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1. INTRODUCTION

1.1 Background

The council is required to operate a balanced budget, which broadly means that cash raised and received 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. Cash can often be set aside (e.g. reserves) or received ahead of when it is required, for example government capital grant funding, and therefore surplus monies are invested in counterparties or instruments commensurate with the council's risk appetite, and always prioritising adequate liquidity 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 down may be restructured to meet council risk or cost objectives.

The contribution that the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity and the ability to meet spending commitments as they fall due, either on day-to-day revenue spending 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 holding reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a direct loss to the General Fund.

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.

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.”

1.2 Reporting Requirements

1.2.1 Capital Strategy

The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a capital strategy report, to provide the following:

- a high-level long term overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- an overview of how the associated risks are managed;
- the implications for future financial sustainability.

The aim of the Capital Strategy is to ensure that all members on the full Council understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This Capital Strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy-driven and commercial investments usually driven by expenditure on an asset.

1.2.2 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 investment 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 Annual 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.
- c. An annual treasury management 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.

This Council delegates responsibility for implementation and monitoring of treasury management to the Policy & Resources Committee (P&R) and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. P&R therefore receives the mid-year report in December and the annual report in July each year.

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

1.3 Treasury Management Strategy for 2020/21

The strategy for 2020/21 covers two main areas:

Capital issues:

- the capital expenditure plans (section 2) and the associated prudential indicators (Annex C);
- the minimum revenue provision (MRP) policy (Section 3).

Treasury management issues:

- the current treasury position (section 1.5);

- treasury indicators which limit the treasury risk and activities of the council (Annex C);
- prospects for interest rates (Annex B);
- the borrowing strategy (section 2);
- policy on borrowing in advance of need (section 2.3);
- debt rescheduling (section 2.4);
- the investment strategy (section 4);
- creditworthiness policy (section 4.4); and
- the policy on the use of external service providers (section 5.3).

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

1.4 Treasury Management Policy Statement

The policies and objectives of the council's treasury management activities are as follows:

- This council defines its treasury management activities as:
'The management of the 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'.
- This 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.
- 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 management techniques, within the context of effective risk management.

1.5 Current Treasury Portfolio Position

A summary of the council's borrowing & investment portfolios as at 31 December 2019 and forecast at the end of the financial year is shown in **Table 1** below:

| Table 1 | Actual at 31 December 2019 | | | Forecast to 31 March 2020 | | |
|--------------------------------------|----------------------------|----------------|--------------|---------------------------|----------------|--------------|
| | £'000 | % of portfolio | Average Rate | £'000 | % of portfolio | Average Rate |
| Investments | | | | | | |
| UK Banks | 60,000 | 36% | 1.10% | 47,500 | 33% | 1.07% |
| Non-UK Banks | 9,500 | 6% | 1.17% | 7,000 | 5% | 1.19% |
| Building Societies | 0 | 0 | 0 | 0 | 0 | 0 |
| Local Authorities | 54,500 | 33% | 0.96% | 49,500 | 34% | 1.02% |
| Money Market Funds | 31,894 | 19% | 0.72% | 20,000 | 14% | 0.72% |
| Aberdeen Ultra Short Dated Bond Fund | 10,076 | 6% | 0.99%* | 10,000 | 7% | 1.00% |

| | | | | | | |
|---|----------------|-------------|--------------|----------------|-------------|--------------|
| Royal London Short Dated Credit Fund | 0 | 0 | 0 | 2,500 | 2% | 3.00% |
| Royal London Investment Grade Short Dated Bond Fund | 0 | 0 | 0 | 7,500 | 5% | 2.00% |
| Total Investments | 165,970 | 100% | 0.98% | 144,000 | 100% | 1.09% |
| Borrowing | | | | | | |
| PWLB loans | 218,520 | 83% | 3.76% | 233,940 | 84% | 3.69% |
| Market loans | 45,000 | 17% | 4.45% | 45,000 | 16% | 4.45% |
| Local Authorities | 0 | 0 | 0 | 0 | 0 | 0 |
| Total external Borrowing | 263,520 | 100% | 3.88% | 278,940 | 100% | 3.82% |

**Annual gross yield to 31 December 2019*

2. BORROWING STRATEGY

The capital expenditure plans of the council are set out in the Budget book (Appendix 1 to this report). 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 the capital expenditure plans.

Any capital investment that is not funded from new and/or existing resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves) increases the council's need to borrow, represented by the council's Capital Financing Requirement (CFR). However, external borrowing does not have to take place immediately to finance its related capital expenditure: the council can utilise cash being held for other purposes (such as earmarked reserves and working capital balances) to temporarily defer the need for external borrowing. This is known as 'internal borrowing' or 'under-borrowing'.

The council's primary objective is to strike an appropriate balance between securing cost certainty and securing low interest rates.

The council operates a two-pool approach for borrowing following the HRA Self Financing regime introduced in March 2012.

On 9 October 2019, the government announced an unexpected increase the Public Works Loan Board (PWLB) interest rate for all new loans after 9:30am on the same date. The increase added 1% (100bps) to the cost of borrowing. Loans to local authorities through the PWLB are based on a margin above the gilt rates; during 2019 gilt rates have been at historically low levels meaning the cost of borrowing for councils has been very low. As a result, councils have been locking into these cheap rates and the government has seen a significant increase in borrowing leading to the concern that the total national PWLB debt would breach its self-imposed government limit. In response to this concern the government has:

- Increased the overall limit of PWLB debt from £85bn to £95bn;
- Increased the cost of borrowing by 1%.

The interest rates through the PWLB during 2019 have been much lower than the prudent assumptions used in evaluating council business cases for capital investment in projects such as the Housing Joint Venture or Madeira Terraces and therefore do not put these projects at risk although the step increase does mean there is less contingency/flexibility.

