## STROUD DISTRICT COUNCIL

**AGENDA ITEM NO**

## AUDIT AND STANDARDS COMMITTEE

## 6 FEBRUARY 2018

**12**

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| **Report Title** | **TREASURY MANAGEMENT STRATEGY, ANNUAL INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2018/19** |
| **Purpose of Report** | This report outlines the Council's prudential indicators for 2018/19 – 2020/21 and sets out the treasury strategy for this period. It fulfils three key reports required by the Local Government Act 2003:<br>• reporting prudential indicators required by the CIPFA Prudential Code for Capital Finance in Local Authorities;<br>• a treasury management strategy in accordance with the CIPFA Code of Practice on Treasury Management;<br>• an investment strategy in accordance with the MHCLG investment guidance.<br>It also fulfils the statutory duty to approve a minimum revenue policy (MRP) statement for 2018/19. |
| **Decision(s)** | **The Audit and Standards Committee RECOMMEND that Council:**<br>**1. adopt the prudential indicators and limits for 2018/19 to 2020/21;**<br>**2. approve the treasury management strategy 2018/19, and the treasury prudential indicators;**<br>**3. approve the investment strategy 2018/19, and the detailed criteria for specified and non-specified investments; and**<br>**4. approve the MRP Statement 2018/19.** |

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| **Consultation and Feedback** | Link Asset Services (LAS) formerly Capita Asset Services. |
| **Financial Implications and Risk Assessment** | This report sets out the expected activities of the Council's Treasury function for 2018/19 and recommends the investment instruments that are available to the council and the limits on these investments. The report also sets out the Council's borrowing strategy, limits and associated policies.<br><br>Paragraph 5 of the report highlights changes in statutory guidance issued by Ministry of Housing, Communities and Local Government that will require the council to amend this strategy during the course of 2018/19.<br><br>The Council has £106.717m of external borrowing (£112.521 including internal borrowing) and the Council's capital spending plans increase the borrowing to £113.213m by 31 March 2021. It is worth noting that the Council's proposed capital programme proposes a further £0.4m of borrowing in 2021/22, but this is not reflected in the prudential indicators in this report due to the differing timescales covered by the Treasury Management Strategy and the Capital Programme.<br><br>It will be important to consider carefully, in conjunction with our Treasury Management advisers, the optimum timing and nature of any new borrowing to minimise the cost to the Council. An under borrowing position has been assumed in the short term to minimise the impact of the difference between borrowing and investment rates. This position will be kept under review in conjunction with our Treasury Management advisers as the council's balances are utilised over the medium term.<br><br>The Council makes investments during the year as part of its management of treasury balances. The investment strategy sets out the Council's investment priorities and the criteria used to make those investments to ensure security of capital, liquidity and a return on investment. The Treasury Management Strategy is designed to protect the Council's finances through limiting exposure to risk.<br><br>David Stanley, Accountancy Manager (Section 151)<br>Tel: 01453 754100<br>Email: david.stanley@stroud.gov.uk |
| **Legal Implications** | The report and recommendations do not raise any direct issues and concerns with regard to non-compliance with statutory requirements.<br>Alan Carr, Solicitor<br>Email alan.carr@stroud.gov.uk<br>Tel 01453754357 |

