APPENDIX A

Treasury Management Strategy and Prudential Indicators for 2019/20

1. Treasury Management Strategy for 2019/20

The proposed Treasury Management Strategy for 2019/20 is set out below.

The strategy covers two main areas:

Capital Issues

- The capital expenditure plans and the associated prudential indictors;
- 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; and
- Policy on the use of external service providers.

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

2. Training

The CIPFA Code requires that the Section 151 Officer ensures that Members with responsibility for treasury management receive adequate training in relevant aspects of this function. This especially applies to members responsible for scrutiny. It is proposed that scrutiny is exercised through the Governance and Audit Committee and training will be provided. The training needs of treasury management officers are also periodically reviewed.

3. Treasury Management Consultants

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisors.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

The scope of investments within the Council's operations now includes both conventional treasury investments, (the placing of residual cash from the Council's functions), and more commercial type investments, such as investment properties. The commercial type investments require specialist advisers.

4. The Capital Prudential Indicators 2019/20 to 2021/22

The Council's capital expenditure plans are set out in Appendix E of the 2019 Budget Report. They are one of the key drivers of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members overview and confirm capital expenditure plans.

5. Capital Expenditure (Indicator 1)

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. Members are asked to approve the capital expenditure forecasts.

Capital Expenditure	**2017/18 Actual £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Services	1,778	6,577	6,983	14,824	10,663
Commercial Activities/Non-Financial Investments	1,075	4,633	10,637	13,702	318
Total	**2,853**	**11,210**	**17,620**	**28,526**	**10,981**

Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties, equity investment etc.

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

Financing of Capital Expenditure	**2017/18 Actual £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Capital Receipts	1,177	935	867	2,600	200
Capital Grants	426	468	2,353	418	418
Capital Reserves	596	2,898	428	400	337
Revenue	84	100	5,604	5,143	82
MRP Exemption	0	0	5,437	8,702	318
Net Financing Need for the Year	**570**	**6,809**	**2,931**	**11,263**	**9,626**

Commercial property acquisition is shown as Revenue funding in the above table as any initial costs of borrowing will be funded from rental yields in the future.

The MRP exemption was approved by the Council in 2018 where expenditure is incurred on provision of assets where there is a future capital receipt, for example housing developments. In these circumstances there is not the need to provide for borrowing as part of the Capital Financing Requirement.

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial Activities/Non-Financial Investments	**2017/18 Actual £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Capital Expenditure	1,075	4,633	10,637	13,702	318
Financing Costs	1,043	61	10,437	13,702	318
Net Financing Need for the Year	**32**	**4,572**	**200**	**0**	**0**
Percentage of Total Net Financing Need %	6%	67%	7%	0%	0%

6. <u>The Council's Borrowing Need (Capital Financing Requirement (CFR) (Indicator 2)</u>

The second prudential indicator is the Council's Capital Financing Requirements (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying need to borrow. Any capital expenditure above, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life, and so charges the economic consumption of capital assets as they are used.

The CFR includes any other long term liabilities such as finance leases which have been brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no finance lease liabilities within the CFR.

The Council is asked to approve the CFR projections below:

	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Capital Financing Requirement					
CFR - Services	5,913	7,571	9,780	19,802	27,722
CFR - Commercial Activities/Non-Financial Investments	29	4,415	4,209	4,003	3,797
Total CFR	5,942	11,986	13,989	23,805	31,519
Movement in CFR	17	6,046	2,003	9,816	7,714

Movement in CFR Represented By:					
Net financing need for the year (above)	570	6,809	2,931	11,263	9,626
Less MRP and other financing movements	(553)	(763)	(928)	(1,447)	(1,912)
Movement in CFR	17	6,046	2,003	9,816	7,714

A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The capital expenditure figures shown in 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's remaining activity.

7. <u>Minimum Revenue Provision (MRP) Policy Statement</u>

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 it wishes to (voluntary revenue provision – VRP).

MHCLG regulations have been issued which require the Council to approve an MRP Statement in advance of each financial year. A number of options are available 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 or which in the future will be Supported Capital Expenditure, the policy will be:

> Existing practice - MRP will follow the existing practice outlined in former MHCLG regulations (option 1).

This option provides for an approximate 4% reduction in borrowing need (CFR) each year.

