAL INDICATORS

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits.

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.

A Capital Expenditure

The Council has to make a reasonable estimate of the capital expenditure that it plans to incur in the following three years and after the year-end must record the actual capital expenditure incurred in that year.

The Council's capital programme informs the requirements of these indicators. The actual capital expenditure that was incurred by the authority in 2018/19, the revised estimate for the current year and estimates for the future years are as follows:

2018/19 Actual £m	**2019/20 Forecast £m**	**Capital Expenditure**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
10.470	11.102	Families & Wellbeing	9.959	0.112	0
4.397	5.164	Corporate Services	5.566	2.000	4.438
44.523	51.284	Environment & Transport	59.036	25.460	12.026
0	13.192	Growth	6.436	0.567	0
0	0	Leases	9.000	0	0
171.296	439.080	Invest to Save Programme	875.866	220.990	68.594
230.686	**519.822**	**Total Capital Expenditure**	**965.863**	**249.129**	**85.058**

Invest to Save programme relates to areas such as capital expenditure on investment properties, loans to third parties, etc.

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

2018/19 Actual £m	2019/20 Forecast £m	Capital Financing	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
194.834	484.470	Unsupported Borrowing	923.042	239.783	76.245
21.762	19.408	Capital Grants and Reserves	16.051	0.112	0
4.488	4.295	Capital Receipts	4.459	4.025	4.563
0.744	0.298	Revenue Funding	9.002	0	0
8.858	11.351	External Funding	13.309	5.209	4.250
230.686	**519.822**	**Total Capital Financing**	**965.863**	**249.129**	**85.058**

B Capital financing cost indicators

One of the indicators of affordability is the estimated ratio of the Council's general fund capital financing costs to its net revenue stream in percentage terms. This indicator shows the proportion of the revenue budget spent on capital financing costs; if the ratio is increasing rapidly over time then a larger proportion of revenue resources is being taken up by capital financing costs, which could be used for other elements of the authority's budget.

For 2020/21, net revenue streams are based on the MTFP draft general fund (GF). For future years, the GF net revenue stream is projected in the Council's MTFP.

2018/19 Actual %	2019/20 Forecast %	Ratio of financing costs to net revenue stream	2020/21 Estimate %	2021/22 Estimate %	2022/23 Estimate %
0.76	1.43	Services	1.74	0.75	0.32

C Capital Financing Requirement – the Council's borrowing need

Another prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is 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 the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need 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 by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes.

2018/19 Actual £m	**2019/20 Forecast £m**	**Capital Financing Requirement (CFR)**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
892.284	**1364.012**	CFR - services	**2274.180**	**2502.216**	**2566.658**
Movement in CFR represented by:					
194.834	484.470	Net financing need for the year	923.042	239.783	76.245
(11.496)	(12.742)	Less MRP, other financing movements	(12.874)	(11.748)	(11.802)
183.338	**471.728**	**Movement in CFR**	**910.168**	**228.035**	**64.443**

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown above demonstrate the scope of this activity and proportionality to the Council's remaining activity.

D Gross Borrowing Requirement

There is a clear linkage between the authority's capital financing requirement indicators and its gross external borrowing. Within the code there is a key indicator of prudence that ensures that, over the medium term, gross borrowing is only for a capital purpose. This can be demonstrated by comparing gross external borrowing shown in the table below to the total CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. Gross external borrowing should not exceed this limit except in the short term. There is some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's treasury portfolio position at 31 March 2019, with forward projections are summarised below. The table shows the actual external debt (the treasury management operation), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing:

2018/19 Actual £m	2019/20 Forecast £m	Current Portfolio Position	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
721.042	870.679	Debt at 1 April	1342.407	2252.575	2480.610
149.637	471.728	Expected change in Debt	910.168	228.035	64.442
870.679	1342.407	External Debt at 31 March	2252.575	2480.610	2545.052
3.782	3.656	Other LT Liabilities (OLTL)	12.521	3.376	3.221
874.461	1346.063	Actual Debt at 31 March	2265.096	2483.986	2548.273
892.284	1364.012	Capital Financing Requirement	2274.180	2502.216	2566.658
17.823	**17.949**	**Under / (over) borrowing**	**9.084**	**18.230**	**18.385**

The level of debt relating to invest to save programme is:

2018/19 Actual £m	2019/20 Forecast £m	External Debt for invest to save programme	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
171.296	439.080	Debt at 1 April	875.866	220.990	68.594
88%	91%	Percentage of total external debt %	95%	92%	90%

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.

E Impact of Capital Investment Decisions on Council Tax

The other indicator of affordability is the estimate of the incremental impact on Council Tax, over and above capital investment decisions that have previously been taken by the Council. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget 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. The indicator is intended to show the effect on Council Tax of approving new capital expenditure in the capital programme.

