



POLICY AND RESOURCES SCRUTINIY COMMITTEE – 14TH JANUARY 2020

SUBJECT: TREASURY MANAGEMENT ANNUAL STRATEGY, CAPITAL FINANCE PRUDENTIAL INDICATORS AND MINIMUM REVENUE PROVISION POLICY FOR 2020/2021

REPORT BY: CORPORATE DIRECTOR FOR EDUCATION AND CORPORATE SERVICES

1. PURPOSE OF REPORT

- 1.1 To submit for consideration prior to its presentation to Council the Authority's Annual Strategy for Treasury Management.
- 1.2 To submit for consideration prior to its presentation to Council a dataset of Prudential Indicators relevant to Treasury Management and Capital Finance. The report also cross-references to the report by the Corporate Director of Education and Corporate Services on Revenue and Capital Budgets ["the budget report"] also considered in this meeting.
- 1.3 To submit for consideration prior to its presentation to Council the Minimum Revenue Provision (MRP) policy to be adopted by the Authority for 2020/2021.
- 1.4 Appendix 7 is based on an indicative capital programme.

2. SUMMARY

- 2.1 The revised (2017) "Code of Practice for Treasury Management in the Public Services" provides that an Annual Strategy be submitted to Members on or before the start of a financial year to outline the activities planned within the parameters of the Treasury Management Policy Statement and the Treasury Management Practices.
- 2.2 The Local Government Act 2003 (the '2003 Act') also requires the Authority to set out its Treasury Management Strategy for borrowing for the forthcoming year and to prepare an Annual Investment Strategy, which sets out the policies for managing its investments, giving priority to the security and liquidity of those investments.
- 2.3 Under Section 15 of the '2003 Act', the Welsh Government (WG) issued guidance on local government investments which is incorporated within the report. Definitions of Local Government investments are given in **Appendix 1**.
- 2.4 Under the provisions of the Local Government Act 2003, The Local Authorities (Capital

Finance and Accounting) (Wales) Regulations 2003 and subsequent amendments [The Capital Regulations], and the CIPFA's "The Prudential Code for Capital Finance in Local Authorities" [the Code], the Authority is obliged to approve and publish a number of indicators relevant to Capital Finance and Treasury Management.

- 2.5 With effect from 1st April 2008, WG introduced the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008 [the "Amendment Regulations"] which requires the Authority to prepare an Annual Minimum Revenue Provision Policy Statement. This report sets out what the Authority needs to do in order to comply with this requirement.

3. RECOMMENDATIONS

- 3.1 That the Annual Strategy for Treasury Management 2020/21 be considered and noted by the Policy and Resources Scrutiny Committee prior to Council approval.
- 3.2 That the strategy be reviewed quarterly within the Treasury Management monitoring reports presented to Policy & Resources Scrutiny Committee and any changes recommended be referred to Cabinet, in the first instance, and to Council for a decision. The Authority will also prepare a half-yearly report on Treasury Management activities.
- 3.3 That the Prudential Indicators for Treasury Management be considered for approval as per Appendix 5.
- 3.4 That the Prudential Indicators for Capital Financing be considered for approval as per Appendices 6 & 7 based on the indicative capital programme.
- 3.5 That Members adopt the MRP policy as set out in Appendix 8.
- 3.6 The continuation of the 2019/20 investment strategy and the lending to financial institutions and Corporates in accordance with the minimum credit rating criteria disclosed within this report.
- 3.7 That the Authority borrows £32.3m for the General Fund to support the 2020/21 capital programme and £52.0m for the HRA WHQS and Affordable Homes programme.
- 3.8 That the Authority continues to adopt the investment grade scale as a minimum credit rating criteria as a means to assess the credit worthiness of suitable counterparties when placing investments.
- 3.9 That the Authority adopts the monetary and investment duration limits as set in Appendix 3 of the report.
- 3.10 That the Authority invests a minimum of £20m into long-term Strategic Pool Funds as set in Appendix 9 of the report, with the aim of generating additional investment income of £718k.

4. REASONS FOR THE RECOMMENDATIONS

- 4.1 The Annual Strategy report is a requirement of the CIPFA "Code of Practice for Treasury Management in the Public Services".

- 4.2 The Investment Strategy is a requirement of the Local Government Act 2003.
- 4.3 To comply with the legislative framework and requirements as indicated in paragraphs 2.1 to 2.5.

5. THE TREASURY MANAGEMENT REPORT

5.1 Interest Rate Prospects- Short-term

- 5.1.1 The Authority uses Arlingclose Limited as its Treasury Management Adviser and part of their service is to assist the Authority to formulate a view on interest rates.
- 5.1.2 The Monetary Policy Committee [MPC] increased Bank Rate in August 2018 to 0.75% and has remained unchanged since. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. The downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal. If rates were to increase in the future then increases are likely to be gradual.
- 5.1.3 The major external influence on the Authority's treasury management strategy for 2020/21 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased. Whilst a technical recession has been avoided in 2019, economic growth is forecasted to remain sluggish throughout 2020/21, with falling household and business confidence.
- 5.1.4 Consumer price inflation reached 1.5% in November 2019. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices and impacting further on energy prices.
- 5.1.5 Growth in Europe remains soft, driven by a weakening German economy which is expected to slip into a technical recession. The European Central Bank is expected to maintain the Eurozone interest rate at zero percent as well as maintaining its quantitative easing programme. In the US, the Federal Reserve began easing monetary policy in 2019 as a pre-emptive strike against slowing global and US economic growth on the back on of the ongoing trade war with China. At its last meeting the Federal Reserve cut interest rates, and financial markets expect further loosening of monetary policy in 2020.
- 5.1.6 Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets. This will have an impact on the Council's Treasury returns. If interest rates fall then the Council's investment income will reduce.
- 5.1.7 The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.75% for the foreseeable future until the end of 2022 although the risks are weighted in favour of a rate cut. The risks are driven by political uncertainty; the need for greater clarity on Brexit; and the continuing global economic slowdown. The Bank of England's MPC have agreed that any future increase would be limited and gradual.

5.2 Interest Rate Prospects- Long-term

5.2.1 Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy. Gilt yields are expected to remain at relatively low levels for the foreseeable future, with risks to be broadly balanced.

5.2.2 Arlingclose interest rate forecasts are shown in **Appendix 2**.

5.3 External Debt - Capital Borrowings and Borrowing Portfolio Strategy

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

5.3.2 Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk.

5.3.3 The difference between current long-term borrowing rates and short-term investment rates has resulted in a "cost of carry" scenario, indicating that it is more advantageous to use internal funding in lieu of borrowing. The cost of carry is likely to remain an issue until the Bank Rate and short term market rates increase in the future. The Authority, having adopted the policy of internal borrowing from the latter half of 2008/09, has an internal borrowing position of £56m (as at 31st March 2019) from which capital expenditure has been funded. Unless the policy is prudent, the Authority will no longer adopt the policy of internal borrowing. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly.

