Appendix 3

Treasury Management Strategy Statement 2018/19

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

INDEX

Worcester CITY COUNCIL

Report to: **Policy and Resources Committee, 12th December 2017**

Report of: **Head of Finance**

Subject: **TREASURY MANAGEMENT STRATEGY 2018/19 to 2022/23**

1. Recommendations

1.1 That the Committee notes that in accordance with the *Code of Practice on Treasury Management in the Public Services,* and the *Prudential Code for Capital Finance* there have been no changes to the medium-term Treasury Management Policy, Treasury Management Procedure Notes, Treasury Management Disaster Recovery Plan or the operational Treasury Management Practices and recommends to Council that:-

1.1.1 the Treasury Management Strategy be approved including the MRP policy statement at 5.3 and the prudential indicators set out in 5.4 of the Strategy;

1.1.2 the borrowing limit be approved at:-

	Capital Financing Requirement	Operational Borrowing Boundary (not expected to be exceeded)	Authorised Limit (prohibited to exceed)
2018/19	**£11.5m**	**£17.3m**	**£23.0m**
2019/20	**£11.1m**	**£16.6m**	**£22.2m**
2020/21	**£10.6m**	**£16.0m**	**£21.3m**
2021/22	**£10.1m**	**£15.1m**	**£20.1m**
2022/23	**£10.8m**	**£16.2m**	**£21.6m**

1.1.3 Pooled Property Funds be added as an additional investment instrument. Further details can be found under Non-specified investments at 7.7 in this document.

2. Background

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

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

2.3 Treasury management operations are defined by CIPFA as follows:-

"the management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2.4 The council has adopted the 2011 CIPFA Code of Practice on Treasury Management in the Public Services and the 2013 Prudential Code for Capital Finance in Local Authorities. There have been no significant changes to these documents during the past twelve months however there are some changes currently under consultation which will take effect in time for the next financial year.

2.5 The Council operates in accordance with the Council's own approved Treasury Management Practices (TMPs) which are operating procedures and statements that form a subset of the Treasury Management Documents.

2.6 The code identifies three key principles which are in place in Worcester City:

i that this Council should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management arrangements.

ii that the Council's policies and procedures should make clear that the effective management and control of risk are prime objectives in the treasury management arrangements, and that it is clear where responsibility for these lies within the organisation. The appetite for risk should be made clear in the annual strategy document and priority should be given to security and liquidity when investing funds. CIPFA endorses an approach of more emphasis being placed on managing and avoiding risks rather than maximising returns.

iii that the Council's policies and practices should reflect the fact that whilst the pursuit of value for money in treasury management is a valid business objective, and the use of suitable performance measures are important tools, this has to be within the context of effective risk management.

2.7 The Council's proposed treasury management strategy for 2018/19 is based upon Officer views on interest rates, supplemented with market forecasts provided by Link Asset Services who are the Council's treasury advisors.

3. <u>Treasury Management Strategy for 2018/19</u>

3.1 The strategy for 2018-19 covers two main areas:

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

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;
- policy on the use of external service providers.

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

3.3 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. The training needs of both members and officers are periodically reviewed.

3.4 The Council uses Link Asset Services (previously Capita Asset Services prior to being sold to The Link Group on 3rd November 2017) as its external treasury 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. To this end the annual renewal of the contract has been put out to tender. Part of the tender requirements is the provision of member training to enhance member knowledge of treasury management policies and decisions.

4. <u>Policy, Legal, Financial, Equality and Risk Management Implications</u>

4.1 **Policy:** The effective management of the investment portfolio is critical to the overall success of the Council's service objectives. It is therefore essential that the Council is positioned to enable it to optimise investment returns whilst showing due diligence to the effective **management of risk** in all treasury management dealings.

4.2 **Legal:** As Treasury Management forms part of the Budget Framework, Full Council is required to approve any changes to the Treasury Management Policy and Strategy, the Prudential Indicators and limits, and the Minimum Revenue Provision policy statement.

