Report of the Director of Governance and Partnerships

Agenda Item No: **3(c)**
Meeting: 26th February 2020

NORTH LINCOLNSHIRE COUNCIL

COUNCIL

Treasury Management Strategy 2020/21

1. OBJECT AND KEY POINTS IN THIS REPORT

1.1. To seek approval of the Council's Treasury Management Strategy 2020/21.

1.2. To adopt the Prudential Code 2017, the CIPFA Treasury Management in Public Services Code of Practice and related MHCLG Guidance.

1.3. To approve the Treasury Management Policy Statement

1.4. To approve the proposed Prudential Indicators 20/23

1.5. To approve the policy on the Minimum Revenue Provision

1.6. To approve the Investment Counterparties and Limits

2. BACKGROUND INFORMATION

2.1 CIPFA has defined treasury management as:

The management of the organisation's borrowing, 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.

2.2 The proposed Treasury Management Strategy Statement (TMSS) for 2020/21 is attached at Appendix 2. The Strategy has been developed in consultation with our treasury management advisors, Link Asset Services Ltd. This statement also incorporates the Investment Strategy.

2.3 Whilst the Council has appointed advisors to support effective treasury management arrangements, the Council is ultimately responsible for its treasury decisions and activity. No treasury activity is without risk. The successful identification, monitoring and control of risk is therefore an important and integral element of treasury management activities.

3. OPTIONS FOR CONSIDERATION

3.1 The options for consideration are contained in the Strategy at Appendix 2.

4. ANALYSIS OF OPTIONS

4.1 The options are analysed in the Strategy at Appendix 2.

5. FINANCIAL AND OTHER RESOURCE IMPLICATIONS (e.g. LEGAL, HR, PROPERTY, IT, COMMUNICATIONS etc.)

5.1 None except those set out in the report and appendices.

6. OTHER RELEVANT IMPLICATIONS (e.g. CRIME AND DISORDER, EQUALITIES, COUNCIL PLAN, ENVIRONMENTAL, RISK etc.)

6.1 Not applicable

7. OUTCOMES OF INTEGRATED IMPACT ASSESSMENT (IF APPLICABLE)

7.1 Not applicable.

8. OUTCOMES OF CONSULTATION AND CONFLICTS OF INTERESTS DECLARED

8.1 Not applicable.

9. RECOMMENDATIONS

9.1 Council is requested to:

a. Adopt the Prudential Code 2017, the CIPFA Treasury Management in Public Services Code of Practice and related MHCLG Guidance.

b. Approve the Treasury Management Policy Statement (Appendix 1)

c. Approve the Treasury Management Policy and Treasury Management and Investment Strategy for 2020/21 (Appendix 2)

d. Approve the prudential indicators for 2020/23 set out in the Strategy (Appendix 2)

e. Approve the revised policy on the Minimum Revenue Provision (Annex 2 of Appendix 2)

f. Approve the Counterparty List contained in the Strategy (Appendix 2)

DIRECTOR OF GOVERNANCE AND PARTNERSHIPS

Church Square House
High Street
Scunthorpe
North Lincolnshire
DN15 6NL
Author: Mark Kitching
Date: 12th February 2020

Background Papers used in the preparation of this report

- Local Government Act 2003
- CIPFA Code of Practice 2018-19
- CIPFA The Prudential Code for Capital Finance in Local Authorities (2017 Edition)

APPENDIX 1

The Treasury Management Policy Statement

1. The Council defines its treasury management activities as:

   The management of the Council's borrowing, 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. 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 Council, and any financial instruments entered into to manage these risks.

3. This 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.

4. The Council's high level policies for borrowing, borrowing in advance and investments.

   - The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

   - This organisation will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

   - The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

Appendix 2

Treasury Management Strategy Statement 2020/21

North Lincolnshire Council

www.northlincs.gov.uk

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Director Governance and Partnerships Overview

The priority for Treasury Management at North Lincolnshire Council is to protect capital rather than to maximise return. However the avoidance of all risk is neither appropriate nor possible but we will continue to strive to minimise risk.