As a result of the government's announcement to increase rates, other market lenders are now more competitive and will potentially offer better rates than the PWLB, although it is expected market lenders are likely to price using PWLB rates as a reference. Therefore the cost of borrowing for the council will be more expensive than before the rate change from the PWLB. The council has already been contacted by market lenders with competitive lending offers.

2.1 General Fund Borrowing Position and Strategy

The General Fund has been carrying an internal borrowing position (i.e. where the General Fund borrows cash from its own reserves) since 2008 as a response to the financial crisis. In response to a combination of an expectation of increasing interest rate forecasts, the reduction of certain reserves and historically low PWLB borrowing rates, the General Fund has entered into planned borrowing of £27.5m from the PWLB to reduce the internal borrowing position over the last three years. The most recent occurrence of this borrowing was undertaken in August 2019, where a £7.5m loan was undertaken for a period of 50 years at a historical low rate of 1.67%. Additionally, £10m of PWLB borrowing was undertaken by the General Fund in March 2019 as part of a debt restructure to replace RBS loans.

Table 2 below demonstrates that the General Fund has a borrowing need of £24m to support the 2019/20 capital programme. No further external borrowing is expected for 2019/20. Any borrowing need will initially be met from internal resources and officers will be exploring external sources of borrowing for the borrowing requirement from 2020/21 onwards.

General Fund Borrowing Strategy for 2020/21

The General Fund (GF) capital programme 2020/21 to 2022/23 forecasts a total of £249m capital investment, £145m of which will be met from existing or new resources. The increase in the GF borrowing need over this period is therefore £104m as shown in **Table 2** below.

| 2019/20 Projected £m | Table 2 – Borrowing Requirement | 2020/21 Estimate £m | 2021/22 Estimate £m | 2022/23 Estimate £m | Total £m |
|-------------------------------------|---|------------------------------------|------------------------------------|------------------------------------|---------------------|
| 80 | GF Capital Expenditure | 108 | 65 | 76 | 249 |
| (56) | Financed by: New & existing resources | (79) | (40) | (26) | (145) |
| 24 | GF Borrowing Need | 29 | 25 | 50 | 104 |

Of the £104m borrowing need shown, £29m is for projects that are awaiting approval or detailed analysis. Therefore, the timing of borrowing is uncertain, and borrowing decisions for these projects will form part of the viability and due diligence process.

For the remaining borrowing need, the strategy will initially focus on meeting this borrowing need from internal borrowing i.e. avoiding external borrowing by utilising the council's own surplus cash flows. Modelling of the movement of reserves and the council's capital expenditure plans demonstrates that the General Fund's long term reserves can support a level of approximately £50m of internal borrowing in the medium term. This will mitigate the increase in the cost of borrowing and reduce counterparty risk within the council's investment portfolio by reducing the portfolio size.

However, borrowing rates from the PWLB were increased by HM treasury by 1% during the autumn. Therefore, the internal borrowing position needs to be carefully and

continually reviewed to avoid incurring higher borrowing costs in the future at a time when the authority may not be able to avoid new borrowing to finance capital expenditure or refinance maturing debt.

There will remain a cost of carry (the difference between borrowing costs and investment rates) to any new long term borrowing that causes a temporary increase in cash balances which will, most likely, lead to a cost to revenue.

2.2 Housing Revenue Account (HRA) Borrowing Position and Strategy

The Housing Revenue Account (HRA) carries a fully funded borrowing position (i.e. the HRA does not borrow from its own reserves, but instead undertakes borrowing for its entire borrowing requirement). Over the last three years, the HRA has entered into a total of £16.5m of external borrowing and £4.5m of borrowing from the General Fund to support the HRA Capital Programme. The most recent of this borrowing was undertaken in August 2019, where a £2.5m loan was undertaken for a period of 50 years at a historical low rate of 1.67%. Additionally, £16m of PWLB borrowing was undertaken by the HRA in March 2019 as part of a debt restructure to replace RBS loans.

HRA Borrowing Strategy for 2020/21

The HRA Capital Programme 2020/21 to 2022/23 forecasts a total £251m of capital investment over the next three years with £119m met from existing or new resources. The increase in the HRA's borrowing need over this period is therefore £132m as shown in **Table 3** below. It is expected that this borrowing need will be met from a combination of borrowing externally and from the General Fund. The extent to which the HRA can borrow from the General Fund is dependent on the level of liquid resources the General Fund has available to lend to the HRA and additionally will depend on the view of interest rate prospects:

- If it is considered that there is a significant risk of reducing long term interest rates, long term borrowing should be postponed;
- If it is considered that there is a significant risk of sharply increasing long term interest rates, long term borrowing should be considered.

| 2019/20 Projected | Table 3 – HRA Borrowing Requirement | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | Total |
|------------------------------|---|-----------------------------|-----------------------------|-----------------------------|--------------|
| £m | | £m | £m | £m | £m |
| 54 | HRA Capital Expenditure | 58 | 101 | 92 | 251 |
| (37) | Financed by: New & existing resources | (32) | (46) | (41) | (119) |
| 17 | HRA Borrowing Need | 26 | 55 | 12 | 132 |