From 1 April 2008 for all unsupported borrowing (including 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 (option 3)

These options provide for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual finance leases are applied as MRP.

Where the Council is investing in assets solely with the intention of generating a capital receipt on completion it will defer the charging of MRP until the loan is repaid through receipt of capital receipts. This will be evidenced through explicit setting aside of future Capital Receipts for this purpose at project inception.

8. Core Funds and Expected Investment Balances

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

9. Affordability Prudential Indicators (Indicators 3 and 4)

The previous sections cover the overall capital expenditure 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 financial position. The Council is asked to approve the following indicators:

Ratio of Financing Costs to Net Revenue Stream (3) – This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in the budget report.

	2017/18 Actual %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
Ratio	6.85%	13.94%	9.26%	20.06%	27.84%

The Ratio represents the cost of borrowing as a proportion of Net Revenue Stream (taxation and non-specific grant income). This therefore excludes the expected revenue contributions from operating activities e.g. leisure. The majority of the increases in 2020/21 and 2021/22 relate to the proposed new leisure centre for which £ 22.050 million is included in the £57.1 million capital programme.

The ratio is therefore high for 2020/21 and 2021/22 pending the commencement of a Leisure procurement. The Capital programme does not currently factor in and potential capital receipt or management fee from a provider to reduce the borrowing cost.

10. <u>Borrowing</u>

The capital expenditure plans set out in paragraph 5 provide details of the service activity of the Council. The treasury management function ensures that the Council’s cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council’s capital strategy.This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. This strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

11. <u>The Current Portfolio Position (Indicator 5)</u>

The overall treasury management portfolio position as at 31 March 2018 and the position as at 27 January 2019 are shown below for both borrowing and investments.

Treasury Portfolio				
	Actual 31.03.18	Actual 31.03.18	Current 27.01.19	Current 27.01.19
Treasury Investments	£000	%	£000	%
Banks	10,705	42%	15,335	41%
Building Societies	15,000	58%	22,500	59%
Total Treasury Investments	25,705		37,835	
Treasury External Borrowing				
PWLB	1,490	100%	1,490	100%
Total External Borrowing	1,490		1,490	
Net Treasury Investments/(Borrowing)	24,215		36,345	

The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need (the Capital Financing Requirement – CFR), highlighting any over or under borrowing.

	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
External Debt					
Debt at 1 April	1,522	1,512	8,321	11,252	22,515
Expected change in debt	(10)	6,809	2,931	11,263	9,626
Other long term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual Gross Debt at 31 March	**1,512**	**8,321**	**11,252**	**22,515**	**32,141**
Capital Financing Requirement	**5,942**	**11,986**	**13,989**	**23,805**	**31,519**
Under/(over) borrowing	**4,430**	**3,665**	**2,737**	**1,290**	**(622)**

Within the above figures the level of debt relating to commercial activities / non-financial investment is:

	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
External Debt For Commercial Activities/Non-Financial Investments					
Actual Debt at 31 March	0	0	200	0	0
Percentage of Total External Debt %	0%	0%	2%	0%	0%

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 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Section 151 Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

12. Treasury Indicators – Limits to Borrowing Activities (Indicators 6 and 7)

The Operational Boundary (6) – This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Debt	8,000	10,000	20,000	28,000
Other long-term liabilities	500	500	500	500
Commercial Activities/Non-Financial Investments	5,000	5,000	5,000	4,000
Total	13,500	15,500	25,500	32,500

The Authorised Limit for External Debt (7) - A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and 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.

- This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific Council, although this power has not yet been exercised.

- The Council is asked to approve the following Authorised Limits:

Authorised limit	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Debt	13,000	15,000	25,000	33,000
Other long-term liabilities	1,000	1,000	1,000	1,000
Commercial Activities/Non-Financial Investments	10,000	10,000	10,000	9,000
Total	24,000	26,000	36,000	43,000

13. <u>Prospects for Interest Rates</u>

The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. Their view is shown in **Appendix C**.

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

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

Investment and borrowing rates

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

- Borrowing interest rates have been volatile so far in 2018/19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

- There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

Further analysis is set out at **Appendix D**.