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| **Chair of Committee** | Councillor Nigel Studdert-Kennedy<br>Tel: 01453 821491<br>E-mail: cllr.nigel.studdert-kennedy@stroud.gov.uk |
| **Options** | Full Council is required to adopt the prudential indicators and approve the annual treasury management strategy. These are largely determined by the Council's revenue and capital budget decisions when setting the 2018/19 Council Tax, Housing rent levels and the capital programme. |
| **Performance Management Follow Up** | A revised Treasury Management Strategy, Annual Investment Strategy and Minimum Revenue Provision Policy Statement 2018/19 will be presented as the half year report to fully comply with the recently revised CIPFA Prudential Code, CIPFA Treasury Management Code, as well as revised Ministry of Housing, Communities and Local Government (MHCLG) MRP and Investment guidance.<br><br>Quarterly and annual Treasury Management reports of actual compared with estimated prudential indicators for 2018/19.<br><br>Any breaches of the Prudential Code will be reported to the Audit and Standards Committee. A breach of the Authorised Borrowing Limit would require immediate investigation and reporting to Council. |
| **Background Papers**<br><br>**Appendices** | Treasury Management Policy Statement<br>Treasury Management Practices - Main Principles<br>Treasury Management Practices – Schedules<br>The Prudential Code for Capital Finance in Local Authorities (2017)<br>Treasury Management in the Public Services Guidance Notes for Local Authorities (2011)<br>Treasury Management in the Public Services Code of Practice and Cross-Sectoral Guidance Notes (2017).<br><br>A. Investments at 31 December 2017<br>B. Explanation of Prudential Indicators<br>C. Economic Background<br>D. Treasury Management Scheme of Delegation |

**Discussion**

1. Under the Local Government Act 2003 (the Act) and supporting regulations the Council is required to “have regard to” the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

2. Council is required to approve an Annual Treasury Management Strategy Statement for borrowing, and an Investment Strategy which sets out the Council’s policies for managing its investments and for giving priority to security and liquidity of investments.

3. Both these CIPFA codes have been reviewed and revised and published in December 2017. This report is based on the new codes, with the exception of introducing a Capital Strategy, which will be presented to Strategy and Resources during 2018/19 and then on to Council, and included in the half-year report Treasury Management report, together with details of any Non-Treasury Investments.

4. Also, there is a statutory duty to approve a Minimum Revenue Provision (MRP) Policy Statement for the year and this is set out in paragraphs 2.6 – 2.11 of this report.

5. Ministry of Housing, Communities and Local Government (MHCLG) have consulted on changes to Statutory Guidance on Local Authority Investments and Statutory Guidance on Minimum Revenue Provision. The consultation closed on 22 December 2017, and the resulting revised guidance is applicable for financial year 2018/19, however it has not been issued at the time of the drafting of this report. Changes to be introduced concern firstly, a tightening up of perceived abuses of MRP, whereby Councils may have imprudently loaded debt repayment liabilities onto future council tax payers, and secondly to ensure that Councils conduct proper due diligence around more speculative investments, particularly around major property acquisitions and other investments funded by PWLB borrowing. This report is based on the pre-existing guidance. Full compliance with the newly revised guidance will be presented in the half-year report.

6. CIPFA Code of Practice on Treasury Management (revised December 2017) requires the Council to maintain a Treasury Management Manual, which is reviewed annually. This manual is a record of internal procedures and operational guidance, as such it is not subject to approval by Members. The manual incorporates the following documentation relating to Treasury management:

    - <u>Treasury Management Policy Statement</u>. This is reviewed annually.
    - <u>Treasury Management Practices (TMP) – Main Principles</u>. There are 12 practices which set out the manner in which this Council will seek to achieve its treasury management policies and objectives and how it will manage and control those activities. These are reviewed annually.

- Treasury Management Practices – Schedules. These schedules set out the details of how the TMPs are put into effect by this Council. This document is revised annually to include the latest detailed procedural documents. In future updates Non Treasury Investments will be included.
- Counterparty Lending List and lending criteria. The list used by the Council is provided by Link Asset Services (LAS), the Council's treasury advisors. A new list is provided weekly, and there are daily updates by email of any changes to ratings.

7. Other CIPFA requirements are:

- a Mid-year Report and an Annual Report covering activities during the previous year;
- 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. At this Council, delegation is to the Section 151 officer;
- delegation by the Council of the role of scrutiny of treasury management reports and strategy to a specific named body. For this Council the delegated body is the Audit and Standards Committee.

# Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Statement 2018/19

## 1. INTRODUCTION

1.1 The Act and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.2 The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). 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 The 2018/19 strategy for the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, LAS. The strategy covers:

- limits in force to mitigate the Council's treasury risk;
- Prudential Indicators;
- current treasury position;
- borrowing requirement;
- prospects for interest rates;
- borrowing strategy;
- policy on borrowing in advance of need;
- investment strategy;
- creditworthiness policy;
- policy on use of external service providers;
- Minimum Revenue Provision (MRP) statement;
- treasury management scheme of delegation and section 151 role;
- miscellaneous treasury issues.

1.4 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges and minimum revenue provision caused by increased borrowing to finance additional capital expenditure, and

- any increases in running costs from new capital projects are limited to a level which is affordable for the foreseeable future.

## 2. CAPITAL PRUDENTIAL INDICATORS FOR 2018/19 TO 2020/21

2.1 Capital expenditure plans are a key driver of treasury management activity. There are prudential indicators that focus on the Council's capital spending plans.

2.2 The first prudential indicator is a summary of the Council's capital expenditure plans, shown in Table 1.

**Table 1: Capital Expenditure**

| Capital Expenditure | 2016/17 £000 Actual | 2017/18 £000 Estimate | 2018/19 £000 Estimate | 2019/20 £000 Estimate | 2020/21 £000 Estimate |
|---|---|---|---|---|---|
| Community Services | 1,588 | 78 | 180 | 150 | - |
| Environment | 1,234 | 909 | 1,140 | 1,900 | 1,066 |
| Housing General Fund | - | 710 | 449 | 330 | 330 |
| Strategy & Resources | 7,706 | 3,148 | 2,820 | 1,582 | 900 |
| **General Fund** | **10,528** | **4,845** | **4,589** | **3,962** | **2,296** |
| **HRA** | **10,975** | **9,189** | **11,720** | **6,414** | **6,489** |
| **Total** | **21,503** | **14,034** | **16,309** | **10,376** | **8,785** |

2.3 Any shortfall of resources to finance the capital programme results in a borrowing need as set out in Table 2 below.

**Table 2: Capital Financing**

| Capital Expenditure | 2016/17 £000 Actual | 2017/18 £000 Estimate | 2018/19 £000 Estimate | 2019/20 £000 Estimate | 2020/21 £000 Estimate |
|---|---|---|---|---|---|
| General Fund | 10,528 | 4,845 | 4,589 | 3,962 | 2,296 |
| HRA | 10,975 | 9,189 | 11,720 | 6,414 | 6,489 |
| **Total** | **21,503** | **14,034** | **16,309** | **10,376** | **8,785** |
| Financed by: | | | | | |
| Capital receipts | 2,761 | 2,755 | 2,184 | 304 | 400 |
| Capital grants | 1,561 | 838 | 2,146 | 812 | 330 |
| Capital reserves | 6,162 | 971 | 3,876 | 1,410 | 10 |
| Revenue | 208 | 7,286 | 7,153 | 5,750 | 6,729 |
| **Net Financing Need for the year** | **10,811** | **2,184** | **950** | **2,100** | **1,316** |

2.4 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic capital expenditure which has not yet been financed from either revenue or capital resources. It is the measure of the Council's underlying borrowing need. Any newly planned unfinanced capital expenditure will increase the CFR.

2.5 The Council is asked to approve the CFR projections below:

**Table 3: The Council's borrowing need (Capital Financing Requirement)**

| Capital Financing Requirement | 2016/17 £000 Actual | 2017/18 £000 Estimate | 2018/19 £000 Estimate | 2019/20 £000 Estimate | 2020/21 £000 Estimate |
|---|---|---|---|---|---|
| CFR - General Fund | 15,715 | 16,779 | 16,438 | 17,431 | 17,471 |
| CFR - HRA | 95,742 | 95,742 | 95,742 | 95,742 | 95,742 |
| Total CFR | 111,457 | 112,521 | 112,180 | 113,173 | 113,213 |
| **Movement in CFR** | 10,252 | 1,064 | -341 | 993 | 40 |

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|---|---|---|---|---|---|
| Movement in CFR represented by | | | | | |
| Net financing need for the year | 10,811 | 2,184 | 950 | 2,100 | 1,316 |
| Less MRP / VRP and other financing movements | -559 | -1,120 | -1,291 | -1,107 | -1,276 |
| **Movement in CFR** | 10,252 | 1,064 | -341 | 993 | 40 |

**Minimum Revenue Provision (MRP) Policy Statement 2018/19**

2.6 The Council's MRP policy statement for 2018/19 is in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003. MRP is only chargeable on General Fund outstanding capital liabilities.