Table 4 below shows the actual expected external debt compared to the capital financing requirement over the next 3 years for both the General Fund and the HRA. This demonstrates that the HRA CFR is expected to be fully funded to 2022/23, and the General Fund is expected to maintain an underborrowed position:

| 2019/20 Estimate | Table 4 | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate |
|--------------------------------|---------------------------------|---------------------|---------------------|---------------------|
| £m | | £m | £m | £m |
| General Fund | | | | |
| 134 | GF Debt at 1 April | 140 | 175 | 194 |
| 6 | Expected change in Debt | 35 | 19 | 42 |
| 140 | GF Debt at 31 March | 175 | 194 | 236 |
| 183 | GF CFR* at 1 April | 201 | 224 | 242 |
| 24 | Borrowing need (Table 2) | 29 | 25 | 50 |
| (6) | MRP | (6) | (7) | (7) |
| 201 | GF CFR* at 31 March | 224 | 242 | 285 |
| 61 | Under / (Over) borrowing | 49 | 48 | 49 |
| 30.3% | % Underborrowed | 21.9% | 19.8% | 17.2% |
| Housing Revenue Account | | | | |
| 127 | HRA Debt at 1 April** | 144 | 170 | 224 |
| 17 | Expected change in Debt | 26 | 54 | 45 |
| 144 | HRA Debt at 31 March | 170 | 224 | 269 |
| 127 | HRA CFR at 1 April | 144 | 170 | 224 |
| 17 | Borrowing need (Table 3) | 26 | 55 | 51 |
| (0) | MRP | (0) | (1) | (6) |
| 144 | HRA CFR at 31 March | 170 | 224 | 269 |
| - | Under / (Over) borrowing | - | - | - |

* GF CFR in Table 4 is the underlying need to borrow and excludes PFI and lease arrangements, which are included in the CFR figure in the Prudential Indicators in Annex C.

** Includes both external debt and sums borrowed from the General Fund (£4.679m as at 1 April 2019).

2.3 Policy on Borrowing in Advance of Need

The council will not borrow purely in order to profit from investment of sums borrowed in advance of need. Any decision to borrow in advance will be within approved Capital Financing Requirement estimates 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. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting.

2.4 Debt Rescheduling

Officers continue to regularly review opportunities for debt rescheduling but there has been a considerable widening of the difference between new borrowing and repayment rates, which has resulted in much fewer opportunities to realise any savings or benefits from rescheduling PWLB debt.

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil long term treasury strategy aims;
- enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

The strategy is to continue to seek opportunity to reduce the overall level of the council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayment costs, and potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt. All rescheduling will be agreed by the S151 Officer.

2.5 Interest Rate Risk & Continual Review

The council's total borrowing need of £236m is identified in **Tables 2 & 4**. This borrowing need, together with the debt at risk of maturity shown in **Table 5** is the extent to which the council is subject to interest rate risk over the next three years.

| Table 5 | 2020/21 | 2021/22 | 2022/23 |
|--|-----------|-----------|-----------|
| | £m | £m | £m |
| Maturing Debt | 2 | 2 | 12 |
| Debt Subject to early repayments options | 15 | 20 | 20 |
| Total debt at risk of maturity | 17 | 22 | 32 |

Officers continue to review the need to borrow taking into consideration the potential increases in borrowing costs, the need to finance new capital expenditure, the need to refinance maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

Against this background and the risks within the economic forecast, caution needs to be exercised. The Chief Finance Officer will therefore continue to monitor interest rates in financial markets and adopt a proactive approach to changing circumstances as follows:

- if it was considered that there was a significant risk of a forthcoming sharp fall in long and short term rates (e.g. due to a marked increase in the risk of relapse into recession or increasing risk of deflation), then long term borrowings will be postponed and potential rescheduling from fixed rate funding into short term borrowing will be considered;
- if it was considered that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, for example, arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that borrowing would be undertaken and fixed rate funding drawn on whilst interest rates are still lower than they will be in the next few years.

3. MINIMUM REVENUE PROVISION POLICY STATEMENT

The council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP). Ministry of Housing, Communities & Local Government (MHCLG) regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options are available to councils, so long as the principle of any option selected ensures a prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

The Council is recommended to approve the following MRP Statement for 2020/21:

For all debt where the government has provided revenue support (supported capital expenditure), the MRP policy will be:

- Provision on a straight line basis over 50 years.

For all debt where the government does not provide revenue support:

- Where the debt relates to an asset, the council will set aside a sum equivalent to repaying the debt over the life of the asset either in equal instalments or on an annuity basis over a maximum life of 50 years. The method to be adopted will be determined according to which is the most financially beneficial to the council over the life of the asset.
- Where the debt relates to expenditure which is subject to a capitalisation direction issued by the government, the council will set aside a sum equivalent to repaying the debt over a period consistent with the nature of the expenditure on an annuity basis.
- In the case of assets under construction, MRP will be delayed until the relevant asset becomes operational.

Where the debt relates to capital loans to a third party:

- The repayments of principal will be set aside as capital receipts to finance the initial capital advance in lieu of making a MRP.

Where the debt relates to the Living Wage Joint Venture:

- The council will set aside, in equal instalments, a sum which is equivalent to repaying the debt at the end of year 40 within the 60 year business plan. Set aside will commence, at the latest, in the year in which net surpluses are modelled for each individual tranche of borrowing.

For on-balance sheet PFI schemes and leases, the MRP policy will be:

- Asset Life Method (annuity method) - The MRP will be calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the asset. Any related MRP will be equivalent to the “capital repayment element” of the annual charge payable.

There is the option to charge more than the prudent provision of MRP each year through a Voluntary Revenue Provision (VRP).

4. ANNUAL INVESTMENT STRATEGY

The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals with financial investments. Non-financial investments are covered in the Capital Strategy (Appendix 2).

The council’s investment policy has regard to the following:

- MHCLG’s Guidance on Local Government Investments (the “Guidance”);
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (the “Code”);
- CIPFA Treasury Management Guidance Notes 2018.

The council's investment priorities will be the security of capital first, portfolio liquidity second and then yield (return).

4.1 Annual Investment Strategy for 2020/21

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is predicted that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments on short term or variable terms.
- Conversely, if it is predicted that Bank Rate is likely to fall within that time period, consideration will be given to locking in the higher rates currently obtainable, for longer periods.