4.3 **Financial:** The income generated by the Council's investments and the interest paid on loans and MRP are all key elements of the Council's financial resources. Details are contained in the MTFF and proposed budget for 2018/19.

4.4 **Equalities:** None directly arising from this report.

4.5 **Risk:** The Council's treasury strategy will ensure that the management of risk is paramount in all of the Council's treasury management operations.

Risk Assessment Matrix

1 Likelihood of occurrence **LOW,** Impact **NOTICEABLE**
2 Likelihood of occurrence **MEDIUM,** Impact **NOTICEABLE**
3 Likelihood of occurrence **LOW,** Impact **SIGNIFICANT**
4 Likelihood of occurrence **HIGH,** Impact **NOTICEABLE**
5 Likelihood of occurrence **MEDIUM,** Impact **SIGNIFICANT**
6 Likelihood of occurrence **LOW,** Impact **CRITICAL**
7 Likelihood of occurrence **HIGH,** Impact **SIGNIFICANT**
8 Likelihood of occurrence **MEDIUM,** Impact **CRITICAL**
9 Likelihood of occurrence **HIGH,** Impact **CRITICAL**

Table 1 Risk assessment of Treasury management operations				
Risk No.	**Description**	**Risk Score**	**Management Action Plan**	**Impact Score**
1	Failure of internal procedures	3	Regular review and update of Strategy and operational procedures in this report. Annual Internal Audit check.	3
2	Failure to secure revenue income from money market	1	Annual review of economic indicators and interest forecasts form part of the Medium Term Financial Strategy and annual budget setting.	1
3	Failure to secure capital from money invested	1	Prudent policy and risk averse strategy in counterparty lists and regular review against credit ratings and money market advice	1

5. The Capital Prudential Indicators 2018/19 to 2022/23

The Prudential Code requires the Council to set a number of prudential indicators and a Minimum Revenue Provision (MRP) policy statement. These should be agreed annually in conjunction with the annual strategy and the budget for the following year, and they should cover a minimum of three years. Ours cover five years in line with our MTFF. The Prudential indicators are designed to ensure that the Council's investment plans are affordable, prudent and sustainable.

5.1 Capital Expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The table below summarises the plans and how these plans are being financed by capital or revenue sources. Any shortfall of resources results in a borrowing need. Members are asked to approve the following forecasts:-

Capital expenditure £000's	**16/17 Actual**	**17/18 Estimate**	**18/19 Estimate**	**19/20 Estimate**	**20/21 Estimate**	**21/22 Estimate**	**22/23 Estimate**
Total	12,268	5,538	2,428	846	1,229	225	1,428
Financed by:							
Capital receipts	(1,358)	(1,024)	(927)	(576)	(689)	(175)	(50)
External grants	(3,198)	(1,181)	(587)	0	0	0	0
S106 contributions	(547)	(806)	(186)	0	0	0	0
Earmarked reserves/Revenue	(962)	(2,085)	(621)	(220)	(490)	0	0
Net borrowing need for the year	**6,203**	**442**	**107**	**50**	**50**	**50**	**1,378**

5.2 The Capital Financing Requirement

The Capital Financing Requirement is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not been immediately paid for, will increase the CFR. The Council's strategy is to avoid new borrowing unless it is fully supported by existing revenue budgets (e.g. vehicle replacement project) or to finance spend to save projects in the Capital Programme e.g. capital investment that reduces revenue costs. The Capital Financing Requirement and other Prudential Indicators have been calculated on the basis that a small element of the Capital Programme will continue to be financed through borrowing.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement £000's	**16/17 Actual**	**17/18 Estimate**	**18/19 Estimate**	**19/20 Estimate**	**20/21 Estimate**	**21/22 Estimate**	**22/23 Estimate**
Total	12,881	11,847	11,511	11,096	10,645	10,071	10,784

5.3 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

Government regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

For capital expenditure incurred before 1 April 2008 the MRP policy will be:

- A straight line repayment starting from 2016/17 of £114,060 which will repay the borrowing in 2047/48;

From 1 April 2008 for all supported and unsupported borrowing (including PFI and finance leases) the MRP policy will be:-

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations and with effect from 2016/17 the method of repayment will be through an annuity calculation (providing a consistent overall annual borrowing charge).