2.7 An MRP charge is not currently required for the HRA. However, following on from the introduction of HRA self-financing the HRA is required to charge depreciation on its assets for financial years commencing April 2017. As a result, depreciation is a real cost to the HRA from financial year 2017/18. The regulations had allowed for the Major Repairs Allowance to be used as a proxy for depreciation until 31 March 2017.

2.8 The government has protected the General Fund from any adverse MRP liability arising from HRA self-financing borrowing. Consequently, as there was no General Fund MRP liability prior to HRA Self-Financing, there has been no General Fund MRP liability until financial year 2016/17. From 2016/17 General Fund borrowing in respect of The Pulse fitness extension, the Multi-Service contract vehicles, premises and equipment, and more recently the Littlecombe Business Units has resulted in a requirement to charge the General Fund with MRP, as a prudent provision for the repayment of that debt.

2.9 Additional planned borrowing arising from the capital budget set in February 2017, which has been revised in 2018 budget setting has created higher MRP and interest revenue cost pressures to the General Fund Medium Term Financial Planning period and beyond.

2.10 MRP will be charged under Option 3 of the MHCLG guidance. Option 3 is an MRP charge over a time period reasonably commensurate with the estimated useful life of a new asset. This is a prudent method of repaying the debt associated with particular assets. The Council is also permitted to make additional Voluntary Revenue Provisions (VRP), and it would be considered prudent to make such additional provisions for the repayment of debt.

2.11 The status of £2m of funding received from the HCA in respect of capital development works to Brimscombe Port is effectively a loan, although a future capital receipt arising from the property asset transferred to the Council as part of the development agreement should be sufficient to repay that loan. At this stage no MRP provision is being charged to the General Fund, as if all goes to plan no MRP will be necessary. However, this position will be kept under review.

2.12 The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year-end balances for each resource and anticipated day-to-day cash flow balances.

**Table 4: Core Funds and Expected Investments**

| Year end resources | 2016/17 £m Actual | 2017/18 £m Estimate | 2018/19 £m Estimate | 2019/20 £m Estimate | 2020/21 £m Estimate |
|---|---|---|---|---|---|
| Fund balances / reserves | 24.381 | 21.328 | 19.256 | 17.563 | 16.124 |
| Capital receipts | 3.490 | 4.755 | 3.796 | 4.117 | 4.342 |
| Provisions | 0.525 | 0.665 | 0.665 | 0.665 | 0.665 |
| Other | 1.062 | 0.500 | 0.500 | 0.500 | 0.500 |
| **Total Core funds** | **29.458** | **27.248** | **24.217** | **22.845** | **21.631** |
| Working capital | 5.314 | 0.500 | 0.500 | 0.500 | 0.500 |
| Under (-) / over borrowing | -4.740 | -5.804 | -4.463 | -4.456 | -3.496 |
| **Expected investments** | **30.032** | **21.944** | **20.254** | **18.889** | **18.635** |

**Affordability of capital plans prudential indicators**

2.13 A prudential indicator is required to assess the affordability of capital expenditure plans. This indicator provides an estimate of the impact of capital investment plans on the Council's overall finances. The Council is asked to approve the cost of capital expenditure plans as a ratio of the net revenue stream indicator shown in table 5.