Currently, Bank Rate is forecast to increase steadily but slowly over the next few years to reach 1.25% by Quarter 1, 2022. Bank Rate forecasts for financial year ends (March) are:

| Year | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|-----------|---------|---------|---------|---------|
| Bank Rate | 0.75% | 0.75% | 1.00% | 1.25% |

Link Asset Service's (LAS) view on the prospect for interest rates, including their forecast for short term investment rates is appended at Annex B.

The primary principle governing the council's investment criteria is the security of its investments, but return on investment is also important. After this main principle, the council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security, and monitoring their security;
- It has sufficient liquidity in its investments.

Approach for 2020/21

Following a review of the expected cash balances over the next 5-10 years, officers have looked at opportunities to invest in longer dated investments to make more effective use of the cash supporting longer term reserves. Two actions have been taken in the last two months to achieve this:

- £15m of loans to other local authorities with an investment length of between 1.5 and 5 years have been entered into. This provides additional yield whilst improving the security of the investment portfolio;
- Following a selection process supported by the council's treasury advisors, £10.0m will be invested across two short dated bond funds managed by Royal London Asset management.

The combined investment rate of the above Local Authority and Royal London investments is expected to be 1.91% for 2020/21. The current investment rate being achieved is 0.98%.

Changes from 2019/20 Strategy

There have been no changes proposed to the 2020/21 Annual Investment Strategy. The strategy proposed therefore reflects the strategy currently in place.

4.2 Investment Policy – Management of risk

Treasury management risks and how these risks are managed and mitigated are identified in the council's Treasury Management Practices and related procedures, details of which are held within the council's Treasury Management Team. The main risks to the council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- re-financing risks (impact of debt maturing in future years); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

The guidance from 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:

- i) Minimum acceptable credit criteria are applied in order to generate a list of high creditworthy counterparties. This also enables diversification and thus avoids a concentration of risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
- ii) Other information: 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 account of information that reflects the opinion of the markets. To achieve this consideration the council will engage with its advisors to monitor market pricing such as "credit default swaps" (CDS) and overlay that information on credit ratings.
- iii) Other information sources used will include the financial press, share prices 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.
- iv) Where there is a significant or sudden deterioration in one or more indicators (such as CDS prices), officers will undertake a review and, where necessary take action. This action may take the form of temporary suspension of a counterparty from the council's approved lending list, or a restriction of the maximum period and investment limits.
- v) This authority has defined the list of types of investment instruments that the treasury management team are authorised to use.
 - a. **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year. The limits and permitted instruments for specified investments are listed within Table 6.

- b. **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. The limits and permitted instruments for non-specified investments are listed within Table 7.
- vi) Lending limits (amounts and maturity) for each counterparty will be set through applying the credit criteria matrix (within Table 7).
- vii) This authority will set limits for the amount of its investments:
 - a. which are invested for longer than 365 days, detailed in the Treasury Indicators in Annex C;
 - b. which are invested in any one sector (paragraph 4.5);
 - c. which are invested in any one counterparty within its relevant sector (paragraph 4.5).
- viii) Investments in Non-UK Banks will only be placed with counterparties from countries with a specified minimum sovereign rating of AA (paragraph 4.3).
- ix) Investments in UK banks will only be placed with counterparties with a minimum credit rating of BBB.
- x) This authority has engaged external consultants, (see paragraph 5.3), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
- xi) All investments will be denominated in sterling.
- xii) As a result of the change in accounting standards for 2018/19 under International Financial Reporting Standard IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018 MHCLG concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for 5 years commencing from 1/4/18).

However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance (see paragraph 4.7). Regular monitoring of investment performance will be carried out during the year.

4.3 Sovereign Credit Ratings

For 2020/21 it is recommended to maintain the policy of lending to sovereign nations and their banks which hold at least an AA credit rating. The list of countries that qualify using this credit criteria (as at the date of this report) are shown below:

- AAA** Australia, Canada, Denmark, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden & Switzerland
- AA+** Finland & United States,
- AA** France, United Arab Emirates, France, Hong Kong & UK

4.4 Creditworthiness Policy

Each counterparty included on the council's approved lending list must meet the criteria set out below. Without the prior approval of the Council, no investment will be made in an instrument that falls outside the list below.

Table 6 below summarises the types of specified investment counterparties available to the council, and the maximum amount and maturity periods placed on each of these. A full list of the council's counterparties and the current limits for 2020/21 are appended at Annex A.

When assessing credit ratings to ascertain limits for each counterparty, the lowest short and long term ratings from each of the three ratings agencies is applied. For simplicity, the ratings for Standard & Poor's are used in the tables below.

Criteria for Specified Investments

| Table 6 | Country/ Domicile | Minimum Capital Requirements | Min. Credit Criteria (L/term / S/term) | Max. Amount | Max. maturity period |
|--|---|--|--|----------------|----------------------------|
| Debt Management and Deposit Facilities (DMADF) | UK | N/A | N/A | unlimited | 6 months |
| UK Local Authorities | UK | N/A | UK Sovereign Rating | £10m per LA | 12 months |
| UK Banks – part nationalised* | UK | UK government must own majority shareholding | N/A | £25m | 12 months |
| UK Banks & credit rated Building Societies | UK | Must meet minimum credit criteria | AA- / A-1+ | £25m | 12 months |
| | | | A / A-1 | £15m | 12 months |
| | | | BBB / A-2 | £10m | 6 months |
| Banks – Non-UK | Those with sovereign rating of at least AA* | Must meet minimum credit criteria | AA- / A-1+ | £25m | 12 months |
| Non-rated Building Societies | UK | Must have an asset base of at least £5bn at the time of investment | N/A | £5m | 6 months |
| Money Market Funds (CNAV and LVNAV) | UK/Ireland/ EU domiciled | Must meet minimum credit criteria | AAA | £15m per fund | Liquid |
| Ultra Short Dated Bond Funds | UK/Ireland/EU domiciled | Must meet minimum credit criteria | AA | £15m per fund | Liquid |

*See Paragraph 4.3 for full list of countries that meet these criteria

Lending to the council's operational banking service provider

An additional operating limit of £2m and an additional investment limit of £5m will be provided for the council's provider of transactional banking services (currently Lloyds Bank plc). It is unavoidable that the £2m operational limit will be breached from time to time however, officers will endeavour to keep this to an absolute minimum.