2018/19 Actual £	2019/20 Forecast £	Impact of capital investment decisions for band D Council Tax	2020/21 Estimate £	2021/22 Estimate £	2022/23 Estimate £
16.01	29.19	Unsupported Borrowing	35.83	15.10	6.48

F 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.

The authority has to set an Authorised Limit, which is the statutory maximum borrowing permitted, and an Operational Boundary, which is the normal level of borrowing expected, for external debt. This is a 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 Authorised Limits set out below are consistent with the authority's current commitments, existing plans and the proposals set out in this report for the capital expenditure and financing, and with its approved treasury policy statement and practices. They are based on the most likely, prudent, but not worse case scenario, with sufficient headroom over and above this to allow for operational management recognising that during the year it may be necessary to exceed the operational boundary in order to take advantage of interest rate movements or to accommodate unusual cash flow movements.

2018/19 Actual £m	2019/20 Forecast £m	Authorised Limit for External Debt	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
981.512	1500.414	Borrowing	2501.589	2752.437	2823.324
3.782	3.656	Other Long Term Liabilities	12.521	3.379	3.221
985.294	**1504.070**	**Total Authorised Limit**	**2514.119**	**2755.813**	**2826.545**

In agreeing these limits, it should be noted that the Authorised Limit for 2020/21 will be 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. This indicator being the maximum limit the Council may borrow at any point in time in the year. If borrowing above this level were needed a report would go to Executive Board for authorisation to increase the limit.

G Operational Boundary for External Debt

The operational boundary is a key management tool for in-year monitoring. Temporary breach of the operational boundary will not in itself be a cause for concern, although a sustained breach might indicate an underlying issue that would need investigation and action.

The Operational Boundaries below are based on the Authorised Limit, estimating the authority's most likely level of borrowing and leasing each year. It includes long term borrowing to fund capital and short term borrowing to meet day to day variations in cash flow but without the additional headroom.

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.

2018/19 Actual £m	**2019/20 Forecast £m**	**Operational Boundary**	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
902.284	1374.012	Borrowing	2284.180	2512.216	2576.658
3.782	3.656	Other long term liabilities	12.521	3.376	3.221
906.066	**1377.668**	**Total**	**2296.701**	**2515.592**	**2579.879**

Treasury management indicators for debt

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:

H Maturity structure of debt

It is recommended that the Council sets upper and lower limits for the maturity structure of its debt for the forthcoming year as follows:

Maturity Structure	Lower Limit		Upper Limit	
	Fixed	**Variable**	**Fixed**	**Variable**
Under 12 months	0%	0%	30%	40%
12 months to 2 years	0%	0%	30%	0%
2 years to 5 years	0%	0%	35%	0%
5 years to 10 years	0%	0%	30%	0%
10 years to 20 years	40%	0%	100%	0%
20 years to 30 years	40%	0%	100%	0%
30 years to 40 years	40%	0%	100%	0%
40 years and above	40%	0%	100%	0%

The above percentages are the ranges for the projected borrowing maturing in each year out of the total projected borrowing. The indicator is designed to be a control over the Council having large concentrations of fixed interest rate debt needing to be replaced at any one time and thus being at risk of having to borrow large amounts when interest rates may be unfavourable.

Please note that the maturity structure guidance for lobo loans deems the maturity date to be the next call date which would account for £68.5m and 5.21% of the current loan portfolio. The loans have remained as the expected maturity date, however, these loans could potentially be called by the lender within the next six month period but they are unlikely to do so due to the current low interest rate environment.

I Fixed interest rate exposure

The table below shows the Council's upper limit for fixed interest rate exposure for the next three years. This indicator shows the percentage of borrowing that can be undertaken at fixed interest rates. Up to 100% of borrowing can be at fixed interest rates. Again, this indicator is set at levels to reduce the risk from interest rate movements.

Upper Limit – Fixed Interest Rate Exposure	2020/21 %	2021/22 %	2022/23 %
Fixed Interest Rates	100	100	100

J Variable interest rate exposure

The following indicator shows the percentage of borrowing that can be undertaken at variable interest rates. The purpose of the indicator is to restrict variable rate borrowing in order to reduce the risk from sudden movements in interest rates. The Council sets its upper limit for borrowing, reflecting variable interest rates less investments that are variable rate investments at 40%.

Upper Limit – Variable Interest Rate Exposure	**2020/21 %**	**2021/22 %**	**2022/23 %**
Variable Interest Rates	40	40	40

K Investment periods

It is recommended that the Council sets a limit on the amount invested for periods longer than one year of **£150m** in total for 2020/21, with the maximum period for any one investment being ten years. 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.

Upper Limit for Total Principal Sums Invested for over 365 days	**2020/21 Estimate £m**	**2021/22 Estimate £m**	**2022/23 Estimate £m**
Investment	150.000	150.000	150.000