**Table 5: Ratio of financing costs to net revenue stream**

| | 2016/17 Actual | 2017/18 Estimate | 2018/19 Estimate | 2019/20 Estimate | 2020/21 Estimate |
|---|---|---|---|---|---|
| Non-HRA | -0.68% | -0.95% | -0.69% | -0.36% | 0.08% |
| HRA | 16.03% | 16.17% | 16.56% | 17.05% | 16.64% |

## 3. BORROWING

3.1 Amongst the objectives of the treasury management function are ensuring that the Council's cash is managed in accordance with relevant professional codes and that sufficient cash is available at the right times to facilitate revenue and capital spending plans. Capital expenditure plans as set out in section 2 indicate if borrowing is required.

3.2 Table 6 shows the actual external debt (the treasury management operations), compared against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

**Table 6: Gross Debt compared with Capital Financing Requirement (CFR)**

| | 2016/17 £m Actual | 2017/18 £m Estimate | 2018/19 £m Estimate | 2019/20 £m Estimate | 2020/21 £m Estimate |
|---|---|---|---|---|---|
| **External Debt** | | | | | |
| Debt at 1 April | 104.717 | 106.717 | 106.717 | 107.717 | 108.717 |
| Expected change in debt | 2.000 | - | 1.000 | 1.000 | 1.000 |
| Other long term liabilities at 1 Apr | - | - | - | - | - |
| **Actual Gross Debt at 31 March** | 106.717 | 106.717 | 107.717 | 108.717 | 109.717 |
| **Capital Financing Requirement** | 111.457 | 112.521 | 112.180 | 113.173 | 113.213 |
| **Under / (-) over borrowing** | 4.740 | 5.804 | 4.463 | 4.456 | 3.496 |

3.3 Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not for revenue purposes.

3.4 The Section 151 officer reports that the Council complied with this prudential indicator in the current year and does not expect any breaches up to and including financial year 2020/21. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.5 There are two Treasury indicators set which limit external debt. The operational boundary is the limit that external debt should not normally exceed. If external debt were to exceed this figure then it should prompt an internal investigation to establish the reasons why the breach had occurred.

**Table 7: Operational Boundary**

| Operational Boundary | 2017/18 £m Estimate | 2018/19 £m Estimate | 2019/20 £m Estimate | 2020/21 £m Estimate |
|---|---|---|---|---|
| Debt | 120 | 122 | 122 | 122 |
| Other Long Term Liabilities | - | - | - | - |
| Total | 120 | 122 | 122 | 122 |

3.6 The Authorised Limit is set or revised by full Council, and must not be exceeded. It represents the level of debt that is unsustainable in the longer term. It is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control local government borrowing in total or for specific councils. This power has not been used to date.

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

**Table 8: Authorised Limit for External Debt**

| Authorised Limit | 2017/18 £m Estimate | 2018/19 £m Estimate | 2019/20 £m Estimate | 2020/21 £m Estimate |
|---|---|---|---|---|
| Debt | 128 | 130 | 130 | 130 |
| Other Long Term Liabilities | - | - | - | - |
| Total | 128 | 130 | 130 | 130 |

3.8 A separate control on the Council's borrowing is a limit on the maximum HRA CFR introduced as part of HRA self-financing. This Council had some headroom to borrow over and above the self-financing settlement amount. The borrowing headroom was used up by 31 March 2017. No further borrowing by the HRA is permitted. This is shown in the next table:

**Table 9: HRA Debt Limit**

| HRA Debt Limit | 2016/17 £m Actual | 2017/18 £m Estimate | 2018/19 £m Estimate | 2019/20 £m Estimate | 2020/21 £m Estimate |
|---|---|---|---|---|---|
| Actual HRA CFR | 95.742 | 95.742 | 95.742 | 95.742 | 95.742 |
| Limit | 95.742 | 95.742 | 95.742 | 95.742 | 95.742 |
| Headroom | - | - | - | - | - |

3.9 Link Asset Services (LAS) are treasury advisers to the Council and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the latest LAS forecast as at November 2017.