UK banks – ring fencing

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

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

While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings (and any other metrics considered) will be considered for investment purposes. The list of approved counterparties in Annex A differentiates the limits for both ring fenced and non-ring fenced banks.

Part-Nationalised Banks

The council can lend up to £25m for up to 12 months to any bank in which the UK Government holds a majority shareholding regardless of the credit rating due to the implied government support of those entities. The Royal Bank of Scotland PLC & National Westminster Bank PLC are the two entities currently treated as part nationalised.

Non-Specified investments

These are any other types of investment that are not defined as specified. All such investments will be sterling denominated, with maturities up to a maximum of 1 year, meeting the minimum ‘high’ rating criteria where applicable:

| Table 7 | Instrument Type | Minimum credit criteria (L/term / S/term) | Maximum investments | Period |
|-------------------------|------------------------|---|---------------------|---------|
| UK Local Authorities | N/A | N/A | £10m per LA | 5 years |
| UK Banks & Non UK Banks | Fixed Deposits | AA+ / A-1+ | £25m | 3 years |
| | | AA- / A-1+ | £25m | 2 years |
| | Negotiable Instruments | AA- / A-1+ | £25m | 5 years |

| | | | | |
|------------------------|-------------------------|---|--------------|--------|
| Short Dated Bond Funds | UK/Ireland/EU domiciled | Short Dated bond funds are not rated. A selection process will evaluate relative risks & returns. Security of the council's money and fund volatility will be key measures of suitability | 15m per fund | Liquid |
|------------------------|-------------------------|---|--------------|--------|

A full list of counterparties that meet the council's criteria for both specified and non-specified investments are listed in Annex A.

4.5 Other Limits

In order to mitigate concentration risk, there are a number of other limits imposed within the investment strategy. **Table 8** sets out the maximum permitted investment for each sector at the time of investment:

| Table 8 – Other Limits | |
|--|------------------------|
| Sector | Max total of portfolio |
| Banking sector | 100% |
| Building Society Sector | 75% |
| Local Authority Sector | 100% |
| Money Market Funds (MMF) | 100% |
| Short Dated & Ultra Short Dated Bond Funds | 50% |
| Debt Management Account Deposit Facility (DMADF) | 100% |

In addition to these limits:

- no more than 25% of the portfolio can be invested for more than 1 year; and
- with the exception of MMF & the DMADF, no one counterparty may have more than 25% of the relevant sector maximum at the time the investment is made.

4.6 Approved Methodology for adding and removing counterparties

A counterparty shall be removed from the council's list where a change in their credit rating results in a failure to meet the criteria set out above.

A new counterparty may only be added to the list with the written prior approval of the Chief Finance Officer and only where the counterparty meets the minimum criteria set out above.

A counterparty's exposure limit will be reviewed (and changed where necessary) following notification of a change in that counterparty's credit rating or a view expressed by the credit rating agency warrants a change.

A counterparty's exposure limit will also be reviewed where information contained in the financial press or other similar publications indicates a possible worsening in credit worth of a counterparty. The review may lead to the suspension of any counterparty where it is considered appropriate to do so by the Chief Finance Officer.

4.7 Investment Risk Benchmarking

The weighted average benchmark risk factor for 2020/21 is recommended to be 0.05%. This is unchanged from 2019/20. This is a measure of the percentage of the portfolio deemed to be at risk of loss by reference to the maturity date, value of investment, and credit rating of the individual investments within the portfolio compared to the historic default data for those credit ratings.

This benchmark is a simple target (not limit) to measure investment risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that the in-house treasury team can monitor the current and trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported with supporting reasons in the mid-year or end of year reviews.

This matrix will only cover internally managed investments, excluding externally managed cash that has been subject to an individual selection process.

For any investment where there is a direct and legal offset against an existing financial liability, the investment will be assumed to have a benchmark risk of 0.00%.

5. OTHER TREASURY MATTERS

5.1 Banking Services

Lloyds Bank plc currently provides banking services for the council.

5.2 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. Training was last provided for members of the Audit & Standards Committee and Policy & Resources Committee on 8 October 2019 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed and training arranged as required.

5.3 Policy on the use of External Service Providers

The council uses Link Asset Services as its external treasury management advisors.

The council recognises that responsibility for treasury management decisions remains with the council 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 subject to regular review.

5.4 Lending to Third Parties

The council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments, rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken, as described in the Capital Strategy (Appendix 2 to this report).

5.5 Updates to Accounting Requirements

▪ IFRS 9 – local authority override – English local authorities

The MHCLG enacted a statutory over-ride from 1 April 2018 for a five year period until 31 March 2023 following the introduction of IFRS 9 and the requirement for any capital gains or losses on marketable funds to be chargeable in year. This has the effect of allowing any capital losses on funds to be held on the balance sheet until 31 March 2023, allowing councils to initiate an orderly withdrawal of funds if required.

▪ IFRS 16 – Leasing

The CIPFA Code of Practice and Guidance notes for 2020/21 will incorporate the requirement to account for all leases onto the council's balance sheet. This has the following impact to this paper:

- The MRP Policy sets out how MRP will be applied for leases bought onto the balance sheet;
- The Council's Capital Financing Requirement authorised limit and operational boundary for 2020/21 onwards has been increased to reflect the estimated effect of this change. These limits can be amended during 2020/21, and brought to full Council to amend with the TMSS Mid Year report if the limits need to be increased following some more detailed work on the leases to be bought onto the balance sheet.

