Agenda Item No:	**11**	Fenland CAMBRIDGESHIRE
Committee:	Corporate Governance Committee	
Date:	7 February 2018	
Report Title:	Treasury Management Strategy Statement, Minimum Revenue Provision Policy Statement and Annual Investment Strategy 2018/19	

Cover sheet:

1 Purpose / Summary

The purpose of this report is to provide Members with information on the proposed Treasury Management Strategy Statement, Minimum Revenue Provision (MRP) Policy Statement and Annual Investment Strategy for 2018/19.

2 Key issues

- The prudential and treasury indicators detailed in paragraphs 2-10, show that the Council's capital investment plans are affordable, prudent and sustainable.
- The MRP policy sets out how the Council will make prudent provision for the repayment of borrowing needs over the medium term forecast.
- The treasury management strategy has been organised so that the Council will have sufficient cash resources to meet capital expenditure plans and operational cash flows.
- Total external interest which includes finance lease interest payments; revised estimate for 2017/18 is £512,365 and the estimate for 2018/19 is £507,885.
- Base rate is expected to hold at 0.50% until Q4 2018 before increasing gradually to 1.25% by 2020/21.
- Due to the Council's long term PWLB debt portfolio (£4.5m at 31/03/18) currently attracting excessive premiums; it is not financially advantageous for the Council to comply with the gross borrowing and capital financing prudential indicator.
- The aim of the Council's annual investment strategy is to provide security of investments whilst minimising risk; investment returns are commensurate with the Council's low risk appetite. The Council achieves these objectives through differentiating between "specified" and "non-specified" investments and through the application of a creditworthiness policy.
- Total investment income is an estimated £110,000 for 2017/18 and £140,000 for 2018/19.
- Revisions (in December 2017) to the Treasury Management Code of Practice and Prudential Code, full implementation in 2019/20.

3 Recommendations

It is recommended that:-

- Corporate Governance Committee endorses the strategy detailed in this report to be included in the final budget report for 2018/19.

Wards Affected	All
Portfolio Holder(s)	Councillor Chris Seaton, Portfolio Holder for Finance
Report Originator(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Contact Officer(s)	Brendan Arnold, Corporate Director and Chief Finance Officer Mark Saunders, Chief Accountant
Background Paper (s)	Link Asset Services template Budget working papers

Report:

1 Introduction

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

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

1.3 The Chartered Institute of Public Finance and Accountancy (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 pursuit of optimum performance consistent with those risks."

1.4 The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Corporate Governance Committee and Cabinet before being recommended to the Council.

1.5 **Prudential and Treasury Indicators and Treasury Strategy** (this report), the first and most important report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the Treasury Management Strategy (how investments and borrowings are to be organised) including treasury indicators; and
- an Investment Strategy (the parameters on how investments are to be managed).

A Mid-Year Treasury Management Report - This will update Members with the progress of the capital position, amending prudential indicators as necessary and whether any policies require revision.

An Annual Treasury Report - This provides details of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.6 The Strategy covers two main areas:

Capital issues;

- the capital plans and the prudential indicators;
- the 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 use of external service providers.

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

1.7 In December 2017 CIPFA issued a revised Treasury Management Code of Practice and Prudential Code. These revisions have particularly focused on:

- non-treasury investments and especially on the purchase of property with a view to generating income, with treasury teams not having the specialist skills in such areas;
- as from 2019/20 all local authorities will be required to prepare an additional Capital Strategy report. The strategy is intended to provide a high level overview of how capital expenditure, capital financing and treasury management activity contribute towards the provision of service. How the associated risk is managed and the implications for future financial sustainability;
- the treasury management role of the Chief Financial Officer has been extended to include a series of new roles in respect of the capital strategy and also a specific role in respect of investment in non-financial assets.

1.8 The aim of the Capital Strategy report is to ensure that all elected members on the Council will fully understand the overall strategy, governance procedures and risk appetite. The report will include capital expenditure, investments, liabilities and treasury management in sufficient detail to allow members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

2 Capital Prudential Indicators 2018/19 to 2020/21

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

2.2 The capital expenditure prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle. The table below summarises the capital expenditure plans and how these are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital Programme	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Forecast Capital Expenditure	**2,247**	**3,145**	**2,236**	**1,195**
Financed by:				
Capital Receipts	513	413	175	115
Capital Grants	1,067	1,003	950	950
Capital Reserves	629	580	111	0
Section 106 Contributions	38	0	0	0
Total Financing	**2,247**	**1,996**	**1,236**	**1,065**
Net Financing Need For The Year (Borrowing)	**0**	**1,149**	**1,000**	**130**

2.3 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure shown above, which has not immediately been paid for will increase the CFR.