**Table 10: Interest Rate Forecast**

| Month | Bank Rate | PWLB Borrowing Rates | | |
|---|---|---|---|---|
| | | 5 year | 25 year | 50 year |
| Dec-17 | 0.5 | 1.5 | 2.8 | 2.5 |
| Mar-18 | 0.5 | 1.6 | 2.9 | 2.6 |
| Jun-18 | 0.5 | 1.6 | 3 | 2.7 |
| Sep-18 | 0.5 | 1.7 | 3 | 2.8 |
| Dec-18 | 0.5 | 1.8 | 3.1 | 2.9 |
| Mar-19 | 0.75 | 1.8 | 3.1 | 2.9 |
| Jun-19 | 0.75 | 1.9 | 3.2 | 3 |
| Sep-19 | 0.75 | 1.9 | 3.2 | 3 |
| Dec-19 | 0.75 | 2 | 3.3 | 3.1 |
| Mar-20 | 1 | 2.1 | 3.4 | 3.2 |

**Borrowing Strategy**

3.10 Currently the Council has £106.717m of borrowing, compared with a Capital Financing Requirement (CFR) of £111.457m. This means that the capital borrowing need (the CFR), is greater than loan debt by £4.740m. The Council has taken no borrowing during the 2017/18 financial year.

3.11 There is a limit on HRA borrowing set by the Government in the Localism Act 2011 known as the HRA debt cap. The Council's HRA debt cap is £95.742m. This cap is the absolute limit for HRA borrowing under the Prudential Code, even if the Council considers further borrowing is affordable by the HRA. The 2017/18 HRA CFR is £95.742m and borrowing is £95.742m, this means that borrowing ‘headroom’ following HRA self-financing has been fully utilised measured against the cap, as shown by table 9.

3.12 HRA capital plans can include no further borrowing in 2018/19 and subsequent years, whilst General Fund capital plans include borrowing of £6.55m up to 2020/21. The Section 151 officer will decide on the length and type of borrowing, as well as the optimum time to borrow in consultation with LAS, and take into account the latest projections for interest rates and other relevant factors including any benefits arising from internal borrowing.

3.13 There is a £1m PWLB loan due for repayment in Mar 2018, and a £2m loan from Hampshire County Council due for repayment in February 2019. The HRA will refinance these loans as there is no budgetary provision within the HRA medium term financial plan for the loan repayment.

3.14 At the end of 2017/18 there is an estimated internal borrowing position of £5.804m. Internal borrowing is currently beneficial because it reduces the financial impact of the differential between borrowing and investment interest rates. This position is projected as continuing through the period to 2020/21. Although, with the MTFP forecasting the running down of balances, and possible future changes in interest rate forecasts the Section 151 officer will keep this under review, and adjust the strategy as necessary in consultation with our Treasury advisers LAS.

**Treasury management limits on activity**

3.15 The purpose of treasury management limits 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 or improve performance. The indicator is maturity structure of borrowing. The gross limits are set to reduce the Council’s exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits

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

**Table 11: Maturity structure of borrowing**

| Maturity structure of new fixed and variable rate borrowing during 2018/19 | Upper Limit | Lower Limit |
|---|---|---|
| Under 12 months | 25% | 0% |
| 12 months and within 24 months | 50% | 0% |
| 24 months and within 5 years | 75% | 0% |
| 5 years and within 10 years | 100% | 0% |
| 10 years and above | 100% | 0% |

**Table 12: Non-specified investment limit**

| Upper Limit for total principal sums invested for over 364 days | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 |
|---|---|---|---|---|---|
| Investments | £8m | £8m | £7m | £6m | £5m |

**Policy on borrowing in advance of need**

3.17 The Council will not borrow more than, or in advance of, need purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates as required by the Prudential Code (see paragraph 3.3). Decisions to borrow will seek to ensure value for money and security of funds.