5.3.4 It is anticipated that the borrowing requirement of £32.3m will need to be taken up in 2020/21 for the General Fund to support the capital programme and provision has been made in the budget to fund this level of borrowing. Much of this borrowing has been deferred from previous financial years. The HRA will borrow £52.0m in 2020/21 to fund the WHQS capital programme and new affordable homes programme, though some of the HRA borrowing may be deferred to future years subject to the Business Plan revisions.

5.3.5 Therefore the total 2020/21 borrowing requirement will be £84.4m comprising of:

- 2020/21 supported borrowing approvals - £4.9m
- 2019/20 supported borrowing approvals - £4.9m
- 2018/19 supported borrowing approvals - £4.9m
- 2017/18 supported borrowing approvals - £5.0m
- 2016/17 supported borrowing approvals - £5.0m
- 21st Century Schools LGBI- £4.2m
- 21st Century Schools prudential borrowing (Band A)- £3.4m

- HRA WHQS- £22.0m
- HRA Affordable Housing - £30.0m

The LGBI borrowing is funded by WG contributions to support the 21st Century Schools Band A capital programme. The borrowing approvals relate to previous financial years whereby the borrowing had been deferred and subsequently these are now being rolled forward until the Authority raises such loans. Capital expenditure in the relevant financial year that would have been funded by the borrowing approvals was subsequently funded from internal borrowing. Retrospectively borrowing these approvals will replenish the internal borrowing.

- 5.3.6 Whilst PWLB interest rates have been included in Appendix 2, it is possible that loans may be taken from other sources if interest rates are more advantageous. It is suggested that the target rate for new borrowing be set at 4.50% for a 25 year period loan. However, other periods will be considered if the rates are favourable.
- 5.3.7 Current PWLB forecasts suggest interest rates will remain volatile during 2020/21 and will be influenced by geopolitical tensions; global economic prospects and the outcome of the Brexit negotiations. The use of internal borrowing to fund the 2020/21 capital programme or the decision to defer borrowing as set out in paragraph 5.3.4 could expose the Authority to rising interest rates thus making it expensive to borrow at a later date. A budget to cover the cost of raising £32.3m new debt finance will remain in place irrespective of the decision to borrow internally or externally.
- 5.3.8 Any short-term funding would need to be in line with the 'Upper Limit for Variable Rates' as defined in the prudential indicators in **Appendix 5** (30% of Net Debt Outstanding) within the CIPFA "Prudential Code for Capital Expenditure in Local Government".
- 5.3.9 Officers, in conjunction with the Treasury Management Adviser, will continue to monitor both the prevailing rates and the market forecasts, responding to changes when necessary. The following borrowing sources will be considered by the Authority to fund short-term and long-term borrowing (and in no particular order):
- Internal reserves
 - Public Works Loan Board (PWLB)
 - Local Authorities
 - European Investment Bank (NB the EIB will only lend up to 50% towards the funding of a specific project and needs to meet the EIB's specific criteria. The project cost must also be at least €10m)
 - Leasing
 - Capital market bond investors
 - Other commercial and not for profit sources
 - Any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds
 - UK Municipal Bonds Agency and other special purpose companies created to enable local authority bond issues
 - Any counterparty approved for investments
- 5.3.10 In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

5.3.11 The Authority may borrow short-term loans (up to twelve months) to cover unexpected cashflow shortages.

5.3.12 The Authority may arrange forward starting loans during 2020/21, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period as well as mitigate against the risk of rising borrowing interest rates.

5.3.13 **Municipal Bond Agency:** The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Cabinet.

5.4 **Authorised Limit for External Debt (The Authorised Limit)**

5.4.1 As a consequence of 5.3.1 to 5.3.13 above, the Authorised Limit will be the upper limit of the Authority's borrowing, based on a realistic assessment of risks. It will be established at a level that will allow the Authority to borrow sums, in excess of those needed for normal capital expenditure purposes in the event that an exceptional situation arises and would allow for take-up of supported borrowing. It is not a limit that the Authority would expect to borrow up to on a regular basis.

5.4.2 The limit will include borrowing and other long-term liabilities such as leases, private finance schemes and deferred purchase schemes.

5.5 **The Operational Boundary**

5.5.1 This is based on the maximum level of external debt anticipated to be outstanding at any time in each year. It will be consistent with the assumptions made in calculating the borrowing requirements of the capital programme, but will also include an estimate of any borrowing for short term purposes, such as temporary shortfalls in incomes or to support active treasury management which would seek to take advantage of beneficial interest rate movements. It also allows for other long-term liabilities such as leases, private finance schemes and deferred purchase schemes.

5.5.2 The Operational Boundary should be set at a level which allows some flexibility but should be sufficiently below the Authorised Limit so that any breach of the operational boundary provides an early warning indicator of a potential breach of the Authorised Limit, allowing corrective action to be taken.

5.6 Interest Rate Exposure

- 5.6.1 The Authority's borrowing policy makes use of both fixed and variable rate opportunities. Whilst fixed-rate borrowing and investment provides certainty with regard to future interest rate fluctuations, the flexibility gained by the use of variable interest rate instruments can aid performance. It allows the Treasury Manager to respond more quickly to changes in the market and to short term fluctuations in cash flow without incurring the penalties that would result from the recall of fixed rate investments.

5.7 Maturity Structure of Borrowing

- 5.7.1 Whilst the periods of loans are dictated by the interest rates prevalent at the time, it is important to be mindful of the maturity profile of outstanding debt. Large 'peaks' are to be avoided, as it is possible for substantial loans to reach maturity at times when prevailing interest rates are high, and conversely, when interest rates are low, windows of opportunity may be lost.
- 5.7.2 As a result, it is necessary to determine both an upper and lower limit for borrowings which will mature in any one year.
- 5.7.3 Over the course of the medium term financial plan and future years, a number of high interest rate PWLB loans will mature resulting in a saving to the Authority as the interest rate on replacement loans are likely to be lower in comparison.
- 5.7.4 Historically, the Authority has favoured PWLB loans with a twenty five year loan maturity profile, but in the current climate of low interest rates (including Bank Rate); the Authority will also consider shorter dated loans (including local authority borrowing) to fund capital expenditure. Periods in excess of 25 years should also be considered in the event interest rates become advantageous.
- 5.7.5 The Authority has £30m of LOBO loans (Lender's Option Borrower's option) of which £20m of these can be "called" within 2020/21. A LOBO is called at its contract review date when the Lender is able to amend the interest rate on the loan at which point the Borrower can accept the new terms or reject and repay the loan. Any LOBOs called will be discussed with the Treasury Management Adviser prior to acceptance of any revised terms. Depending on the advice received, the Authority will consider, in the event of a repayment, the use of its cash investments balances or raising new debt to repay the loan.