ANNEX A - Approved List of Counterparties 2020/21

| Counterparty | Specified /Non-specified | Short-term | | | Long-term | | | Lending Limit | Fixed deposit duration limit (months) |
|---|--------------------------|--|-----|------|-----------|------|------|---------------|---------------------------------------|
| | | F=Fitch M=Moody's SP=Standard & Poor's | | | | | | | |
| | | F | M | SP | F | M | SP | | |
| (1) UK Banks | | | | | | | | | |
| Lloyds Banking Group: | | | | | | | | | |
| Bank of Scotland PLC (RFB) | Specified | F1 | P-1 | A-1 | A+ | Aa3 | A+ | £20m | 12 |
| Lloyds Bank PLC (RFB) | Specified | F1 | P-1 | A-1 | A+ | Aa3 | A+ | £20m | 12 |
| Lloyds Bank Corporate Markets PLC (NRFB) | Specified | F1 | P-1 | A-1 | A | A1 | A | £15m | 12 |
| Total Max. exposure to Lloyds Banking Group | | | | | | | | £20m | 12 |
| Barclays Banking Group: | | | | | | | | | |
| Barclays Bank PLC (NRFB) | Specified | F1 | P-1 | A-1 | A+ | A2 | A | £15m | 12 |
| Barclays Bank UK PLC (RFB) | Specified | F1 | P-1 | A-1 | A+ | A1 | A | £15m | 12 |
| Total Max. exposure to Barclays Banking Group** | | | | | | | | £15m | 12 |
| HSBC Group: | | | | | | | | | |
| HSBC Bank PLC (NRFB) | Specified | F1+ | P-1 | A-1+ | A+ | Aa3 | AA- | £15m | 12 |
| HSBC UK Bank PLC (RFB) | Specified | F1+ | | A-1+ | A+ | | AA- | £15m | 12 |
| Total Max. exposure to HSBC Group** | | | | | | | | £15m | 12 |
| RBS/Natwest Group: | | | | | | | | | |
| Natwest Markets PLC (NRFB) | Specified | F1 | P-2 | A-2 | A | Baa2 | A- | £10m | 6 |
| National Westminster Bank PLC (RFB) | Specified | F1 | P-1 | A-1 | A+ | A1 | A | £25m | 12 |
| The Royal Bank of Scotland PLC (RFB) | Specified | F1 | P-1 | A-1 | A+ | A1 | A- | £25m | 12 |
| Total Max. exposure to RBS/Natwest Group** | | | | | | | | £25m | 12 |
| Close Brothers Ltd | Specified | F1 | P-1 | | A | Aa3 | | £15m | 12 |
| Clydesdale Bank PLC | Specified | F2 | P-2 | A-2 | A- | Baa1 | BBB+ | £10m | 6 |
| Goldman Sachs International Bank | Specified | F1 | P-1 | A-1 | A | A1 | A+ | £15m | 12 |
| Handelsbanken PLC | Both | F1+ | | A-1+ | AA | | AA- | £25m | 24 |
| Santander UK PLC | Specified | F1 | P-1 | A-1 | A+ | Aa3 | A | £15m | 12 |
| Standard Chartered Bank | Specified | F1 | P-1 | A-1 | A+ | A1 | A | £15m | 12 |
| Sumitomo Mitsui Banking Corporation Europe Ltd | Specified | F1 | P-1 | A-1 | A | A1 | A | £15m | 12 |
| (2) Building Societies⁺ | | | | | | | | | |
| Coventry (2) | Specified | F1 | P-1 | | A- | A2 | | £10m | 6 |
| Leeds (5) | Specified | F1 | P-2 | | A- | A3 | | £10m | 6 |
| Nationwide (1) | Specified | F1 | P-1 | A-1 | A | Aa3 | A | £15m | 12 |
| Principality (6) | Specified | F2 | P-2 | | BBB+ | Baa2 | | £10m | 6 |
| Skipton (4) | Specified | F1 | P-2 | | A- | Baa1 | | £10m | 6 |

Appendix 3

| Counterparty | Specified /Non-specified | Short-term | | | Long-term | | | Lending Limit | Fixed deposit duration limit (months) |
|---|--------------------------|--|-----|------|-----------|-----|-----|---------------|---------------------------------------|
| | | F=Fitch M=Moody's SP=Standard & Poor's | | | | | | | |
| | | F | M | SP | F | M | SP | | |
| Yorkshire (3) | Specified | F1 | P-2 | | A- | A3 | | £10m | 6 |
| (3) Non-UK Banks | | | | | | | | | |
| Australia & NZ Banking Group (Australia) | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| Commonwealth Bank of Australia (Australia) | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| National Australia Bank Ltd (Australia) | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| Westpac Banking Corporation (Australia) | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| Toronto Dominion (Canada) | Both | F1+ | P-1 | A-1+ | AA- | Aa1 | AA- | £25m | 24 |
| Nordea Bank Abp (Finland) | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| Landwirtschaftliche Renenbank (Germany) | Both | F1+ | P-1 | A-1+ | AAA | Aaa | AAA | £25m | 36 |
| NRW.BANK (Germany) | Both | F1+ | P-1 | A-1+ | AAA | Aa1 | AA | £25m | 24 |
| Bank Nederlandse Gemeenten (The Netherlands) | Both | F1+ | P-1 | A-1+ | AA+ | Aaa | AAA | £25m | 36 |
| Nederlandse Waterschapsbank N. V. (The Netherlands) | Both | | P-1 | A-1+ | | Aaa | AAA | £25m | 36 |
| DBS Bank Ltd (Singapore) | Both | F1+ | P-1 | A-1+ | AA- | Aa1 | AA- | £25m | 24 |
| Overseas Chinese Banking Corporation Limits (Singapore) | Both | F1+ | P-1 | A-1+ | AA- | Aa1 | AA- | £25m | 24 |
| United Overseas Bank Limited (Singapore) | Both | F1+ | P-1 | A-1+ | AA- | Aa1 | AA- | £25m | 24 |
| Svenska HandelsBanken AB (Sweden) | Both | F1+ | P-1 | A-1+ | AA | Aa2 | AA- | £25m | 24 |
| First Abu Dhabi Bank PJSC | Both | F1+ | P-1 | A-1+ | AA- | Aa3 | AA- | £25m | 24 |
| Bank of New York Mellon (USA) | Both | F1+ | P-1 | A-1+ | AA | Aa1 | AA- | £25m | 24 |