3.18 The Council will consider borrowing up to 12 months ahead of capital spend:

- If such capital spend is considered very likely to occur within 12 months;
- treasury advisers demonstrate that rates are particularly low and likely to move higher within 12 months;
- treasury advisers evaluate a net saving after assessing cost of carry;
- a trigger rate(s) will be set by s151 officer in consultation with treasury advisers and treasury officers;
- borrowing will be conducted in parcels – eg £4m could be split into 4 x £1m or 2 x £2m;

- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been fully considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;

3.19 The foregoing usual procedure will not prevent the s151 officer from forward borrowing to the fullest extent permitted by the Prudential Code, CFR for the current year plus the following two years, if extraordinary conditions arise in the short term to make such action in the interests of the authority.

**Debt rescheduling**

3.20 Now that the Council has £106.7m of debt, the Section 151 officer will keep under review opportunities for debt rescheduling. Debt rescheduling is reported to Council at the next meeting after it occurs.

## 4. ANNUAL INVESTMENT STRATEGY

**Investment Policy**

4.1 The Council will have regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance such as the March 2010 revision, and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code"). The Council's investment priorities in order are:

1) security of capital
2) liquidity of investments
3) rate of return

4.2 In accordance with the above, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what the ratings mean for each agency. LAS's bank ratings service enables real-time monitoring of a bank's rating. Daily emails are sent to the Council to notify of any significant change to a bank rating, and are available on the Passport online portal.

4.3 Further, 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. Assessment will also take account of information reflecting the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" (CDS). Other information sources used will include the financial press, share price and other such information about the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

4.4 The intention of the strategy is to provide security of investment and minimisation of risk.

4.5 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of investments, however this does not preclude the consideration and implementation of higher risk investments as part of a balanced portfolio of investments, subject to proper due diligence in line with the changes to be introduced by MHCLG.

4.6 Borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

4.7 'Specified' and 'Non-Specified' Investments categories identify investment instruments for use during the financial year.

**Specified Investments**

4.8 All specified investments will be sterling denominated, with maturities up of 1 year or less (including any forward deal time), subject to LAS's colour coding rating system as set out in creditworthiness policy paragraphs 4.16 – 4.21.

**Table 13: Specified Investments**

| Type of Investment | Minimum 'High' Credit Criteria | Max Sum** per institution / group |
|---|---|---|
| Debt Management Agency Deposit Facility | * | £45m |
| Term deposits – local authorities | * | £8m |
| Term deposits – banks and building societies | Colour coded as per CAS Weekly counterparty listing (AA- countries & UK only) | £8m |
| UK Government Gilts | * | £12m |
| Bonds issued by multilateral development banks | * | £8m |
| Bonds issued by a financial institution which is guaranteed by the UK government | * | £8m |
| Treasury Bills | * | £12m |
| Certificates of deposits issued by banks and building societies | Colour coded as per CAS Weekly counterparty listing (AA- countries & UK only) | £8m |
| Money Market Funds | AAA | £4m per MMF & £12m total in MMFs |
| Enhanced Money Market Funds | AAA | £4m per MMF & £12m total in MMFs |

### Non-Specified Investments

4.9 All investments will be sterling denominated.

**Table 14: Non-specified Investments - Maturities in excess of 1 year**

| Financial instrument / institution | Minimum Credit Criteria | Max. maturity period | Max. Sum** |
|---|---|---|---|
| Term deposits – banks and building societies | Colour coded as per CAS Weekly counterparty listing (AA- countries & UK only) | 3 years | £8m |
| Certificates of deposits issued by banks and building societies | Colour coded as per CAS Weekly counterparty listing (AA- countries & UK only) | 3 years | £8m |
| Property Funds | *** | 25 years | £3m |
| Corporate Bonds | AA- | 3 years | £3m |
| UK Local Authorities | * | 3 years | £8m |
| UK Government Gilts | * | 3 years | £8m |
| Bonds issued by multilateral development banks | * | 3 years | £8m |
| Bonds issued by a financial institution which is guaranteed by the UK government | * | 3 years | £8m |

* Government institutions have the highest security, although they are not formally rated.

** A maximum sum refers to the combined total of specified and non-specified investments with a particular bank, or group if specified.