5.8 Gross Debt and the Capital Financing Requirement

- 5.8.1 A further requirement of the revised Prudential Code is to ensure that over the medium term debt will only be for a capital purpose, the Authority will ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

5.9 Debt Rescheduling

- 5.9.1 Due to the difference in the rates, it is unlikely that there will be many viable opportunities to reschedule loans (General Fund and the HRA) in the foreseeable future. However, should any such opportunities arise; any decision on debt rescheduling will be supported by the

appropriate report detailing the options and potential savings from the Authority's Treasury Management Adviser.

5.10 Policy on Borrowing In advance of Need

5.10.1 Whilst the Authority is able to borrow in advance of need, it is a requirement of the Code that any instance of pre-funding must be supported by a clear business case setting out the reasons for such activity. The Authority will prepare a business case whenever there is need to borrow in advance of need.

5.11 Annual Investment Strategy

5.11.1 The CIPFA Code and the Welsh Government Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.11.2 **Current strategy (2019/20)** - At present the Authority lends to financial institutions, corporates and the UK Government using a range of financial instruments to diversify risk. These include unsecured corporate bonds; covered bonds (secured); fixed term deposits; certificate of deposits (CDs); T-Bills; the DMADF (DMO) money market funds and call accounts.

5.11.3 **The 2020/21 Investment Strategy** will continue with the lending approach as set out in the 2019/20 Strategy. Considerations will be given to pooled investments (property funds; equity funds; multi-asset funds) and non-treasury investments for the purpose of enhancing returns. Pooled funds will be held for minimum of five years to offset any premature exit costs. A lesser period would be considered only if it is cost neutral to the Authority. Appendix 9 discusses pool funds in more detail.

5.11.4 This Strategy (2020/21), in line with the Welsh Government guidance, sets out the Authority's policies for (and in order of priority) the security, liquidity and yield of its investments. It will have regard to credit ratings and determine the periods for which funds may be prudently invested, whilst aiming to achieve, or better a target rate for investments of **0.50% (the DMO rate)**. Creditworthiness approach, investment periods and the rationale for the target rate are explained in **Appendix 3**. The Authority's objective when investing cash is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.11.5 The strategy sets out which investments the Authority may use for the prudent management of its balances during the financial year within the areas of 'specified' and 'non-specified' investments, and provides the appropriate authorisation for the in-house investment team to manage such investments. These are listed in **Appendix 4**.

5.11.6 The Authority will continue to diversify into more secure and/or higher yielding asset classes during 2020/21 in order to mitigate the risk stemming from regulations associated with Bank Bail-In; political uncertainty; and the risk of zero or negative Bank Rate. Short-term cash that is required for liquidity management will be deposited with local authorities (secured), Government securities (secured), money market funds (unsecured) and bank and building society investments (unsecured). Up to £60m will be made available for long-term investments.

- 5.11.7 In view of the ongoing volatility in the economy, and bank bail in risk, it is recommended that investments (both new and maturing) be placed with the most secure institutions as well as the most secure instruments (subject to liquidity requirements) as detailed in **Appendix 3**. Currently this would be AAA rated covered bonds, the Government (Debt Management Account Facility and Treasury Bills and Gilts), other Local Authorities and Public Bodies, such as Police and Fire Authorities, Repos, Registered Landlords, AAA Money Market Funds, and highly credit rated banks (subject to the creditworthiness limits referred to in the appendix 3). In light of Statutory and regulatory changes adopted by the Bank of England and Regulators with respect to Bail-In, it is recommended that the Authority moves away from unsecured lending (where possible and subject to liquidity requirements) to secured investments.
- 5.11.8 With respect to Repo agreements, Repo/Reverse Repo is accepted as a form of securitised lending and should be based on the GMRA 2000 (Global Master Repo Agreement). Should the counterparty not meet our senior unsecured rating then a 102% collateralisation would be required. The acceptable collateral can be anyone or combination of the following securities:
- Index linked Gilts
 - Conventional Gilts
 - UK Treasury bills
 - DBV (Delivery By Value)
 - Corporate bonds
- 5.11.9 The Welsh Government maintains that the borrowing of monies for the purposes of investing or on-lending to benefit from differences in interest rates is unlawful. This Authority will not engage in such activity.
- 5.11.10 Under the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2004 regulation 12(b), the acquisition of share or loan capital in any corporate body would not be defined as capital expenditure as long as it is an investment for the purposes of the prudent management of the Authority's financial affairs. Due to the high risk of capital loss involved with such instruments, this Authority will not engage in such activity.
- 5.11.11 A loan or grant to another body for capital expenditure by that body is also deemed by the 2003 Regulations to be capital expenditure by the Authority. This Authority will only engage in such activity with the approval of Council.
- 5.11.12 In the event that any existing investment appears to be at risk of loss, the Authority will make proper revenue provision of an appropriate amount in accordance with the relevant Accounting Regulations.
- 5.11.13 At the end of the financial year, the Authority will prepare a report on its investment activity as part of its Annual Treasury Management Strategy Report. This report will be supported throughout the year by quarterly monitoring reports to the Policy & Resources Scrutiny Committee (the responsible body for scrutiny of Treasury Management activities as required by the Code), which will include a review of the current strategy. A report to Council will also be prepared on a half-yearly basis.
- 5.11.14 It is a fundamental requirement of the Code that officers engaged in Treasury Management follow all Treasury Management policies and procedures and all activities must comply with the Annual Strategy.

5.11.15 The Welsh Government has reservations with regard to borrowing in advance of need on the grounds that more money than is strictly necessary is likely to be put at risk in the investment market. As a result Officers must report any investment made as a result of borrowing in advance and must set out the maximum period for which the funds can be prudently committed. In the event that this Authority decides to take up such borrowing, it is suggested that any deposit made with these funds be limited to a maturity period of up to twelve months and pro-rata to coincide with the profiling of capital expenditure.

6. Policy on Use of Financial Derivatives

6.1 The Localism Act 2011 includes a general power of competence that removes the uncertain legal position over English local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). Although this change does not apply to Wales, the latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the Annual Treasury Management Strategy.

6.2 In the absence of any legislative power, the Authority's policy is not to enter into standalone financial derivatives transactions such as swaps, forwards, futures and options. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall risk management strategy.

7. Non-Treasury Investments

7.1 Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes. Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

8. Treasury Management Adviser

8.1 The Authority has appointed Arlingclose Limited as its external Treasury Management Adviser and receives a number of services including specific advice on investment, debt and capital finance issues; counterparty advice; economic forecasts and commentary; workshops, training and seminar events; and technical advice (including accountancy).