We have become accustomed to high levels of uncertainty over recent years and have the tools and access to external advice in place to help guide us through any volatility. This strategy provides enough flexibility within which to operate in all but the most extreme circumstances.

One event that we were unable to predict occurred in October 2019 when the Public Works Loan Board, our primary source of long-term funding, raised it's rates by 1% over night. At the time of writing we are reviewing other financing options available but it will take time for these alternatives to develop. It is very apparent that borrowing will be more expensive, less predictable and more resource intensive than we have been accustomed to and we will review how we manage this new environment over the coming months. PWLB borrowing remains an active option due to its ease of access but the additional cost will have to be factored in to any decision.

Aside from one-off events such as those above a projection of gradual rises in interest rates also has implications for our capital programme and historic internal borrowing. The forecast however remains fragile against a background of economic uncertainty, domestically and internationally, and therefore, in 2020-21, I propose continuing our current borrowing strategy of undertaking limited size transactions, subject to availability, at reasonably regular intervals as spending plans and rate paths become more certain. In that way we can hope to manage historically low rates and unnecessary costs.

Becky McIntyre, Director of Governance and Partnerships

10 February 2020

Introduction

The Council is required to set a balanced budget, which broadly means that cash received during the year will meet cash expended. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer-term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer-term cash may involve arranging long or short-term loans, or using longer-term cash flow surpluses. On occasion, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

The contribution the treasury management function makes to the Council is important, as the balance of debt and investment operations ensure liquidity or 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 balances, it is paramount to ensure adequate security of the sums invested.

Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities. The CIPFA revised 2017 Prudential and Treasury Management Codes require all local authorities to prepare an additional report, a capital strategy report. The Capital Investment Strategy is reported within the 2020/21 Budget Report.

Introduction (contd.)

CIPFA defines treasury management as:

"The management of the local authority's borrowing, 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."

This authority has limited commercial investments and has no material non-treasury investments.

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

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and covers:

- the capital plans, (including prudential indicators);
- a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy, (how the investments and borrowings are to be organised), including treasury indicators; and
- an investment strategy, (the parameters on how investments are to be managed).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision, if applicable. In addition, this Council will receive quarterly update reports.

c. **An annual treasury report** – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

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

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

Introduction (contd.)

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

Treasury Management Strategy for 2020/21
The strategy for 2020/21 covers two main areas:

Treasury management issues

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

Capital issues

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

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

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

External Context

Prospects for interest rates

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. The following table gives their central view at November 2019.

Link Asset Services Interest Rate View	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.90	1.00	1.00	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	0.90	0.90	1.00	1.10	1.20	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.30	2.40	2.40	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.00	3.10
10yr PWLB Rate	2.50	2.50	2.60	2.60	2.70	2.80	2.90	3.00	3.10	3.10	3.20	3.20	3.30
25yr PWLB Rate	3.00	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.80	3.80	3.90	3.90
50yr PWLB Rate	2.90	2.90	3.00	3.10	3.20	3.30	3.40	3.50	3.60	3.70	3.70	3.80	3.80

Link's forecasts are predicated on an assumption there not being shocks to the world economy which have a major impact on international trade and world economic growth.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently, although there are likely to also be periods of sharp volatility from time to time.

External Context (contd).

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

- If the Bank of England is too slow in its pace and strength of increases in Base Rate and allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The US Federal Reserve causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Funds Rate and reversal of Quantitative Easing

Inflation. The Consumer Price Index (CPI) measure of inflation fell from 2.7% to 2.4% in September. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's inflation report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

Global Picture. With tighter global financial conditions, increased political and economic uncertainties, and fading U.S. fiscal stimulus, this year's economic divergence – with U.S. growth accelerating and other regions slowing – should give way to a more synchronised deceleration; the U.S., the Eurozone and China should all see lower growth than this year.