2.4 The CFR does not increase indefinitely, as each year the Council is required to pay off an element of the capital spend (including finance leases) through a statutory revenue charge (MRP). This has the effect of reducing the Council's (CFR) broadly over the assets life.

2.5 The CFR includes any other long term liabilities (finance leases). A finance lease is a commercial arrangement between the Council and a lessor (finance company), where in consideration for a series of payments the Council has the right to use an asset (e.g. refuse vehicle, leisure equipment) for the lease duration (typically 3 to 7 years). The annual lease payment is made up of a capital and interest repayment.

2.6 Although legally the Council doesn't own the asset during the lease duration, International Accounting Standards require that the Council capitalise the asset and liability on its balance sheet, much like a loan. Whilst this increases the CFR, the nature of the finance lease agreement doesn't require the Council to separately borrow to fund the asset.

Capital Financing Requirement	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
CFR at 1 April	**981**	**766**	**1,763**	**2,560**
Movement in CFR	**(215)**	**997**	**797**	**(119)**
Net financing need for the year	0	1,149	1,000	130
Less MRP	(215)	(152)	(203)	(249)
Movement in CFR	**(215)**	**997**	**797**	**(119)**

3 Minimum Revenue Provision (MRP) Policy Statement

3.1 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), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision).

3.2 CLG regulations have been issued which require the Council to approve an MRP statement in advance each year. A variety of options are provided to Councils, so long as there is a prudent provision. For all unsupported borrowing (including finance leases) the MRP policy will be the asset life method - MRP will be based on the estimated useful life of the assets, in accordance with regulations. This option provides for a reduction in the borrowing need over approximately the asset's life. Repayments included in finance leases are applied as MRP.

4 The Use of Council's Resources and the Investment Position

4.1 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.

Year End Resources	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Fund balances / reserves	**(9,150)**	**(8,600)**	**(8,500)**	**(8,500)**
Capital receipts	**0**	**0**	**0**	**0**
Capital Grants Unapplied	**(44)**	**(44)**	**(44)**	**(44)**
Total core funds	**(9,194)**	**(8,644)**	**(8,544)**	**(8,544)**
Expected investments	**(19,000)**	**(18,000)**	**(17,000)**	**(17,000)**

5 Affordability Prudential Indicators

5.1 The previous sections cover the overall capital and control of borrowing prudential indicators; also within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicator.

5.2 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.

Financing Costs to Net Revenue Stream	2017/18 Revised Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
General Fund	**3.17**	**2.92**	**2.63**	**2.09**

The estimates of financing costs include current commitments and the proposals in the budget.

6 Treasury Management Strategy

6.1 The capital expenditure plans set out in section 2 provide a summary of future level of spend. 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 service activity and the Council’s capital strategy. This will involve both the organisation of cash flow and where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

6.2 The Council's expected treasury portfolio position at 31 March 2018, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR)

	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Debt at 1 April	**7,800**	**7,800**	**7,800**	**7,800**
Expected change in debt	**0**	**0**	**0**	**0**
Other long term liabilities (OLTL)	**930**	**715**	**563**	**407**
Expected change in OLTL	**(215)**	**(152)**	**(156)**	**(163)**
Actual debt at 31 March	**8,515**	**8,363**	**8,207**	**8,044**
Capital financing requirement (CFR) at 31 March	**766**	**1,763**	**2,560**	**2,441**
Borrowing less CFR – 31 March	**7,749**	**6,600**	**5,647**	**5,603**

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

6.4 As a result of the Council's long term Public Works Loan Board (PWLB) debt portfolio of £4.5m (31/03/18) currently attracting excessive premiums (£3.08m at the time of writing this report), if it were prematurely repaid and the Lender Option Borrower Option (LOBO) debt of £3.3m (31/03/2018), attracting a premium charge on application to prematurely repay, it is not financially advantageous for the Council to fully comply with this prudential indicator. This has been the case since the housing stock transfer in 2007 and has been acknowledged and approved by Council since then. In addition, the Council's external auditors have also acknowledged this situation and have not raised any issues with our strategy.