5.4 Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Ratio of financing Costs to net revenue stream

Estimates of the ratio of financing costs to net revenue stream for the current and future years are set out below. The net revenue stream is the amount of the budget to be met from Formula Grant and Council Tax income (also known as the Budget Requirement).

Ratio of financing costs to net revenue stream £000's	**16/17 Actual**	**17/18 Estimate**	**18/19 Estimate**	**19/20 Estimate**	**20/21 Estimate**	**21/22 Estimate**	**22/23 Estimate**
Net financing costs	615	964	959	969	981	1,097	1,130
Net revenue stream	10,171	10,504	10,201	9,984	10,017	10,348	10,772
Ratio of financing costs to net revenue stream	6.05%	9.18%	9.41%	9.71%	9.79%	10.60%	10.49%

Ratio of financing Costs to budgeted gross expenditure

Estimates of the ratio of financing costs to budgeted gross expenditure for the current and future years are set out below. Gross expenditure is shown to demonstrate the proportion of our financing costs compared to our total expenditure.

Ratio of financing costs to net revenue stream £000's	16/17 Actual	17/18 Estimate	18/19 Estimate	19/20 Estimate	20/21 Estimate	21/22 Estimate	22/23 Estimate
Net financing costs	615	964	959	969	981	1,097	1,130
Gross expenditure	20,659	20,625	20,322	20,105	20,137	20,468	20,893
Ratio of financing costs to net revenue stream	2.98%	4.67%	4.72%	4.82%	4.87%	5.36%	5.41%

Incremental impact of capital investment decisions on the band D council tax

The table below identifies the revenue costs associated with the proposed changes within the capital programme recommended in this budget report compared to the Council's approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates such as the expected level of capital receipts and level of Government support which are not published over a five year period. The table identifies the incremental effect on Council Tax of the proposed capital programme.

Council tax - band D impact (£)	17/18 Estimate	18/19 Estimate	19/20 Estimate	20/21 Estimate	21/22 Estimate	22/23 Estimate
Proposed Capital Programme (per annum)	1.34	0.03	0.50	0.90	4.05	1.25

6. Borrowing

The capital expenditure plans set out in 5.1 provide details of the service activity of the council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant prudential indicators, the current and projected debt positions and the annual investment strategy.

6.1 Current Portfolio Position

An analysis of loans by lender category and by maturity is as follows:

	2016/17	**2015/16**
	£000's	£000's
P.W.L.B.	**3,367**	3,408
Money Market	**5,000**	5,000
	8,367	8,408

Maturing within one year	**6,033**	5,041
Maturing in 1-2 years	**41**	1,032
Maturing in 2-5 years	**147**	155
Maturing in 5-10 years	**146**	180
Maturing in more than 10 years	**2,000**	2,000
	8,367	8,408

The Council's treasury portfolio position at 31st March 2017, with forward projections are summarised below. The table shows the actual external debt against the underlying capital borrowing need, highlighting any over or under borrowing.

External Debt (£000)	16/17 Actual	17/18 Estimate	18/19 Estimate	19/20 Estimate	20/21 Estimate	21/22 Estimate	22/23 Estimate
Debt at 1st April	8,408	8,367	7,334	7,293	7,252	7,179	7,146
Expected change in Debt	(41)	(1,033)	(41)	(41)	(73)	(33)	(65)
Other long-term liabilities (OLTL)	0	0	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0	0	0
Actual gross debt at 31st March	**8,367**	**7,334**	**7,293**	**7,252**	**7,179**	**7,146**	**7,081**
CFR	**12,881**	**11,847**	**11,511**	**11,096**	**10,645**	**10,071**	**10,784**
Under / (over) borrowing	**4,514**	**4,513**	**4,218**	**3,844**	**3,466**	**2,925**	**3,703**

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 four financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. The Head of Finance reports that the Council complied with this prudential indicator in the current financial year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans and the proposals in this report.