Investment and borrowing rates

Investment returns are likely to remain low by historical standards during 2020/21 but to be on a gently rising trend over the next few years.

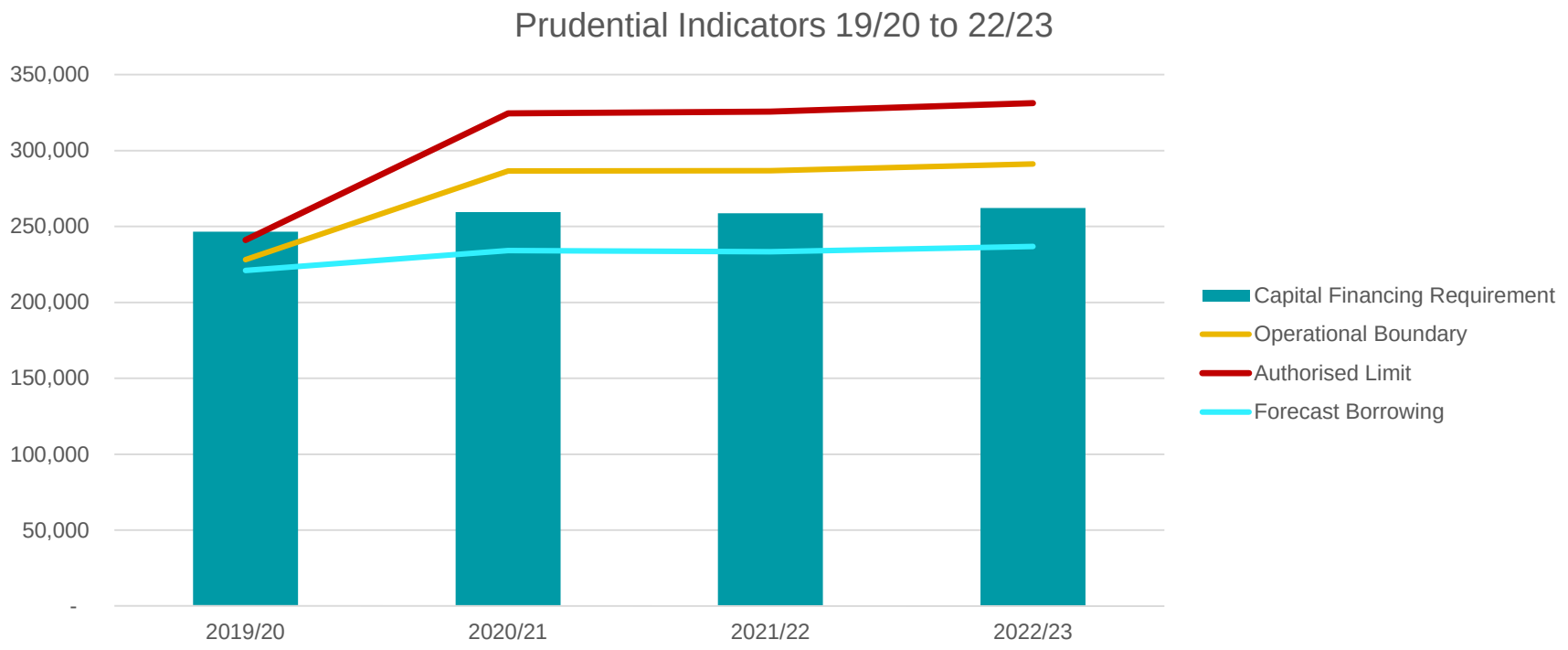
The biggest change in borrowing rates for 2020/21 is not market related and came on 9th October 2019 when PWLB increased the rates at which they will lend to their customers by 100bps (1%) overnight. This move has had the effect of providing margin for private sector lenders to re-enter the Local Authority debt market and whilst – at the time of writing – the level at which the market will support their involvement is still unclear it will necessarily undercut new PWLB levels but be more expensive than previous debt transacted over the past few years.