14. <u>Borrowing Strategy</u>

The Council’s estimated longer term debt portfolio will stand at £1.51m at 1 April 2019. The estimated average rate of interest payable on long-term debt during 2019/20 will depend on when borrowing transactions actually occur. At present borrowing is delayed while cash flow is healthy in order to minimise cost to the Council Tax payer. The Section 151 officer monitors with advice from Link Asset Services the interest rate forecasts to aim to borrow at the most advantageous rate.

The total debt portfolio is funded by the Public Works Loans Board (PWLB. The details of the portfolio are set out in **Appendix E**. During 2018/19 no annuity principals will have been repaid, as all of the current loans are repayable at maturity. The average maturity profile of the loan portfolio is 28.6 years.

The Council is currently maintaining an under borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances, for example :-

- *if it was felt that there was a significant risk of a sharp fall in long and short term rates* (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- *if it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position would be re-appraised.Most likely fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity

15. 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 certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs and/or 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:

Maturity structure of fixed interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	20%
5 years to 10 years		0%	30%
Over 10 years		0%	100%
Maturity structure of variable interest rate borrowing 2019/20			
		Lower	**Upper**
Under 12 months		0%	10%
12 months to 2 years		0%	10%
2 years to 5 years		0%	20%
5 years to 10 years		0%	30%
Over 10 years		0%	100%

16. Policy on Borrowing in Advance of Need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and 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 through the mid-year or annual reporting mechanism.

17. Debt Rescheduling

As short term borrowing rates will be considerably cheaper than long term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

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

- the generation of cash savings and/or discounted cash flow savings
- helping to fulfil the treasury strategy
- enhance the balance of the portfolio (amending the maturity profile and/or the balance of volatility)

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investment are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council at the earliest meeting following its action.

18. Investment Policy and Strategy

The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, and then return.

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum credit criteria in order to generate a list of highly creditworthy counterparties which will also enable diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings should 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 maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of 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.

Investment instruments identified for use in the financial year are listed in **Appendix B** under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set out through the Council's treasury management practices which were last reviewed and agreed by Council on 26th February 2018, next review due 2020.

19. Creditworthiness Policy

This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies – Fitch, Moody's, and

Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

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

- Yellow 5 years
- Dark Pink 5 Years
- Light Pink 5 Years
- Purple 2 years
- Blue 1 year (nationalised/or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No Colour not to be used (NB: except Building Societies)

In respect of building societies, the Council will use those societies that have assets in excess of £1 billion, subject to them having a minimum credit rating of P-2 (Moody's). In addition the Council proposes to use the locally based Market Harborough Building Society

The Council will use nationalised or part nationalised institutions such as RBS and Lloyds, subject to a monetary limit of £8m.

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

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

All credit ratings will be monitored on an ongoing basis. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- In addition to the use of credit ratings the Council will be advised of information regarding movements in credit default swaps against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on any external support for banks to help support its decision making process.

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

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.

20. <u>Country and Sector Limits</u>

The Council has considered the use of non-UK based banks, but given the current economic situation, has discounted their use for the foreseeable future, in the interests of prudence. Due care will be taken to consider the group and sector exposure of the Council's investments. The limits referred to above will apply to group companies, and sector limits will be monitored regularly for appropriateness.

21. <u>Investment Strategy</u>

In-house Funds

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.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, 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, such as existing reserves, capital receipts and the Vat shelter receipts, could be utilised as follows:

- To be invested over a longer term (one to three years) to secure a competitive / enhanced rate of interest that may not be available in a year's time; and / or
- To mitigate the need for additional future long term borrowing (where long term borrowing rates are in excess of prevailing investment rates).

The criteria to be used in determining whether the Council may invest with a counterparty is set out in **Appendix B**.

The Council's proposed Counterparty List appears at **Appendix F**.

Investment Returns Expectations

The Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for the next four financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

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

2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

The overall balance of risks to economic growth in the UK is probably neutral.

The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

Investment Treasury Indicator and Limit (Indicator 10) - 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.

The Council is asked to approve the treasury indicator and limit:

Maximum principal sums invested for more than 365 days	**2019/20**	**2020/21**	**2021/22**
	£000s	£000s	£000s
Principal sums invested > 365 days	10,000	10,000	10,000

For its cash flow generated balances, the Council will seek to utilise business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

22. Investment Risk Benchmarking

The Council will use an investment benchmark to assess the investment performance of its investment portfolio of the 7 day LIBID.

23. End of Year Investment Report

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