* Ratings as advised by Link Asset Services 24 January 2020

+ UK Building Societies ranking based on Total Asset size – Source: Building Societies Association Jan 2020

** Where there are multiple counterparties within a banking group, exposure to the overall group will be the largest limit, but exposure to individual counterparties within the group will be based on the individual counterparty limit. Eg, exposure to Lloyds Banking Group can be up to £20m, but max exposure to Lloyds Bank Corporate Markets PLC will be £15m.

ANNEX B - ECONOMIC OVERVIEW

Provided by Link Asset Services on 4 February 2020

UK. Brexit. 2019 was a year of upheaval on the political front culminating in a new Conservative Government gaining a large overall majority in the **general election** on 12 December on a mandate of leaving the EU on 31 January. However, there will still be much market uncertainty as the detail of a comprehensive trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. Should this prove to be an unrealistically short timetable for such major negotiations that leaves open three possibilities; a partial agreement on many areas of agreement and then continuing negotiations to deal with the residual areas, the need for the target date to be put back, probably two years, or, a no deal Brexit in December 2020.

GDP growth took a big hit from both the political and Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% (+1.1% year-on-year). However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The forward-looking surveys in January have indicated that there could be a significant recovery of growth now that much uncertainty has gone. Nevertheless, economic growth may only come in at about 1% in 2020, pending the final outcome of negotiations on a trade deal. Provided there is a satisfactory resolution of those negotiations, which are in both the EU's and UK's interest, then growth should strengthen further in 2021.

At its 30 January meeting, the Monetary Policy Committee held Bank Rate unchanged at 0.75%. The vote continued to be split 7-2, with two votes for a cut to 0.50%. The financial markets had been predicting a 50:50 chance of a rate cut at the time of the meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after the election, had depressed economic growth in quarter 4. In addition, three members of the MPC had made speeches in January which were distinctly on the dovish side, flagging up their concerns over weak growth and low inflation; as there were two other members of the MPC who voted for a rate cut in November, five would be a majority at the January MPC meeting if those three followed through on their concerns.

However, that downbeat news was backward looking; more recent economic statistics and forward-looking business surveys, have all pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and immediate Brexit uncertainty. In addition, the September spending round increases in expenditure will be kicking in in April 2020 while the Budget in March is widely expected to include a substantial fiscal boost by further increases in expenditure, especially on infrastructure. However, the MPC's forecasts for growth that were cut from 1.2% to 0.8% for 2020, and from 1.8% to 1.4% for 2021, could not include any allowance for the March Budget. Overall, the MPC clearly decided to focus on the more recent forward-looking news than the earlier downbeat news.

The quarterly Monetary Policy Report did, though, flag up that there was still a risk of a Bank Rate cut; "Policy may need to reinforce the expected recovery in UK GDP growth should the more positive signals from recent indicators of global and domestic activity not

be sustained or should indicators of domestic prices remain relatively weak." Obviously, if trade negotiations with the EU failed to make satisfactory progress, this could dampen confidence and growth. On the other hand, there was also a warning in the other direction, that if growth were to pick up strongly, as suggested by recent business surveys, then "some modest tightening" of policy might be needed further ahead. It was therefore notable that the Bank had dropped its phrase that tightening would be "limited and gradual", a long-standing piece of forward guidance; this gives the MPC more room to raise Bank Rate more quickly if growth was to surge and, in turn, lead to a surge in inflation above the 2% target rate.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell again in both October and November to a three-year low of 1.5% and then even further to 1.3% in December. It is likely to remain close to or under 2% over the next two years and so, it does not pose any immediate concern to the MPC at the current time. However, if there was a hard or no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market**, growth in numbers employed has been quite resilient through 2019 until the three months to September, where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000 and then a marked increase of 208,000 in the three months to November. The unemployment rate held steady at a 44-year low of 3.8% on the Independent Labour Organisation measure. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.4% in November (3-month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

Coronavirus. The recent Coronavirus outbreak could cause disruption to the economies of affected nations. The Chinese economy is now very much bigger than it was at the time of the SARS outbreak in 2003 and far more integrated into world supply chains. However, a temporary dip in Chinese growth could lead to a catch up of lost production in following quarters with minimal net overall effect over a period of a year. However, it's unknown quite how big an impact the virus may have around the world; if the efforts of the WHO and the Chinese authorities to contain the virus are successful this is likely to minimise economic impact.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing **globalisation** i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy.

The trade war between the US and China is a major concern to financial markets due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though

this is probably overblown. These concerns resulted in government bond yields in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries.

Prospects for interest rates

The council has appointed Link Asset Services (LAS) as its treasury advisor and part of their service is to assist the council in formulating a view on interest rates. The following table gives LAS's central view

| 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 |

The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU, at some point in time. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a comprehensive trade deal within the short time to December 2020, as the prime minister has pledged.