*** Any investment would be subject to an evaluation process and a report to Strategy and Resources Committee.

### Investment Strategy

4.10 Cash flow forecast requirements and the outlook for short-term interest rates are important factors considered when making investments. During 2017 base interest rate was 0.25% until November when the base interest rate rose to 0.5%. This was the first base interest rate rise since 2007.

4.11 In 2018-19 the Council will continue to invest for the longest permitted duration with quality counterparties to maximise return without compromising security, or liquidity. In particular instances the Section 151 Officer will authorise investments in the LAS blue category (see para 4.16) for a period of up to two years, which is currently longer than the LAS recommended duration of one year. Otherwise, the length of investments permitted will vary if necessary in line with LAS advice subject to the Council's 3-year upper limit.

**Table 15: Investments maturing after the end of the current financial year.**

| Financial Institution | Amount £ | Maturity | Rate |
|---|---|---|---|
| Goldman Sachs | 2,000,000 | 01/06/2018 | 0.50% |
| Lloyds | 2,000,000 | 22/05/2018 | 0.65% |
| RBS | 1,000,000 | 20/07/2018 | 0.64% |
| RBS | 2,000,000 | 10/09/2018 | 0.57% |

4.12 Bank Rate is currently forecast to continue on a rising trend with further 0.25% increases forecast for March 2019 and March 2020, this would take base rate up to 1% in March 2020.

4.13 The Council will primarily make short-dated deposits of up to a year with appropriately rated banks or UK local authorities rather than utilising call accounts or money market funds in order to maximise interest. Transaction costs will be taken into account in any investment decision for smaller sums, which means balances of up to £1m may be retained in lower interest rate accounts. This will be done to save transaction costs, where transaction costs would exceed interest earned.

4.14 At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

**Creditworthiness policy**

4.15 This Council applies the creditworthiness service provided by LAS. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

4.16 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- **Yellow** 3 years

- **Dark pink** 3 years for Enhanced money market funds with credit score of 1.25
- **Light pink** 3 years for Enhanced money market funds with 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

4.17 This creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, does not give undue impact to just one agency's ratings.

4.18 Typically the minimum credit ratings criteria the Council uses will be a short term rating (Fitch or equivalents) of short term rating 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.

4.19 All credit ratings will be monitored prior to making an investment decision. The Council is alerted to changes to ratings of all three agencies through its use of the LAS creditworthiness service.

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

4.20 The Council will not place sole reliance on the use of this external service. In addition this Council will use market data and market information, and information on external support for banks to help support its decision making process.

**Country limits**

4.21 The Council will only invest in the UK and countries with a sovereign rating of AA- or higher. The following countries currently have sovereign ratings of AA- or higher, and also have banks operating in sterling markets which have credit ratings of green or above in LAS credit worthiness service.

| AAA | AA+ | AA | AA- |
| --- | --- | --- | --- |
| Australia | Finland | Abu Dhabi (UAE) | Belgium |
| Canada | Hong Kong | France | Qatar |
| Denmark | USA | UK | |
| Luxemburg | | | |
| Germany | | | |
| Netherlands | | | |
| Norway | | | |
| Singapore | | | |
| Sweden | | | |
| Switzerland | | | |

## 5. MISCELLANEOUS TREASURY ISSUES

**Use of external service providers**

5.1 Link Asset Services (LAS) formerly Capita Asset Services, are the Council's treasury management advisers. However, responsibility for treasury management decisions remains with the Council at all times, therefore undue reliance will not be placed upon our external treasury management advisers. The current contract has an end date of 30 September 2018, together with an option to extend until 30 September 2020.

**MiFID II**

5.2 The second Markets in Financial Instruments Directive (MiFID II) is now effective commencing 3 January 2018. In order to maintain the range of investments available to the Council there has been an administrative exercise to opt up from retail to professional classification for all counterparties where this has been required.

**Member Training**

5.3 The CIPFA Code requires the Section 151 officer to arrange the provision of adequate training for members. Member training was held on 1 November 2017. Training is necessary to enable Audit and Standards Committee members to fulfil their role more effectively.