6.2 Treasury Indicators: limits to borrowing activity

Operational Boundary for External Debt

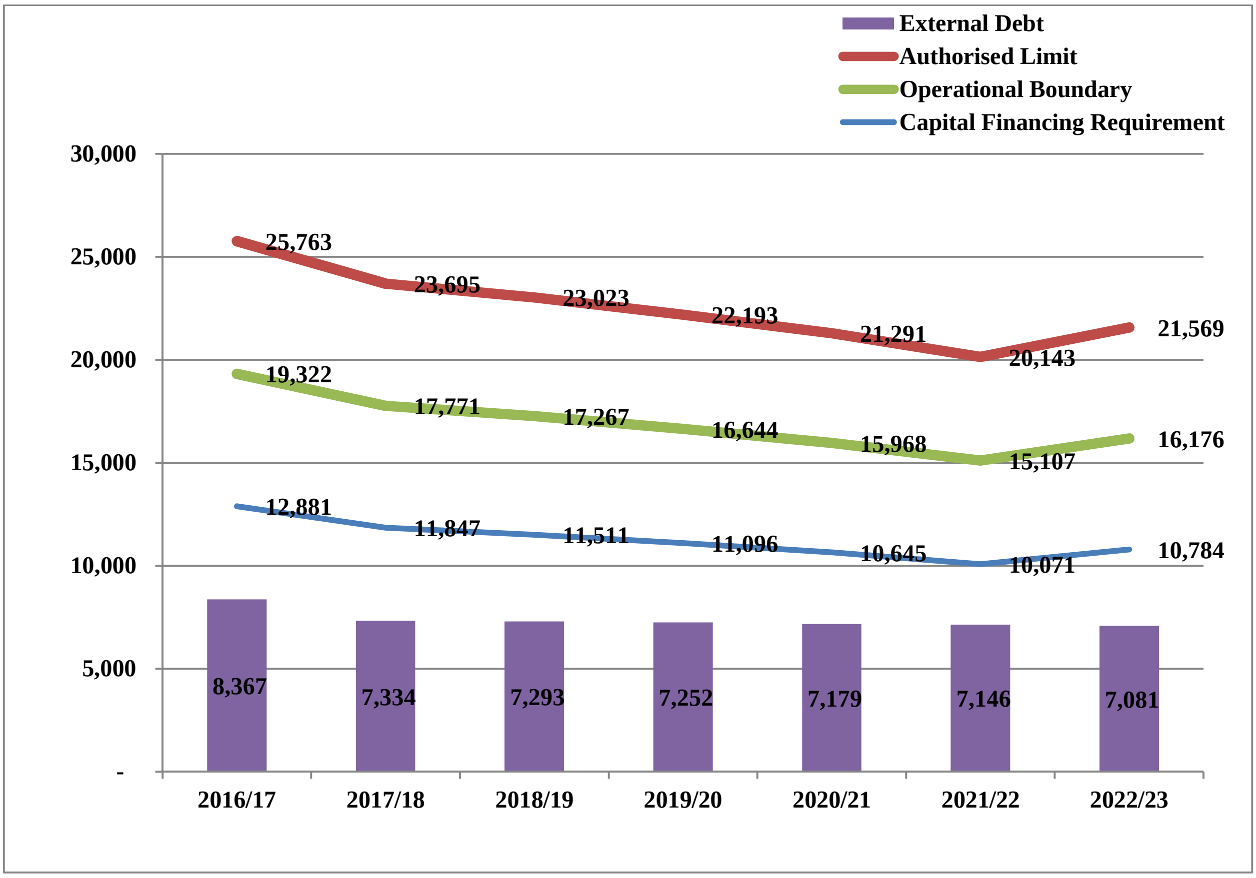
The Council is required to approve the following Operational Boundary for external debt. This is the limit beyond which external debt is not normally expected to exceed i.e. the maximum level of external debt for cash flow purposes. The Council's actual external debt at 31st March 2017 was £8.367m. Recommended limits are as follows:

Operational Boundary £000's	16/17 Actual	17/18 Estimate	18/19 Estimate	19/20 Estimate	20/21 Estimate	21/22 Estimate	22/23 Estimate
Borrowing	19,322	17,771	17,267	16,644	15,968	15,107	16,176
Other long term liabilities	0	0	0	0	0	0	0
Total	**19,322**	**17,771**	**17,267**	**16,644**	**15,968**	**15,107**	**16,176**

Authorised Limit for External Debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. The Council is recommended to approve the following authorised limits:

Authorised Limit £000's	16/17 Actual	17/18 Estimate	18/19 Estimate	19/20 Estimate	20/21 Estimate	21/22 Estimate	22/23 Estimate
Borrowing	25,763	23,695	23,023	22,193	21,291	20,143	21,569
Other long term liabilities	0	0	0	0	0	0	0
Total	**25,763**	**23,695**	**23,023**	**22,193**	**21,291**	**20,143**	**21,569**



Please note figures in the graph above are in £000's.

6.3 **Prospects for borrowing interest rates**

The council's treasury advisors Link Asset Services have formulated a view on PWLB interest rates up until March 2020 as follows:

	5 year	10 year	25 year	50 year
Dec 2017	1.50%	2.10%	2.80%	2.50%
Mar 2018	1.60%	2.20%	2.90%	2.60%
Jun 2018	1.60%	2.30%	3.00%	2.70%
Sep 2018	1.70%	2.40%	3.00%	2.80%
Dec 2018	1.80%	2.40%	3.10%	2.90%
Mar 2019	1.80%	2.50%	3.10%	2.90%
Jun 2019	1.90%	2.60%	3.20%	3.00%
Sep 2019	1.90%	2.60%	3.20%	3.00%
Dec 2019	2.00%	2.70%	3.30%	3.10%
Mar 2020	2.10%	2.70%	3.40%	3.20%
Jun 2020	2.10%	2.80%	3.50%	3.30%
Sep 2020	2.20%	2.90%	3.50%	3.30%
Dec 2020	2.30%	2.90%	3.60%	3.40%
Mar 2021	2.30%	3.00%	3.60%	3.40%

Borrowing interest rates increased sharply after the result of the general election in June 2017 and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However this will be carefully reviewed to avoid incurring higher borrowing costs in the future when the Council may not be able to avoid new borrowing to finance new capital projects. There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a significant revenue cost i.e. the difference between borrowing costs and investment returns.

6.4 **Borrowing Strategy**

The Council is currently maintaining an under-borrowed position of £4.5m. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cashflow has been used as a temporary measure. This strategy is currently prudent as investment returns are low.

The current economic uncertainty and the impact over future interest rates increase the risks associated with treasury activity. As a result the Council will continue to take a cautious approach in its dealings under the prudential borrowing regime and closely monitor the financial markets on a daily basis.

Prior to any decisions being made on borrowings, a financial review will be undertaken and this will be reported through to Council to inform any future strategy and actions.

Long term borrowing decisions will be made taking account of:

- the Council's overall need to borrow;

- including any unused borrowing capacity (e.g. use of temporary internal funding);
- re-scheduling of the loan debt portfolio to take advantage of prevailing interest rates and the opportunity to reduce revenue costs and best value for the taxpayer.

The Council will consider borrowing to invest/borrowing in advance of need but only where this can be justified in accordance with regulations and statutory guidance provided by CIPFA. These needs are determined by the Capital Financing Requirement. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

Before long term borrowing is undertaken the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need;
- ensure the on-going revenue liabilities created, and the implications for the future plans and budgets have been 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, and;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use.