2019 was a weak year for UK economic growth as political and Brexit uncertainty depressed confidence. It was therefore of little surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% during the year. However, during January 2020, financial markets were predicting a 50:50 chance of a cut in Bank Rate at the time of the 30 January MPC meeting. Admittedly, there had been plenty of downbeat UK economic news in December and January which showed that all the political uncertainty leading up to the general election, together with uncertainty over where Brexit would be going after that election, had depressed economic growth in quarter 4 of 2019. However, that downbeat news was backward looking; more recent economic statistics and forward looking business surveys, all pointed in the direction of a robust bounce in economic activity and a recovery of confidence after the decisive result of the general election removed political and Brexit uncertainty. The MPC clearly decided to focus on the more recent forward-looking news, rather than the earlier downbeat news, and so left Bank Rate unchanged.

Provided that the forward-looking surveys are borne out in practice in the coming months, and the March Budget delivers with a fiscal boost, then it is expected that Bank Rate will be left unchanged until after the December trade deal deadline. However, the MPC is on alert that if the surveys prove optimistic and/or the Budget disappoints, then they may still take action and cut Bank Rate in order to stimulate growth.

Investment and borrowing rates

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress were made with an agreed Brexit, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019/20 but then jumped up by 100 bps on 9/10/2019. The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a re-think of local authority treasury management strategy and risk management. As Link Asset Services' long-term forecast for Bank Rate is 2.25%, and all PWLB certainty rates are close to or above 2.25%, there is little value in borrowing from the PWLB at present. Accordingly, the council will reassess its risk appetite in terms of either seeking cheaper alternative sources of borrowing or switching to short term borrowing in the money markets until such time as the Government might possibly reconsider the margins charged over gilt yields. Longer term borrowing could also be undertaken for the purpose of certainty, where that is desirable, or for flattening the profile of a heavily unbalanced maturity profile.
- While this authority will not be able to avoid borrowing to finance new capital expenditure and to replace maturing debt, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

ANNEX C - PRUDENTIAL AND TREASURY INDICATORS 2020/21 to 2022/23

The council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. Local authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2020/21 to 2022/23 are set out in **Table A** below:

| Table A | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate |
|---|-----------------------------|-----------------------------|-----------------------------|
| General Fund (GF) Prudential Indicators | | | |
| GF Capital Expenditure £m (gross) General Fund capital expenditure plans | £108m | £65m | £76m |
| GF Capital Financing Requirement £m* Measures the underlying need to borrow for capital purposes (including PFI & Leases) | £279m | £297m | £336m |
| GF Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream | 5.30% | 5.46% | 5.32% |
| Housing Revenue Account (HRA) Prudential Indicators | | | |
| HRA Capital Expenditure £m (gross) HRA capital expenditure plans | £58m | £101m | £92m |
| HRA Capital Financing Requirement £m* Measures the underlying need to borrow for capital purposes | £170m | £224m | £269m |
| HRA Ratio of financing costs to net revenue stream** Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream | 10.41% | 11.51% | 20.89% |

* From 2020/21, the CFR includes an estimate for leases that will be bought onto the balance sheet under a change in leasing accounting regulations.

** the ratio of financing costs to net revenue stream illustrates the percentage of the Council's net revenue budget being used to finance the council's borrowing. This includes interest costs relating to the council's borrowing portfolio and MRP, net of the investment income from the council's investment portfolio.

The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2020/21 to 2022/23 are set out in **Tables B & C** below. These have been calculated and determined by Officers in compliance with the Treasury Management Code of Practice:

| Table B | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate |
|--|-----------------------------|-----------------------------|-----------------------------|
| Authorised Limit for External Debt £m* The council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. | £469m | £540m | £625m |
| Operational boundary for external debt £m* The council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons. | £459m | £530m | £615m |
| Principal Sums invested for longer than 365 days | £30m | £30m | £30m |

**From 2020/21 The Authorised Limit and Operational Boundary includes an estimate for leases that will be bought onto the balance sheet under a change in leasing accounting regulations.*

| Table C | | |
|--|-------|-------|
| Maturity Structure of fixed interest rate borrowing* | | |
| The council needs to set upper and lower limits with respect to the maturity structure of its borrowing. | | |
| | Lower | Upper |
| Under 12 months | 0% | 40% |
| 12 months to 2 years | 0% | 40% |
| 2 years to 5 years | 0% | 50% |
| 5 years to 10 years | 0% | 75% |
| Over 10 years | 40% | 100% |

ANNEX D - SCHEME OF DELEGATION

1. Full Council

- Approval of Annual Investment Strategy, Treasury Management Strategy Statement, Capital Strategy, Treasury Management Policy Statement;
- Approval of the Minimum Revenue Provision Policy;
- Approval of the Prudential and Treasury indicators, including the Affordable borrowing limits;
- Approval of the annual revenue budget for financing costs.

The requirements are all contained within this appendix (TMSS incorporating the AIS) and Appendix 2 (Capital Strategy) of this report.

- Any changes to the Annual Investment Strategy during the year require approval by full Council.
- Full Council are able to delegate the implementation and monitoring of the treasury management function. This function is delegated to the Policy & Resources Committee.

2. Policy & Resources Committee

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- Budget development, consideration and approval;
- Approval of the division of responsibilities;
- Receiving and reviewing regular monitoring reports and acting on recommendations.

P&R receive the following reports in order to fulfil these requirements:

- A **Mid-Year Review Report** – an update on progress of the treasury and investment strategy against budget and the treasury & prudential indicators for the first six months of the year. Any amendments to the indicators or investment strategy require P&R committee to recommend that full Council approve the changes.
- **End of Year Review report** – an update regarding the actual outturn of the treasury position provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.
- **Quarterly TBM reports** - includes the revenue impact of the financing cost budget.

P&R Committee is the body held responsible for the scrutiny of the actual performance of the treasury activities against the strategy.

3. Role of the Section 151 Officer

The Section 151 (responsible) Officer is responsible for:

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;

- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.

There are further responsibilities for the S151 Officer identified within the 2017 Code in respect of non-financial investments. They are identified and listed in the Capital Strategy where relevant.