Local Context

As at 31.12.2019 the Council had £183m of borrowing and £15m of investments. This is set out in further detail at Annex 1.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. The Council forecasts that it expects to comply with this recommendation during 2020/21 and the 2 subsequent periods. This view takes into account current commitments, existing plans, and the proposals in the 2020/21 budget report.



Borrowing Strategy

The Council is currently maintaining an under-borrowed position subject to a minimum investment balance of £10m. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This has been a prudent approach as investment returns have been low and counterparty risk is still an issue that needs to be considered, however, this strategy has a limited lifespan and only delays, rather than removes, the borrowing required to support our Capital plans.

The Council will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves. With longer lead-in times needing to be planned round, there will likely be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances until the money is spent.

Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and the Capital Investment Strategy, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

New financial institutions as a source of borrowing or types of borrowing

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 from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (primarily insurance companies and pension funds but also some banks)
- Municipal Bonds Agency (no issuance at present but there is potential)

Debt rescheduling

Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

All rescheduling will be reported to Cabinet following its action through the usual reporting timetable.

Borrowing Strategy (contd)

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

Strategy: Our default strategic response to the expected (but far from certain) trend of slowly rising rates is to transact new borrowing in smaller sizes and at relatively steady intervals to average out the cost of borrowing whilst also seeking to limit the cost of carry.

The Objectives and Strategy above are carried over from 2019/20 but are impacted by PWLB's decision to re-price it's offering from October 2019. The anticipated impacts on our borrowing activity are:-

- Longer lead-in times to access required funds
- Added complexity to our borrowing with new risks and resourcing requirements that follow
- Future debt will likely still be priced above 2019 levels even if accessed from private sector, by up to £0.6m p.a.
- Potential fragmentation of debt market, favouring those Authorities who are formally rated and/or can transact large value arrangements (£50m+) due to limited liquidity offered by third-party lenders

Borrowing Strategy (contd)

This table is an expanded list of the possible sources and types of borrowing that the Council will consider in 2020/21.

All new long-term borrowing is backed by a Officer Decision Record (ODR) signed in advance by the S151 Officer. The information supporting the ODR will cover the reason for the amount, term and source of finance among other relevant risk evaluations.

Source of Borrowing	Fixed	Variable
PWLB	•	•
Local Authorities	•	•
Banks (UK and overseas (Sterling only) incl State-owned banks)	•	•
Pension Funds (excl. East Riding Pension Fund)	•	•
Insurance Companies	•	•
Type/Structure of Debt		
Market (long-term incl. Bond issuance)	•	
Market (temporary)	•	•
Market (LOBOs)		
Green Bonds	•	•
Stock Issues		
Local Temporary	•	•
Local Bonds	•	
Local Authority Bills	•	•
Overdraft		•
Negotiable Bonds	•	•
Internal (Capital Receipts and Revenue Balances)	•	
Commercial Paper	•	
Repurchase Agreements	•	
Medium Term Notes	•	
Finance Leases	•	•

Borrowing Strategy (contd)

The Council has previously raised the majority of its long-term borrowing from the PWLB but it will now need to consider much more closely other sources of finance, such as those listed above.

Municipal Bond Agency: UK Municipal Bonds Agency plc (UKMBNA) was established in 2014 by the Local Government Association as an alternative to the PWLB. A number of councils, including North Lincolnshire Council, invested in the UKMBNA at that point. Since that time it has been attempting to issue bonds on the capital markets and lend the proceeds to local authorities, but so far has not managed to complete a transaction. Whilst the recent change in PWLB margin provides room for UKMBNA to operate in our current understanding is that this will be a more complicated source of finance than other options for two reasons: borrowing authorities will be required to provide bond investors with a joint guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

Borrowing for Commercial or Social Return

In order to support frontline services as central Government funding changes over time, Councils have to consider how best they might deploy their resources, knowledge and borrowing capacity to replace lost income. The drivers, characteristics, available credit data and risks associated with such transactions will differ from one scheme to another as well as from general treasury activity. Schemes, for instance, may take into account non-financial 'social' returns alongside pure financial gain.