9. Treasury Management Training

9.1 The revised CIPFA Code, adopted by the Authority in January 2012, requires that Local Authorities must ensure that all staff and those Members with responsibility for Treasury Management receive the appropriate training. To this end the following will be observed:

- The contract for Treasury Consultancy Services includes requirements for Member and Officer training to be provided during any year.
- Officers will attend any courses/seminars that are appropriate especially where new regulations are to be discussed.
- Officers will update Members during the financial year by way of seminars/workshops/reports.
- Officers will utilise on line access to the CIPFA Treasury Forum and the CIPFA Technical

Information Service.

- Relevant staff is encouraged to study professional qualifications from CIPFA; the Association of Corporate Treasurers; and other relevant organisations.

9.2 Officers will look to schedule Member training for autumn 2019. Further training will be undertaken as and when required.

10. PRUDENTIAL INDICATORS

10.1 Capital Financing Requirement

10.1.1 The Capital Financing Requirement (CFR) measures the authority's underlying need to borrow for a capital purpose. In accordance with best professional practice, the authority does not associate borrowing with particular items or types of expenditure. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years.

10.1.2 The capital financing requirement is below the authorised borrowing limits in order to allow scope for short-term cash flow borrowing and provision for unforeseen contingencies.

10.1.3 The estimated values of Capital Financing Requirement for the period under review are shown in **Appendix 6** attached.

10.2 Prudential Indicators – “Prudence”

10.2.1 The proposed Prudential Indicators for Treasury Management Strategy are detailed in **Appendix 5**.

10.3 Prudential Indicators – “Affordability” [Appendices 6 and 7]

10.3.1 There is a requirement to analyse and report the capital financing costs, and express those costs as a percentage of the net revenue streams of the Authority.

10.3.3 The General Fund future revenue streams are based upon the content of “the Budget Report”.

10.3.4 Future revenue streams for Housing Revenue Account (H.R.A.) have been projected on the basis of 3% inflation (1.5% inflation and 1.5% growth) applied to the rental income (using 2019/20 as a base), less an adjustment for estimated reduction in housing stock as a result of the “Right to Buy” sales.

10.4 Capital Expenditure and Funding

10.4.1 The summary Capital Expenditure and funding, as shown in **Appendix 7** of this report has been considered in “the Budget Report”. The capital expenditure and funding detailed in Appendix 7 is subject to further change in the final report that will be presented to Full Council in light of General Fund working balances being made available to support the core capital programme.

10.4.2 The Revenue Support Grant (RSG) provided by the Welsh Government (WG) includes an element to off-set the costs of borrowing funds for capital purposes. WG has announced supported borrowings of £4.87m in respect of the 2020/21 financial year, together with General Capital Grant funding of £4.88m.

10.4.3 For calculation purposes, it has been assumed that the supporting borrowing element of funding support will remain static for 2021/22 and for 2022/23, whilst the capital grant has been revised down to 2018/19 level. HRA provisional values for the years 2020-2023 are based on the 2020/21 allocation of the Major Repairs Allowance of £7.35m and assumed to continue at this level for future years.

11. Minimum Revenue Provision (MRP)

11.1 In accordance with the Amendment Regulations, rather than applying a defined formula, the Authority is now only required to apply a charge that is 'prudent'. A "prudent" period of time for debt repayment is defined as one which reflects the period over which the associated capital expenditure provides benefits.

11.2 The Amendment Regulations also introduced an additional reporting requirement. Authorities are now required to submit to full Council, for approval, an Annual MRP Statement, setting out the policy to be adopted for the year following.

11.3 The Authority will continue to apply the revised MRP policy that was agreed by Members on 24th January 2017. MRP on supported borrowings will be charged at 2% over 50 years. MRP on unsupported borrowings will be charged at the PWLB annuity loan rate equivalent to the life of the asset. The MRP policy is detailed in **Appendix 8**.

12. Other Local Issues

12.1 The Authority's Banker

12.1.1 The Authority will ensure that its day-to-day banking activity is undertaken with an investment grade bank. If the Authority's Bank is downgraded during the contract period (as specified under the Banking Services Contract) to non-investment grade, reasonable measures will need to be undertaken to mitigate the risk associated with further downgrades, and the risk of losing funds if the Bank was to default.

12.1.2 Reasonable measures will need to include (and not limited to) keeping balances to a minimum; hourly review of bank balances for the Group Accounts and subsequently transferring surplus balances to a Call Account; re-routing material income (maturing investments, grants) to a bank account held outside of the existing bank arrangement; and consideration of contingency banking arrangements with another bank should the risk be severe to the Authority's operational requirements. Cabinet will be kept informed if such risks arise.

12.2 Policy on Apportioning Interest to the HRA

12.2.1 On 1st April 2015 the HRA exited the subsidy mechanism by way of the HRA buyout process.

As a result, the Authority will operate a single consolidated pool of debt that will hold all debt (new and old loans), and annually recharge the HRA the interest payable on all loans using the average rate of interest as a recharge rate.

12.3 Markets in Financial Instruments Directive: The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

12.4 IFRS 9 Classification

12.4.1 Under the IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost

13. ASSUMPTIONS

13.1 The details set out in the report are based on interest rate forecasts provided by the Authority's Treasury Management Adviser.

13.2 It is currently assumed that investment cash balances remain at £100m throughout 2020/21 in order to deliver the investment returns stated within this report.

13.3 It has been assumed that the Authority will fund a proportion of its capital programme through supported borrowing.

13.4 It has been assumed that the HRA's borrowing needs are based on the current Business Plan at the time of writing this report.

14. LINKS TO STRATEGY

14.1 The report has links to the strategic themes of the Authority, taking into account cross-cutting issues where relevant. It has specific links to the effective and efficient application and use of resources.

14.2 Prudent financial management contributes to the following Well-being Goals within the Well-being of Future Generations Act (Wales) 2015:-

- A prosperous Wales.
- A resilient Wales.
- A healthier Wales.
- A more equal Wales.
- A Wales of cohesive communities.
- A Wales of vibrant culture and thriving Welsh Language.
- A globally responsible Wales.

15. WELL-BEING OF FUTURE GENERATIONS

- 15.1 The establishment of treasury management strategy is a key element of effective financial management and risk management of the Authority's cash balances, investments and the timely service of debt, which assists the achievement of the Well-being Goals within the Well-being of Future Generations Act (Wales) 2015.

16. EQUALITIES IMPLICATIONS

- 16.1 There are no potential equalities implications of this report and its recommendations on groups or individuals who fall under the categories identified in the Council's Strategic Equality Plan. There is no requirement for an Equalities Impact Assessment Questionnaire to be completed for this report.