Replacement of Lenders Option Borrowers Option (LOBO) loan

The Council approved a strategy (at a meeting held on 5th November 2009) for the replacement of the LOBO loan (£5m) in the event that the lender exercises their option to increase the interest rate of 4.5%. This is highly unlikely to happen due to current market conditions. However the agreed action, in this event, is to replace the loan with a shorter dated loan and keep the rate as low as possible bearing in mind the Capital Financing Requirement projections.

6.5 Treasury indicators for debt

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within set 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 and improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments.

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

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing and are required for upper and lower limits.
  The Council is asked to approve the following treasury indicators and limits:

Type of borrowing:	Percentage of net outstanding principal sums
Variable rate exposure	Manage within range 0% to 30% (upper limit)
Fixed rate exposure	Manage with the range 70% to 100% (upper limit)

Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total borrowing that is fixed rate		
	Upper limit	Lower limit
Under 12 months	100%	0%
Above 12 months and within 24 months	100%	0%
Above 24 months and within 5 years	100%	0%
Above 5 years and within 10 years	100%	0%
Above 10 years	100%	0%

These limits give maximum flexibility for borrowing. This Council has LOBO borrowings of £5m. The maturity date of a LOBO loan is deemed to be the next call date as stated in the 2011 CIPFA guidance notes page 15. In our case this is every 6 months.

6.6 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than this offered by the Public Works Loan Board (PWLB). This Authority may consider making use of this new source of borrowing as and when appropriate.

7. <u>Investments</u>

7.1 Current Portfolio Position

The City Council's cash investment portfolio is managed in-house. The budgeted level of income from cash investments was decreased for 2017/18 to £82k (2016/17: £138k). This was to reflect the use of internal cash balances to fund the Swimming Pool Project, thus significantly reducing the capacity to generate investment returns. In addition, interest rates have remained extremely low. The Council is estimated to receive approximately £82k from its cash investments in 2017/18 and therefore meet the budgeted target set. The 2018/19 budget will be decreased by £50k to £32k due to lower levels of surplus cash being available to invest.

The overall rate of return for our cash investments in 2017/18 is estimated to be approximately 0.61% which is 0.36% above the current benchmark 1 month LIBOR rate (London Inter-bank Offer Rate) of 0.25%.

7.2 Investment Policy

The Council's investment policy has regard to the CLG's Guidance on Local Government Investments, the revised CIPFA Treasury Management in Public Services Code of Practice and Gross Sectoral Guidance Notes. The Council's investment priorities will be security first, liquidity second, then return.
The Council's investment priorities are:

- to invest prudently;

- to give priority to security and liquidity before yield;
- to achieve optimum return commensurate with the two bullet points above;
- to use only those investment instruments categorised as specified investments
- to only borrow in advance of need where this can be justified in accordance with regulations and statutory guidance provided by CIPFA., and;
- to place emphasis on credit ratings to establish the credit quality of investment counterparties

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take into account of information that reflects the opinion of the markets.

To this end the Council will engage with its advisors to maintain a monitor on market pricing such as 'credit default swaps' and overlay that information on top of the credit ratings. Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

All investments will be in sterling.

7.3 Creditworthiness Policy

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.

The Council will also ensure 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.