The Council recognises that investment in other financial assets and property primarily for financial return, taken for non-treasury management purposes, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios.

The Council will ensure that all the organisation's capital investments are covered in the Capital Investment Strategy and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments. It recognises that the risk appetite for these activities may differ from those in this report which relate only to treasury management.

Common across both 'commercial ' transactions and treasury investments is the need for holistic council-wide planning, robust due diligence and formal oversight processes.

The Council will compile and maintain a schedule setting out a summary of existing material non-treasury investments, subsidiaries, joint ventures and liabilities including financial guarantees and the organisation's risk exposure.

Investment Strategy

The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2019/20 investment balances have ranged between £11.1m and £33.8m. Balances for 2020/21 are anticipated to remain broadly similar.

Objectives: The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration.

Strategy: the Council will ensure that:

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

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

Investment Strategy (contd.)

Approved Counterparties: The Council may invest its surplus funds with any of the counterparty types in table below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved Investment Counterparties and Limits.

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£5m 20 years	£5m 20 years	£2m 5 years	£2m 20 years
AA+	£3m 5 years	£5m 10 years	£5m 10 years	£2m 5 years	£2m 10 years
AA	£3m 4 years	£5m 5 years	£5m 5 years	£2m 4 years	£2m 5 years
AA-	£3m 3 years	£5m 4 years	£5m 4 years	£2m 3 years	£2m 4 years
A+	£3m 2 years	£5m 3 years	£5m 3 years	£2m 2 years	£2m 3 years
A	£2m 13 months	£4m 2 years	£5m 2 years	£2m 13 months	£2m 2 years
A-	£2m 6 months	£3m 13 months	£3m 13 months	£1m 6 months	£1m 13 months
BBB+	£1m 100 days	£1.5m 6 months	£1.5m 6 months	£1m 100 days	£1m 6 months
None	n/a	n/a	£5m* 5 years	£0.1m 5 years	£1m 6 months
Pooled funds	Money Market Funds - CNAV or LVNAV - £3m per fund, VNAV £1m per fund but not more than 50% of overall balances in aggregate				

* Other UK Local Authorities – per Authority

The above table is derived from an assessment of Available Reserves and our Advisors general guidance across the ratings spectrum.

Investment Strategy (contd.)

Risk Appetite Statement
The guidance from the MHCLG and CIPFA places a high priority on the management of risk.
This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

Credit Rating: Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria in Table 1**.** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Additional requirements under the Code require the Council to supplement credit rating information. Further operational market information will therefore be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating (Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. If the Council's current account bank were to be rated BBB' unsecured balances with that bank will be minimised in both monetary size and time invested.

Banks Secured: Covered bonds, reverse repurchase agreements (Repo) and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Repo/Reverse Repo is accepted as a form of securitised lending and should be based on the GMRA 2000 or GMRA 2011 (Global Master Repo Agreement). Should the Counterparty not meet our senior unsecured rating then a 102% collateralisation would be required.

The acceptable collateral is as follows:

- Index linked Gilts
- Conventional Gilts
- UK Treasury bills
- Delivery By Value (DBV)
- Corporate bonds

Investment Strategy (contd.)

Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Some secured bank investments include the option for the issuer to extend the maturity date even though this is not common practice (most Covered Floating Rate Notes operate in this fashion). When choosing such investments the Authority will apply Non-Specified Investment criteria as if the Bond were to run to its final allowable maturity date.

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

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

Registered Providers: Loans to, and bonds issued by, guaranteed by, or secured on the assets of Registered Providers of Social Housing (Housing Associations). These bodies are tightly regulated by and, as providers of public services, retain the likelihood of receiving government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low volatility may be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period could be used for longer investment periods. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow diversification into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but offer withdrawal after a notice period, their performance and continued suitability will be monitored regularly.