17. FINANCIAL IMPLICATIONS

- 17.1 The Treasury Management Strategy for 2020/21 as outlined in this report, if approved by Members, is likely to generate estimated interest of £600k on cash investments and a further £718k on pool fund investments, and this has been reflected in the budget report for 2020/21. Although the Authority has a new borrowing requirement of £32.3m in 2020/21 to fund the General Fund capital programme and replenish internal borrowing. The HRA will be borrowing up to £52.0m to fund the WHQS and Affordable Homes capital programmes.

18. PERSONNEL IMPLICATIONS

- 18.1 There are no personnel implications.

19. CONSULTATION

- 19.1 No external consultation is required for the purposes of the report. However, advice has been sought from the Authority's current Treasury Management Adviser.

20. STATUTORY POWER

- 20.1 Local Government Act 1972

Author: Nadeem Akhtar – Group Accountant -Treasury Management & Capital

Consultees: Corporate Management Team (CMT)
Stephen Harris - Interim Head of Business Improvement Services & Deputy S151 Officer
Andrew Southcombe – Finance Manager, Corporate Finance
Robert Tranter- Head of Legal Services & monitoring Officer
Cllr E. Stenner – Cabinet Member for Finance, Performance & Planning

Appendices:

Appendix 1	Local Government Investments - Definitions
Appendix 2	Interest Rates – Forecasts/Indicative
Appendix 3	Credit Policy, Investment Ratings, Periods and Targets
Appendix 4	Investments to be used and “in house” authorisations
Appendix 5	Treasury Management Strategy Indicators
Appendix 6	Prudential Indicators – Capital Finance
Appendix 7	Capital Expenditure and Funding
Appendix 8	MRP Policy
Appendix 9	Strategic Pool Funds

Appendix 1

Local Government Treasury Management Definitions

- **Investment**

In the context of a local authority cash deposit, an investment is a monetary asset deposited with a credible institution with the objective of providing income in the future. This is a transaction which relies upon the power in section 12 of the 2003 Act and is recorded in the balance sheet under the heading of investments within current assets or long-term investments.

- **Long-term Investment**

This is any investment other than one which is contractually committed to be paid within 12 months of the date on which the investment was made.

- **Credit Rating Agency**

An independent company that provides investors with assessments of an investment's risk and the three most prominent are.

Standard and Poor's (S & P)

Moody's Investors Service Limited (Moody's)

Fitch Ratings Limited (Fitch)

- **Specified Investment**

An investment is a specified investment if it satisfies the following conditions:

1. The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
2. The investment is not a long-term investment (as defined above).
3. The investment is not considered to be capital expenditure.
4. One or both of the following conditions is both:
 - The investment is made with the UK Government or a local authority (as defined in section 23 of the 2003 Act) or local authorities in Scotland and Northern Ireland or a parish or community council.
 - The investment is made with a body or in an investment scheme which has been awarded a high credit rating by a credit rating agency

5. The principal sum to be repaid at maturity is the same as the initial sum invested other than investments in the UK Government.

- **Non-specified Investments**

These are investments, which do not meet the conditions of specified investments.

Appendix 2 Interest Rate Forecasts

Bank Rate (Forecasts as at November 2019 and subject to change)

	Arlingclose (Central case)
2020/21 Q1	0.75%
Q2	0.75%
Q3	0.75%
Q4	0.75%
2021/22	0.75%
2022/23	0.75%

PWLB (Forecasts as at November 2019 and subject to change- Source Arlingclose (Upside case)

	Q1 – 2020/21	Q2 – 2020/21	Q3 – 2020/21	Q4 – 2020/21
5 Year	2.60%	2.65%	2.70%	2.75%
10 Year	2.85%	2.95%	2.95%	3.00%
25 year	3.30%	3.40%	3.40%	3.40%
50 Year	3.30%	3.40%	3.40%	3.40%

For budget setting and financial planning, the following rates have been assumed.

Budget Period	Investment Returns	Borrowing Rates (PWLB 50 Years)
2020/21	0.75%	3.50%
2021/22	0.75%	3.50%
2022/23	0.75%	4.00%
2023/24	1.00%	4.50%
2024/25	1.00%	5.00%

Appendix 3 Credit Risk Policy

Bank Bail-In

Bail-in legislation has now been fully implemented in the European Union and major economies around the World. In addition, the largest UK banks have ring-fence their retail and investment banking functions into separate legal entities during 2018 and 2019. The impact of the structural change on the banks credit rating was minimal. Bail-In proposals, an approach where retail customers of a failing bank are protected under compensation schemes (up to a threshold) and losses are covered by investor's equity capital in the first instance, followed by junior debt and then senior unsecured debt and deposits. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

A bail-in is likely, although not certain, to happen over the course of a weekend, with much of the preparatory work having been undertaken in advance as the bank continues to fail regulatory conditions. The announcement of a bail-in, including which creditors will be affected, will normally be made by the Bank of England on a Sunday evening before the Asian markets open. Apart from the affected creditors, the bank will open for business as normal on the Monday morning. Where a banking group comprises several UK bank companies, it is likely that all group banks will be bailed-in together. Separately capitalized subsidiaries in other countries might not be bailed-in; that will be a matter for the local regulator. Before a bail-in, the bank's ordinary shareholders will have their shares expropriated and they will therefore no longer be the bank's owners. Building societies, which are mutually owned by their customers, will be converted to banks before bail-in. Hybrid capital instruments that convert to equity in certain circumstances will also be converted. Creditors will then be bailed-in in this order:

- junior or subordinated bonds, in order of increasing seniority;
- senior unsecured bonds issued by the non-operating holding company (if any);
- senior unsecured bonds issued by the operating bank companies;
- **Unsecured deposits (money market funds, call accounts and fixed-term deposits with banks and building societies) and certificates of deposit (except interbank deposits of less than seven days original maturity); and**
- **Insured deposits that are larger than the FSCS £85,000 coverage limit.**

Subject to cashflow liquidity requirements, the Authority will manage bail-in risk by way of investing surplus cash in instruments that are considered to be exempt from bail-in and include (and in no particular order) the Government, Corporate bonds, Registered Providers (Housing Associations) and secured bank instruments (Repos, Covered Bonds and other collateralised instruments). These instruments are considered to have a medium to long-term investment horizon; and therefore it is likely that the Authority will hold investment instruments with financial institutions that will not be exempt from the bank bail-in process such as fixed term deposits, call accounts and money market funds. The Authority will look to limit such holdings for the purpose of managing liquidity.

Counterparty Criteria

The Authority considers, in order of priority, security, liquidity and yield when making investment decisions. Credit ratings remain an important element of assessing credit risk, but they are not a

sole feature in the Authority's assessment of counterparty credit risk. The intention of the strategy is to provide security of investment and minimisation of risk which will also enable diversification and thus avoidance of concentration risk.