6.5 Interest repayments associated with the external debt (including finance leases) above are shown below.

YEARS	INTEREST DUE £
2017/18	512,365
2018/19	507,885
2019/20	502,595
2020/21	497,125

6.6 The operational boundary 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.

Operational Boundary	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Debt	10,000	10,000	10,000	10,000
Other long term liabilities	2,000	2,000	2,000	2,000
Total	12,000	12,000	12,000	12,000

6.7 The authorised limit is a key prudential indicator, which represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited and this limit needs to be set or revised by 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.

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

Authorised limit	2017/18 Revised Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Debt	15,000	15,000	15,000	15,000
Other long term liabilities	2,000	2,000	2,000	2,000
Total	17,000	17,000	17,000	17,000

7 Prospects for Interest Rates

7.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives Link Asset Services central view.

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

7.2 The Monetary Policy Committee, (MPC) delivered a 0.25% increase in bank rate at its meeting on 2 November 2017. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase bank rate only twice more to 1.00% by 2020. The Link Asset Services forecast as above includes increases in bank rate of 0.25% in November 2018, November 2019 and August 2020.

7.3 After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

7.4 Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

7.5 The key issue now is that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets.

7.6 One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after bank rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in bank rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of bank rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

7.7 While there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out. The UK will continue as a full EU member until March 2019, with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during a two year transitional period, which will start after March 2019. Over this two year period the UK and EU will attempt to negotiate a bi-lateral trade agreement.

7.8 Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

7.9 In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.). This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action.

8 Borrowing Strategy

8.1 The Council will not borrow more than or in advance of its needs purely in order to profit from investment of the extra sums borrowed. 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.

8.2 As a result of the Council's decision not to repay debt of £7.8m at the time of the housing stock transfer in 2007, the Council is currently over borrowed (see paragraph 6.4 above), the Council's gross debt exceeds its CFR over the term of the treasury strategy.

8.3 New borrowing is not required to support future capital plans (the CFR), as these can be met from internal borrowing as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still a consideration. 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.

8.4 The Chief Finance Officer will monitor capital plans and interest rates in financial markets and adopt a pragmatic approach to funding the capital programme. Any borrowing decisions and budget consequences would be reported to Cabinet at the earliest opportunity.

8.5 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 the risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. 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.

Interest rate exposures	2018/19 Upper £000	2019/20 Upper £000	2020/21 Upper £000
Limits on fixed interest rates based on net debt	**(14,000)**	**(14,000)**	**(14,000)**
Limits on variable interest rates based on net debt	**(10,200)**	**(10,200)**	**(10,200)**
Limits on fixed interest rates:			
• **Debt only**	**10,000**	**10,000**	**10,000**
• **Investments only**	**(24,000)**	**(24,000)**	**(24,000)**
Limits on variable interest rates:			
• **Debt only**	**3,300**	**3,300**	**3,300**
• **Investments only**	**(13,500)**	**(13,500)**	**(13,500)**

Maturity structure of fixed interest rate borrowing 2018/19	Lower %	Upper %
Under 12 months	**0**	**20**
12 months to 2 years	**0**	**50**
2 years to 5 years	**0**	**75**
5 years to 10 years	**0**	**75**
10 years and above	**0**	**100**

Maturity structure of variable interest rate borrowing 2018/19	Lower %	Upper %
Under 12 months	**0**	**100**
12 months to 2 years	**0**	**100**
2 years to 5 years	**0**	**100**
5 years to 10 years	**0**	**100**
10 years and above	**0**	**100**

9 Debt Rescheduling / Repayment

9.1 The Council has sufficient cash balances set aside to pay off its external debt.

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

- the generation of cash savings;
- helping to fulfil the treasury strategy;
- enhancing the balance of the portfolio by flattening the maturity profile.

9.3 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to switch debt to generate savings. However, the penalty position which would arise from early redemption of the external debt would need to be considered.