Investment Strategy (contd.)

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

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

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

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

Given our Strategy of minimizing balances and maintaining short-duration average liquidity the Council will use 7 day LIBID uncompounded an investment benchmark to assess the performance of its investment portfolio.

Investment returns expectations.
Bank Rate is forecast to increase steadily but slowly over the next few years to reach 1.25% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

- 2019/20 0.75%
- 2020/21 0.75%
- 2021/22 1.00%
- 2022/23 1.25%

Investment Strategy (contd.)

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

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

This council has defined the list of types of investment instruments that the treasury management team are authorised to use.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year (366 days).
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors. The Council has determined that it will limit the maximum total exposure to non-specified investments as follows:-

Investment Strategy (contd.)

Table 2: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£2m*
Total investments without credit ratings or rated below A- (excluding other Local Authorities)	£1.5m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	£1.5m
Total non-specified investments	£3m

*The Council has used a significant amount of internal borrowing over the last decade to fund its Capital Programme. This has created a capacity for external borrowing within current limits and Prudential Indicators. With current spending envelope challenges it makes sense for the Council to look at ways externalising this borrowing might be used to generate revenue savings. Any planned use of long-term investments in this way would be subject to a sound business case and usual governance oversight (See Capital Investment Strategy for details)

Investment Limits: In order that the risk to available reserves is managed the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Investment Strategy (contd.)

Table 3: Investment Limits (Unchanged)

	Cash limit
For durations less than 366 days in any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a Tri-party Agent/broker's nominee account	£25m per broker
Foreign countries (Minimum Sovereign rating AA-)	£5m per country
Registered Providers	£2m in total
Unsecured investments with Building Societies	£2m in total
Loans to unrated corporates	£5m in total
Money Market Funds	50% of overall balances

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

Treasury Management Indicators

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

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

	Target
Portfolio average credit rating	A

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

	Target
Total cash available within 1 month	£10m

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

Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. All borrowing due to mature within 12 months is classed as variable as renewal will be subject to any short term movement in rates.

	2019/20	2020/21	2021/22	2022/23
Upper limit on variable interest rate exposure	£70m	£70m	£70m	£70m

Treasury Management Indicators (contd.)

Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

	2019/20	2020/21	2021/22	2022/23
Upper Limit on fixed interest rate exposure	£241m	£325m	£326m	£331m

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

	Upper	Lower
Under 12 months	60%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and more	100%	0%

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

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

	2020/21	2021/22	2022/23
Limit on principal invested beyond year end	£2m	£2m	£2m
Current investments as at 30.12.19 in excess of 1 year	0	0	0

Other Items

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

Policy on Use of Financial Derivatives:
The Council will not use standalone financial derivatives (such as swaps, forwards, futures and options) . 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.

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. Members of the Audit Committee are provided with timely training prior to reviewing the Strategy in January of each year. This training is provided by our Advisors under the terms of our contract.

The training needs of treasury management officers are periodically reviewed.

Treasury management consultants
The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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.

Other Items (contd)

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

The total amount borrowed will not exceed the authorised limit of £331million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2020/21 is £50k. The budget for debt interest paid in 2020/21 is £8.3 million, based on an average debt portfolio of £225 million at an average interest rate of 3.7%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Negative interest rates remain a possibility on certain investments. The Council continues to prioritise Security and Liquidity over yield and so views negative rates only in terms of relative return compared to other options. Where the preference for Security or Liquidity dictates placing an investment against negative return the principal amount shall be deemed constant and the interest return will be accounted for separately.

Benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID uncompounded and will also evaluate its performance regularly through benchmarking reports provided by both our Treasury Management System (Treasury Live) and our Advisors, Link Asset Services. Updates will be provided to members at the half-year and outturn.

Other Options Considered

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

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Prudential Indicators 2020/21

Treasury Management Indicators
To demonstrate that the Council has fulfilled the objectives it lays out, the Prudential Code requires the following indicators to be set and monitored each year.