The Authority also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. In accordance with the 2017 Treasury Management Code of Practice, the Authority will use the following key tools to assess credit risk:

- Published credit ratings of the financial institution and its sovereign rating;
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

The Authority is advised by Arlingclose Limited, who provides counterparty risk management services. Credit rating lists are obtained and monitored by Arlingclose, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

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

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

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

Due to the ongoing strengthening of bank regulations it is recommended that the Authority adopts the Investment Grade scale as the minimum credit rating criteria. This will enable greater flexibility when placing investments especially during periods of regulatory stress tests where the outcome can result in a downsized counterparty list as a result of the downgrading of credit ratings. Furthermore, the need to hold a diversified investment portfolio and the impact of bank bail-in regulations means that the Authority will need to adopt a more structured credit rating criteria matrix for specific instruments. **The table below details maximum monetary and investment duration limits.**

Maximum Monetary and Investment Duration Limits						
Credit Rating (Long-Term)	Banks Unsecured	Banks Secured	Government	Local Authorities	Corporates	Registered Providers
UK Govt	-	-	£ Unlimited 50 years	-	-	-
AAA	£20m 5 years	£20m 20 years	£20m 50 years	£20m 50 years	£10m 20 years	£10m 20 years
AA+	£10m 5 years	£20m 10 years	£20m 25 years	£10m 25 years	£10m 10 years	£10m 10 years
AA	£10m 4 years	£20m 5 years	£20m 15 years	£10m 15 years	£10m 5 years	£10m 10 years
AA-	£10m 3 years	£20m 4 years	£20m 10 years	£10m 10 years	£10m 4 years	£10m 10 years
A+	£10m 2 years	£20m 3 years	£10m 5 years	£10m 5 years	£10m 3 years	£10m 5 years
A	£10m 13 months	£20m 2 years	£10m 5 years	£10m 5 years	£10m 2 years	£10m 5 years
A-	£10m 6 months	£20m 13 months	£10m 5 years	£10m 5 years	£10m 13 months	£10m 5 years
BBB+	£10m 100 days	£10m 6 months	£10m 2 years	£10m 2 years	£10m 6 months	£10m 2 years
BBB	£5m next day only	£5m next day only	-	£5m next day only	-	£5m next day only
None Rated	£1m 6 months	-	£5m 25 years		-	£5m 5 years
REITS			£20m per fund			
Pooled funds			£20m per fund			

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks Unsecured: Call accounts, term deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB are restricted to overnight deposits at the Authority's current account bank [Barclays Bank Plc] or the Debt Management Office. The use of Banks unsecured instruments will be limited to aid the management of cashflow liquidity. In accordance with advice from the Authority's Treasury Management adviser, International banks will also be considered.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments. Investments placed in conjunction with a Repo Agreement will be classed as a secured investment.

Government: The Debt Management Office, Loans, bonds and bills issued or guaranteed by national governments and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years. Multilateral / Supranational institutions and State Agencies will also be classed as Government institutions as a number of sovereign states are key shareholders.

Local Authorities: Fixed term deposits / bills/ Bonds issued by local and regional authorities who include police and fire authorities. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Local authorities are not rated by credit rating agencies (though a handful of authorities have obtained a credit rating), but it is assumed that local authorities have the same credit rating as the UK Government (AA). Therefore a limit of £10m and duration of 15 years will be applied.

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

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services; they retain the likelihood of receiving government support if needed. Consideration will also be given to providing liquidity facilities, such as a revolving credit facility, subject to a detailed credit assessment of the Registered Provider.

Pooled Funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. **Money Market Funds** that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts to manage short-term liquidity, while long-term strategic **pooled funds** whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly. Appendix 9 sets out the Authority's approach to investing in pool funds.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

Investment periods

- **Short-term (up to 365 days)**

At the time of writing, all short-term investments are managed in-house as a result of day-to-day cash flow management.

For the purpose of flexibility to respond to day-to-day cash flow demands, the proposed minimum percentage of its overall investments that the Authority will hold in short-term investments is **40%**.

Members are reminded that once a deposit has been made for a fixed period it can only be withdrawn (repaid early) by mutual consent albeit at a cost and subject to the underlying terms and conditions of the contract.

- **Long-term (one year and over)**

The Authority will continue to invest in long-term investments. Excluding the UK Government, it is suggested that no more than £20m be placed with any one institution with duration as set out in the table above. The Authority will not have more than £60m deposited in long-term investments (the Upper Limit).

Target Rate

Forecasts of base rate can be quite diverse as illustrated by the table in **Appendix 2**. In view of the uncertainty inherent in such predictions, it would be imprudent to set a target rate which may be difficult to achieve. In view of the foregoing, it is proposed to set a target rate of return for short-term deposits in 2020/21 of at least **0.50%**.

This rate reflects the forecast of Bank Rate and the relationship between that rate and the rate achievable from the DMADF. If deposits are made with other counterparties as detailed in Section (a) of this Appendix, it is possible that the above rate could be exceeded.

Appendix 4 - Specified and Non-Specified Investments

Investments are categorised as “Specified” or “Non-Specified” within the investment guidance issued by the Welsh Government.

Specified investments are sterling denominated investments with a maximum maturity of one year. They also meet the “high credit quality” as determined by the Authority and are not deemed capital expenditure investments under Statute. Non specified investments are, effectively, everything else.

The Authority’s credit ratings criterion is set out in **Appendix 3** and will be consulted when using the investments set out below. Credit ratings are monitored on a daily basis and the Treasury Management Adviser will advise the Authority on rating changes and appropriate action to be taken.

The types of investments that will be used by the Authority and whether they are specified or non-specified are listed in the table below.

	Specified	Non-Specified
Government		
Debt Management Account Deposit Facility	✓	✗
Gilts (UK Government)	✓	✓
Treasury Bills (T-Bills- UK Government)	✓	✗
Bonds issued by AAA rated Multilateral Development Banks	✓	✓
Registered Providers (Housing Associations)		
Registered Providers (Housing Associations)	✓	✓
Corporates		
Corporate Bonds (including Floating Rate Notes and Commercial Paper)	✓	✓
Local Authorities		
Term deposits with other UK local authorities	✓	✓
Local Authority Bills / Bonds	✓	✓
Banks- Secured		
Repurchase Agreements (Repos)- Banks & Building Societies	✓	✓
Covered Bonds	✓	✓
Other Collateralised arrangements	✓	✓
Banks- Unsecured		
Term deposits with banks and building societies	✓	✗
Certificates of deposit with banks and building societies	✓	✗
AAA-Rated Money Market Funds	✓	✗
Authority's Banker	✓	✗
Pooled Funds (Variable Net Asset Valuation)		
Other Money Market and Collective Investment Schemes	✗	✓
Pooled Funds (Property; Bonds; Equity; Multi-Asset)	✗	✓
Real Estate Investment Trusts	✗	✓

Authorisation for the in-house team

A. Short-term Investments

Due to the nature of the in-house team's duties, in that they need to respond to cash-flow fluctuations by dealing on the money market generally between 8.00am and 10.00am each day, it is impractical for each decision to be referred to the most senior management levels.