Any institute must hold the following credit ratings as a minimum:

Ratings Agency	Minimum Short Term Rating	Minimum Long Term Rating
Moody's Investors Service Ltd	P-2 and above	Baa1 and above
Standard & Poor's	A-2 and above	BBB+ and above
Fitch Ratings Ltd	F-2 and above	BBB+ and above

- **Banks** – the Council will only use banks which:
  i) are UK banks; or
  ii) are non-UK and domiciled in a country which has a minimum sovereign Long-term rating of AAA

- **Part nationalised UK Banks** – Royal Bank of Scotland and Natwest. These banks will be included provided they continue to be part nationalised or meet the minimum ratings specified above

- **Building Societies –** the Council will not use any Building Societies due to the vast majority being unrated, however this position will be reviewed annually

- **Money Market Funds –** must have a minimum AAA rating

- **Ultra Short Dated Bond Funds** – must have a minimum AAA rating

- **UK Government (including DMO, UK Treasury Bills or UK Gilts) –** criteria not applicable as high quality

- **Local Authorities, Parish Councils etc. –** criteria not applicable as high quality

- **Supranational Institutions –** criteria not applicable as high quality

7.4 **Specified Investments**

These are Sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. They are investments which would not be defined as capital expenditure. They offer **high security** and **high liquidity** and are investments with:-

Specified Investment Category	**Investment limit per institute**
The UK Government (such as the Debt Management Office, UK Treasury Bills or Gilts with less than one year to maturity)	No limit
Supranational Bonds of less than one year's duration	Maximum £3m or 20% of portfolio
A UK Local Authority (including Town and Parish Councils)	Maximum £3m or 20% of portfolio
Term deposits with Banks (UK and non-UK as specified below)	Maximum £3m or 20% of portfolio
Certificates of Deposit with Banks (UK and non-UK as specified below)	Maximum £3m or 20% of portfolio
UK Banks nationalised or part nationalised by government	Maximum £3m or 20% of portfolio
Money Market Funds domiciled in the UK or Ireland (either CNAV, LVNAV or VNAV)	Maximum £3m or 20% of portfolio
Ultra Short Dated Bond Funds domiciled in the UK (formerly called Enhanced Money Market Funds)	Maximum £3m or 20% of portfolio

Floating Rate Notes with Banks (UK and non-UK as specified)	Maximum £3m or 20% of portfolio

7.5 Instrument Types

Fixed Term Deposits: are financial instruments provided by banks which provide investors with a higher rate of interest than regular savings accounts and cannot be broken until the agreed maturity date.

Certificates of Deposit: are a negotiable form of fixed term deposit. The difference is that you are not obligated to hold the investment to maturity, it is possible to realise the cash by selling it in the secondary market. This gives an added benefit of liquidity over a fixed term deposit.

Treasury Bills: are short-dated forms of UK government debt issued by the Debt Management Office (DMO) via a weekly tender. Usually for 1, 3 and 6 month periods.

Floating Rate Notes: are money market instruments with a floating/variable rates of interest which re-fix over a reference rate, for example LIBOR. The rate of return usually re-fixes every 3 months at a set margin over LIBOR. They are used primarily as a way of managing interest rate risk.

Money Market Funds: are a type of open-ended mutual fund that invests in short-term debt securities characterised by their minimal credit risk. They are highly liquid as cash can be drawn back at any notice.

Ultra Short Dated Bond Funds: are a type of bond fund that invests only in fixed-income instruments i.e. asset and mortgage backed corporate, treasury and government agency securities with short-term maturities usually around one year.

7.6 Country and Sector Limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign rating of AAA (other than the UK and Ireland). The approved list of countries that qualify using this credit criteria are shown below:

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

No more than 50% of the investment portfolio will be placed with any non-UK country. This will be monitored regularly for appropriateness.

7.7 Non-specified investments

These are other types of investment for which, in accordance with the Code of Practice, the Council sets additional criteria and generally carry more risk. These are any other type of investment which are not classified as specified investments above and can have a maturity of any period. Officers will seek substantial advice on the appropriateness and associated risks with these types of investments.

Non-specified Investment Category	**Investment limit per institute**
Pooled Property Funds	Maximum £5m or 50% of portfolio

7.71 Pooled Property Fund: this is a pooled investment vehicle whose assets mainly comprise property holdings. These can be focused on a specific sector or include a multitude of types, for example retail, offices, industrial etc.