Estimates of Capital Expenditure: The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Capital Expenditure and Financing	2019/20 Revised £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Total Expenditure	39.4	51.5	21.2	19.3
Government Grants	19.4	26.9	9.8	9.3
Revenue Financing	0.1	0	0	0
Borrowing	16.8	18.8	5.5	10
Capital Receipts	3.1	5.8	5.9	0
Total Financing	39.4	51.5	21.2	19.3

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.19 Actual £m	31.03.20 Estimate £m	31.03.21 Estimate £m	31.03.22 Estimate £m	31.03.23 Estimate £m
Total CFR	235.1	246.5	259.5	258.7	262.2

Prudential Indicators (contd.)

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

£m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
External Debt					
Debt at 1 April	189.8	193.6	221.1	234.1	233.3
Other long-term liabilities (OLTL)	0	0	0	0	0
Debt at 31 March	**193.6**	**221.1**	**234.1**	**233.3**	**236.8**
Capital Financing Requirement	235.1	250.6	255.9	257.9	259.5
Under / (over) borrowing	**41.5**	**43.1**	**44.8**	**46.2**	**52.6**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income. As borrowing arrangements typically form very long term commitments the ability, once drawn, to generate savings from this portion of spend is very limited.

Ratio of Financing Costs to Net Revenue Stream	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
General Fund	6.5%	8.77%	8.80%	9.87%	9.93%

Other Prudential Indicators

Operational Boundary for External Debt: This is the limit beyond which external debt is not normally expected to exceed. (i.e. prudent but not worst case). It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance leases and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing	226	265	264	267
Other long-term liabilities	2	22	23	24
Total Debt	**228**	**287**	**287**	**291**

Authorised Limit for External Debt: A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and can only 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 Authorised Limit 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.

Authorised Limit	2019/20 £m	2020/21 £m	2021/22 £m	2022/23 £m
Borrowing	236	295	294	297
Other long-term liabilities	5	30	32	34
Total Debt	**241**	**325**	**326**	**331**

Adoption of the CIPFA Treasury Management Code: The Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition in February 2018.

Borrowing Prudential Indicators Summary

A summary of the Council's projected borrowing set against it's Prudential Indicator Limits is shown across.

Prudential Indicators	2019/20	2020/21	2021/22	2022/23
	£'000	£'000	£'000	£'000
Capital Financing Requirement	246,509	259,500	258,715	262,210
Borrowing	226,128	264,500	263,715	267,210
Long Term Liabilities	2,000	22,000	23,000	24,000
Operational Boundary	**228,128**	**286,500**	**286,715**	**291,210**
Borrowing	236,128	294,500	293,715	297,210
Long Term Liabilities	5,000	30,000	32,000	34,000
Authorised Limit	**241,128**	**324,500**	**325,715**	**331,210**
Capital Financing Costs as a %age of Net Revenue Stream	8.77%	8.80%	9.87%	9.93%

Annex 1- Existing Investment & Debt Portfolio Position

	31.12.2019 **Actual Portfolio** **£m**	31.12.2019 **Average Rate** **%**
External Borrowing:		
PWLB – Fixed Rate	**159.2**	**3.76**
PWLB – Variable Rate	**0.0**	**N/A**
Local Authorities	**24.0**	**0.88**
Bank Loans	**0.0**	**N/A**
Total Gross External Debt	183.2	3.38
Investments:		
Managed in-house		
Short-term investments	15.0	0.61
Long-term investments	0.0	N/A
Total Investments	**15.0**	
Net Debt	**168.2**	

Annex 2 – Annual Minimum Revenue Provision Statement

Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2017.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

The Council uses the asset life annuity option for all schemes. This policy was implemented from 2017/18.

The Council can provide capital loans as part of its capital investment programme. MRP on loans secured against assets will be charged over the life of those assets. MRP on unsecured loans will be charged over the period of the loans.

MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2019 the total VRP overpayments were £0m.