As a result, it is proposed that day-to-day decisions remain the responsibility of the Group Accountant (Treasury Management & Capital) who is the *de facto* Treasury Manager. In the absence of the Group Accountant (Treasury Management & Capital), the responsibility will pass to any of the appropriate line managers.

It is proposed that all Treasury Management decisions that arise from the daily cashflow will be supported by the completion of a pro-forma which will evidence compliance with the strategy.

B. Long-term Investments

It is proposed that decisions regarding long-term investments be referred to the Head of Finance & S151 Officer (as Chief Financial Officer) after consultation with the Finance Manager for Corporate Finance.

C. General Authorisations

Whilst it is generally the intention to refer all decisions regarding long-term borrowing to the Head of Corporate Finance, there are times when to do so will risk the loss of a potentially advantageous deal, due to non-availability. This is particularly relevant to the raising of PWLB loans.

The Authority's Treasury Management Adviser continually monitors the movement of interest rates and is able to predict the changes in PWLB rates. On occasions it may be necessary to respond to advice from the Adviser to take up PWLB loans (whether as part of the current years funding requirement, or as part of a rescheduling exercise) before interest rates increase and make the necessary application to the PWLB before their cut-off time. In these circumstances, it is not always possible to have access to the Head of Corporate Finance, at short notice, for approval.

As a result, it is proposed that, in the event that the Head of Corporate Finance & S151 Officer is unavailable, the decision be referred, in the first instance, to the Interim Head of Business Improvement Services, Corporate Services & Deputy S151 Officer; then to Corporate Finance Manager. In the absence of all three, then the decision will be made by the Group Accountant (Treasury Management and Capital) provided that the reason for the transaction is appropriately documented, falls within the approved Annual Strategy and prudential indicators, and failure to act upon the advice given would result in additional interest charges.

In all of the foregoing, it must be remembered that any action taken, based on a view of interest rates, can only be assessed on the data available at the time.

Appendix 5 Treasury Management Strategy Indicators 2020/21-2022/23

	Budget 2020-21	Budget 2021-22	Budget 2022-23
	£000	£000	£000
Authorised limit for external debt -			
Borrowing	371,944	366,533	361,773
Other long term liabilities	28,426	26,388	24,254
Total	400,370	392,921	386,027
Operational boundary for external debt -			
Borrowing	297,555	293,227	289,418
Other long term liabilities	28,426	26,388	24,254
Total	325,982	319,614	313,672
Capital Financing Requirement	434,387	456,271	452,497
Upper limits for interest rate exposure			
Principal outstanding on borrowing	297,555	293,227	289,418
Principal outstanding on investments	100,000	90,000	80,000
Net principal outstanding	197,555	203,227	209,418
Fixed rate limit – 100%	197,555	203,227	209,418
Variable rate limit – 30%	59,267	60,968	62,825
Upper limit for total invested for over 365 days	60,000	60,000	60,000

Maturity structure of fixed rate borrowing	Upper Limit	Lower Limit
Under 12 months	35%	0%
Over 12 months and within 24 months	40%	0%
Over 2 years and within 5 years	50%	0%
Over 5 years and within 10 years	75%	0%
Over 10 years	100%	0%

Gross Debt and Net Debt	Budget 2020-21	Budget 2021-22	Budget 2022-23
	£000	£000	£000
Outstanding Borrowing	297,555	293,227	289,418
Other long term liabilities	28,426	26,388	24,254
Gross Debt	325,982	319,614	313,672
Less investments	100,000	90,000	80,000
Net Debt	225,982	229,614	233,672

Gross and The CFR	Budget 2020-21	Budget 2021-22	Budget 2022-23
	£000	£000	£000
Gross Debt	325,982	319,614	313,672
CFR	434,387	456,271	452,497

Appendix 6 - Prudential Indicators - Capital Finance

Ratio of Financing costs to net revenue stream	Budget 2020-21	Budget 2021-22	Budget 2022-23
General Fund	£000	£000	£000
Principal repayments	2,548	2,956	3,080
Interest costs	8,829	9,080	8,969
Debt Management costs	49	42	41
Rescheduling discount			
Investment income	(1,518)	(1,443)	(1,368)
Interest applied to internal balances	813	812	825
Total General Fund	10,720	11,447	11,548
Net revenue stream	356,621	359,933	363,393
Total as percentage of net revenue stream	3.01%	3.18%	3.18%
Housing Revenue Account			
Principal repayments	2,481	2,971	3,412
Interest costs	6,301	6,942	7,121
Rescheduling discount			
Debt Management costs	33	34	37
Total HRA	8,815	9,948	10,570
Net revenue stream	50,515	51,537	52,568
Total as percentage of net revenue stream	17.45%	19.30%	20.11%

Capital financing requirement [end of year position]	Budget 2020-21	Budget 2021-22	Budget 2022-23
	£000	£000	£000
Council Fund	285,817	285,671	285,310
Housing Revenue Account	148,571	170,599	167,187
Total Authority	434,387	456,271	452,497

Appendix 7 - Capital Expenditure and Funding

	Budget 2020-21	Budget 2021-22	Budget 2022-23
	£000	£000	£000
Expenditure			
Council Fund	11,363	9,846	9,726
Housing Revenue Account	36,000	45,000	20,000
Total	47,363	54,846	29,726
Funding			
Surplus/ (Deficit) Balance b/f	-	454	199
Borrowing - Supported (GF)	4,865	4,865	4,865
General Capital Grant - WG	4,878	3,020	3,020
Internal Borrowing	-	-	-
RCCO Budget	128	128	128
Capital underspends frm previous years	306	-	-
General Fund working balances	-	-	-
One off funding- MRP Review	1,640	1,578	1,514
RCCO- (HRA)	16,650	12,650	12,650
Unsupported Borrowing HRA- WHQS	7,000	-	-
Unsupported Borrowing HRA- Affordable Housing	5,000	25,000	-
Major Repairs Allowance (HRA)	7,350	7,350	7,350
Total	47,817	55,045	29,726
Surplus C/f	454	199	-

Appendix 8 MRP 2020/21 Policy

The Minimum Revenue Provision (MRP) is an amount charged to the revenue account for the repayment of debt, which has been used to finance capital expenditure. The Local Government Act 2003 requires the Authority to have regard to the Welsh Government's Guidance on Minimum Revenue Provision (most recently issued in 2010).

The broad aim of the WG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The WG Guidance requires the Authority to approve an Annual MRP Statement each year. The Authority's MRP policy for 2020/21 is stated below.