Rather than owning a single property with the risk exposure of that one property rising or falling in value, incurring significant maintenance costs, having tenants' rent or lease issues etc., a pooled fund offers the advantage of diversified investment over a wide portfolio of different properties. This can be attractive for authorities who want exposure to the investment potential of the property sector but with a reduced risk profile and without having to actively manage the assets.

Property Funds offer enhanced returns over the longer term, but are more volatile in the short term. An investment of a minimum of 5 years is recommended to ensure that the full benefit of the return is seen and also to ensure that any entry and exit costs are covered over the life of the investment. It allows the Council to diversify into asset classes other than cash without the need to own and manage the underlying investment. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

The use of Property Funds can be deemed capital expenditure, and as such require funding from capital resources. However the Council is considering investment in the CCLA Local Authorities Property Fund. The Local Authorities (Capital Finance and Accounting) (Amendment) (England) Regulations 2010 exempts this investment from being capital expenditure. Dividends are treated as revenue but the General Fund is protected from fluctuations in the unit price. The investment is treated as an available for sale financial asset. This means that a benefit can be realised from the income without having to reflect capital value changes until the investment is sold. Refer to the factsheet provided by the fund managers at **Appendix A.**

A limit of £5m will be applied to the use of non-specified investments based upon an assessment of reserves and balances going forward.

7.8 Investment Strategy

7.8.1 Ensuring Sufficient Liquidity Levels

The Council needs to ensure that it has sufficient liquidity in its cash flow. For this purpose it has set out procedures (TMPs) for determining the maximum periods for which funds may prudently be committed. These are reviewed on an annual basis. Detailed daily cash projections are calculated by the Treasury Officer to ensure that the Council keeps minimal overnight cash balances, while maximising the amounts invested.

7.8.2 Monitoring of Investment Counterparties

Counterparty credit ratings are monitored by the Treasury Officer on a daily basis via e-mail communications from our Treasury Advisors. The Head of Finance will maintain a counterparty list in compliance with the Councils criteria and will revise the criteria and submit to Council for approval as and when necessary. Credit rating information is supplied by Link to the treasury officer on a daily basis via e-mail on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria will be omitted from the dealing list. Any rating changes, rating watches (notification of a likely change) and rating outlooks (notification of a possible longer term change) are provided to the Treasury Officer almost immediately after they occur and this information is considered before dealing. For instance, a negative watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

7.8.3 Treasury Function Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking.

The following Treasury Management performance indicators will be used to measure performance and will be included in the Annual Treasury Report:

- investment returns benchmarked against the average 7 day LIBOR for the year;
- average rate of return on investments;
- investment management costs per average sum invested;
- annual debt management cost;
- cost of borrowing, and;
- FTE staff involved in Treasury Management function

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

7.8.4 Investment Returns Expectations

Suggested budgeted investment earnings for each year are as follows:

- 2017/18 0.40%
- 2018/19 0.60%

- 2019/20 0.90%
- 2020/21 1.25%
- 2021/22 1.50%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.75%

Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years. Our forecasts are cautious and in line with a subdued path for increases in Bank Rate; we do not currently see inflation posing a significant threat over the next three years. Our central assumption is that the UK will make progress with concluding a satisfactory outcome over the Brexit negotiations with the EU by March 2019, although the UK finance sector is likely to be an area of particular concern and difficulty.

Bank Rate forecasts in line with market expectations are:

- Current 0.50%
- November 2018 0.75%
- November 2019 1.00%
- August 2020 1.25%

This is subject to many economic and political factors including the outcome of Brexit negotiations, future inflation levels, GDP growth and movements in the US Fed as there is normally a high degree of correlation between this and UK bank rate.

7.9 Investment treasury indicator and limit

Total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end. This is likely to primarily relate to any investment in property funds which are by nature a longer-term investment.

	2018/19	2019/20	2020/21
Maximum principal sums invested > 365 days	£5m	£5m	£5m

Ward(s): **All**
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Background Papers: **None**