9.4 The Council’s debt rescheduling position will be monitored throughout 2018/19.

10 Annual Investment Strategy

10.1 The Council’s investment policy has regard to the Communities and Local Government Investments (“the Guidance”) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes 2017 (“the CIPFA TM Code”). The intention of the strategy is to provide security and minimise risk. The Council’s investment priorities are:

- the security of capital;
- the liquidity of its investments;
- return on its investments.

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

10.3 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 maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

10.4 Investment instruments identified for use in the financial year are listed below under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s treasury management practices – schedules.

10.5 **Specified Investments –** These investments are sterling investments (meeting the minimum ‘high’ quality criteria where applicable) of not more than one year maturity, or those which could be for a longer period but where the Council has the right to repay within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. Investment instruments identified for use in the financial year are as follows:

- term deposits with part nationalised banks and local authorities;
- term deposits with high credit criteria deposit takers (banks and building societies);
- callable deposits with part nationalised banks and local authorities
- callable deposits with high credit criteria deposit takers (banks and building societies);
- money market funds
- Debt Management Agency Deposit Facility (DMADF);
- UK Government gilts, custodial arrangement required prior to purchase.

10.6 **Non-Specified Investments –** These are any other type of investment (i.e. not defined as specified above). Investment instruments identified in both “specified” and “non-specified” categories are differentiated by maturity date and classed as non-specified when the investment period and right to be repaid exceeds one year. Investment instruments identified for use in the financial year are as follows:

- term deposits with high credit criteria deposit takers (banks and building societies);
- term deposits with part nationalised banks and local authorities;
- callable deposits with part nationalised banks and local authorities
- callable deposits with high credit criteria deposit takers (banks and building societies);
- Debt Management Agency Deposit Facility (DMADF);
- UK Government gilts, custodial arrangement required prior to purchase.
- Property funds.

10.7 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). Bank rate is forecast to remain unchanged at 0.50% before starting to rise from quarter 4 of 2018. Bank rate forecasts for financial year ends (March) are:

- 2018/19 - 0.75%
- 2019/20 - 1.00%
- 2020/21 - 1.25%

10.8 The overall balance of risks to these forecasts is currently probably skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively . Forecast average investment interest rates for the next three years are as follows:

- 2018/19 - 0.59%
- 2019/20 - 0.78%
- 2020/21 - 1.07%

10.9 Estimated investment income is shown below.

YEARS	**INTEREST RECEIVED £**
2017/18	110,000
2018/19	140,000
2019/20	175,000
2020/21	230,000

10.10 **Investment treasury indicator and limit –** total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year end.

	2018/19 £000	**2019/20 £000**	**2020/21 £000**
Maximum principal sums invested > 365 days	**10,000**	**10,000**	**10,000**

10.11 For its cash flow generated balances, the Council will seek to utilise its call accounts and short dated deposits (overnight to 100 days) in order to benefit from the compounding interest.

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

11 Creditworthiness Policy

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

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

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

- yellow 5 years;
- dark pink 5 years for ultra-short dated bond funds with a credit score of 1.25;
- light pink 5 years for ultra-short dated bonds funds with a credit score of 1.5;
- purple 2 years;
- blue 1 year (only applies to nationalised or semi nationalised UK banks);
- orange 1 year;
- red 6 months;
- green 100 days
- no colour not to be used.

11.3 The Link Asset Services creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue preponderance to just one agency's ratings.

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

11.5 The Council's own bank currently meets the creditworthiness policy. However, should they fall below Link Asset Services creditworthiness policy the Council will retain the bank on its counterparty list for transactional purposes, though would restrict cash balances to a minimum.

11.6 All credit ratings are monitored weekly and prior to any new investment decision. 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 in movements in credit default swaps against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

11.8 To further mitigate risk the Council has decided that where counterparties form part of a larger group, group limits should be used in addition to single institutional limits. Group limits will be as set through the Council's Treasury Management Practices – schedules.

11.9 The Council currently only invests in UK banks as it lacks detailed knowledge about investments in other sovereign rated countries. It should be noted that in some cases these banks are subsidiaries of foreign banks but these are of the highest credit quality.

12 External Service Providers

12.1 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 authority at all times and will ensure that undue reliance is not placed upon our external service providers.

12.2 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.