Supported Borrowings

MRP on historic debt liability as at the 31st March 2007 and subsequent capital expenditure funded from supported borrowings will be charged to revenue over 50 years.

The MRP charge for supported borrowing will be based on an assumed annuity rate of 2%.

The annuity method results in a lower charge in earlier years and a higher charge in the later years, and takes into consideration the time value of money.

Unsupported Borrowings

The MRP charge for individual assets funded through unsupported borrowing will be based on the estimated life of each asset or 25 years where this cannot be determined.

The MRP charge for unsupported borrowing will be based on the average Public Works Loan Board (PWLB) interest rate for new annuity loans in the year that an asset becomes operational.

Advice on asset life (land and buildings) will be sought from the Council's property valuation team. The first MRP Charge will start in the year after the asset becomes operational.

MRP Charges Relating to Other Capital Expenditure

- 1 For assets acquired by leases or the Private Finance Initiative [and for the transferred debt from local authorities], MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- 2 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is

thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

- 3 MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- 4 The MRP charge for the HRA will be determined by using an interest rate of 2% on the opening capital financing requirement on a reducing balance basis.
- 5 The Authority has the option to make voluntary overpayments on MRP where possible to reduce the revenue charge in later years.

Capital expenditure incurred during 2020/21 that is financed by debt will not be subject to a MRP charge until 2021/22.

Appendix 9 - Strategic Pool Funds

The UK Government's austerity programme has led to unprecedented cuts in the level of funding that local authorities receive annually to fund services. Austerity has affected the Settlement that Welsh Government receive from Westminster, which is passed onto Welsh local authorities. At a time of increasing pressure on budgets many local authorities are reviewing their treasury management investment strategy and seeking to diversify into strategic funds to enhance their treasury management returns.

Strategic investment funds (pool funds) offer investors the opportunity to buy into asset classes that would otherwise be difficult to purchase, as well as diversify risk and enhance returns. They are managed externally by a fund manager. Such funds invest in a variety of asset classes such as property, equities, bonds, currencies, and commodities. The performance and riskiness of such funds can vary, as does the investment horizon (i.e. the length of time the cash is invested). Typically such funds (non-government investment funds) have generated returns in excess of the UK Government's inflation target of 2.0%. Strategic funds can also have a mixture of asset classes. These are known as Diversified Income Funds. Property funds typically hold investment properties located all over the United Kingdom.

As noted throughout this report, the outlook for interest rates and subsequently investment returns is bleak due to the impact of political uncertainty and global economic downturn. This is likely to result in investment returns on traditional treasury investments (bonds; cash deposits) remaining low or potentially falling. Strategic investment funds would enable the Authority to diversify into other asset classes that yield higher returns.

Investment Proposal and Limits

It is proposed that the Authority invests in 2020/21 a minimum of £20m but no more than £30m into strategic pool funds, for a minimum period of 5 years. The investment should be further split into the following categories in order to mitigate volatility (based on a £20m investment):

- Property fund: £10m
- Equity fund: £5m
- Multi-asset or Bonds or Diversified Income Fund: £5m

As per Appendix 4, a £20m investment limit will apply to each fund manager. Investment returns will need to be equal to or greater than inflation as measured by the Consumer Price Index (CPI).

In a deteriorating market the Authority should seek to exit the pool fund whilst minimising financial losses.

Risks

Strategic investment funds, like any other investment, are considered to be risky investments. In general, the risks associated with strategic investment funds are:-

- A lack of a credit rating. Most, if not all, funds are not rated by the main credit rating agencies and require due diligence to be undertaken prior to making the initial investment. The Authority will seek advice from its Treasury Management Advisor and undertake a due diligence to find a suitable investment fund.

- Duration. Investments are tied up for a minimum three to five year investment horizon. Any attempt to recall the investment back prematurely would result in additional costs or a loss in the nominal investment as the underlying assets would need to be sold to release the cash proceeds.
- Fund in “lock down”- There have been a number of circumstances whereby investors have been prevented from accessing their funds. Funds adopt this approach when there is a high demand from investors to suddenly withdraw their money on the back of an event (negative publicity, misappropriation, bad management or a political event to name a few). Under such circumstances the fund manager needs to sell assets from the fund to finance the recall of investor’s cash. For certain asset categories there is no liquid market and it takes time to find a buyer (for example commercial property). As a result the fund goes into “lock down” mode and ceases to accept new investments.
- During adverse market conditions certain asset categories do not sell or are sold at low prices resulting in a loss for the investor. The property market is considered to be an illiquid market, in the context of other asset classes, and takes time for a sale to complete. In comparison bond and equity markets are very liquid and the risk would remain on the price side.
- Lack of transparency. Investing in external funds can often result in a lack of transparency and control as decisions are made by others outside of the Authority. Whilst there are strict regulatory rules that govern investment funds, the terms, conditions and objectives are disclosed in the fund prospectus as approved by the parent company. As part of the due diligence exercise, the Authority will request the fund manager to disclose monthly / quarterly investment holdings to mitigate the risk stemming from a lack of transparency.

Accounting for Pooled Funds

The introduction of International Financial Reporting Standard 9 (financial instruments) resulted in changes in the way in which financial assets are accounted for. More specifically, gains and losses on strategic investment funds are charged directly to the revenue account, resulting in an impact on the bottom line (working balances). In England the Ministry of Housing, Communities and Local Government have issued a capital directive to mitigate the impact of gains or losses to an unusable reserve for a period of time (five years). The Welsh Government is yet to adopt a similar approach. The gain or loss would only impact the bottom line upon realisation (i.e. whenever the cash is withdrawn from the fund), and would be dictated by market prices at the time of withdrawal.

Under IFRS 9 pooled funds are categorised as Equity Instruments as the investor has no contractual right to receive back any particular sum of money. The cash flows from a pooled fund are not solely principal and interest. Consequently, pool funds are accounted for at fair value through profit and loss (FVPL) unless “elected”.

IFRS 9 includes an option to irrevocably elect to account for equity instruments at fair value through other comprehensive income (FVOCI). The main difference is that Under FVPL gains and losses from changes in fair value are charged to the revenue account, thus impacting on working balances. Under FVOCI accounting gains and losses from changes in fair value are taken to the Financial Instruments Revaluation Reserve (FIRR). Upon derecognition, the balance in the FIRR is transferred to the revenue account via the Movement in Reserves Statement. There is no impact on working balances.

An election to FVOCI may only be made on initial recognition of an investment (or upon transition to IFRS 9 on 1st April 2018 if later), and it is irrevocable.

The Authority will elect all strategic pool funds to fair value through other comprehensive income (FVOCI) upon opening the fund in order to mitigate any fair value gains or losses against working balances at 31 March 2021.