Report to:

Joint Audit and Governance Committee
Cabinet
Council

Report of Interim Head of Finance

Author: Jelena Peet/Simon Hewings

Telephone: 01749 341260/01235 422499

E-mail: treasury@southandvale.gov.uk

Simon.hewings@southandvale.gov.uk

Cabinet member responsible: Councillor David Turner
Telephone: 01865 891169
E-mail: david.turner@southoxon.gov.uk

To:	JOINT AUDIT AND GOVERNANCE COMMITTEE on	27 January 2020
	CABINET on	30 January 2020
	COUNCIL on	13 February 2020

Treasury Management and Investment Strategy 2020/21

Recommendations

That Joint Audit and Governance Committee approves each of the following key elements of this report, and recommends these to Cabinet:

1. To approve the treasury management strategy 2020/21 set out in appendix A to
this report;

2. To approve the prudential indicators and limits for 2020/21 to 2022/23 as set out in, appendix A.

3. To approve the annual investment strategy 2020/21 set out in appendix A, (paragraphs 40 to 81) and the lending criteria detailed in table 5.

That Cabinet considers any comments from committee and recommends Council to approve report.

Purpose of report

1. This report presents the council's Treasury Management Strategy (TMS) for 2020/21. This sets out how the council's treasury service will support financing of capital investment decisions, and how treasury management operates day to day. It sets out the limitations on treasury management activity informed by the prudential indicators, within which the council's treasury function must operate. The strategy is included as appendix A to the report. This report includes the three elements required by legislation as follows:

   - The **prudential indicators** required by the CIPFA Prudential Code 2017 for Capital Finance in Local Authorities and CIPFA TM code of Practice 2017;

   - The **annual investment strategy**. This sets out the council's criteria for selecting counterparties and limiting exposure to the risk of loss on its investments.

   - A statutory duty to approve a **minimum revenue provision** policy statement. (appendix A, paragraph 15-19).

   It is a requirement of the CIPFA Code of Practice on Treasury Management 2017 that this report is approved by full Council on an annual basis.

Strategic objectives

2. Managing the finances of the authority in accordance with the treasury management strategy will help to ensure that resources are available to deliver its services and meet the council's strategic objectives.

Background

3. Treasury management is the planning of the council's cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

4. The funding of the council's capital expenditure is also a function of treasury management. The capital programme provides a guide to the funding needs of the council and informs long-term cash flow plans to ensure that the council can meet its capital spending obligations.

5. Treasury investments are effectively what the council does with its cash resources before it is spent on the provision of services and the funding of the capital programme. All expenditure of a capital nature is managed through the council's capital programme and is not covered by this report.

6. The treasury management and annual investment strategy set out the council's policies for managing investments and confirms the council gives priority to the security and liquidity of those investments. It also includes the prudential indicators for the next three years; these demonstrate that the council's capital investment plans are affordable, prudent and sustainable.

7. The council's treasury management strategy 2020/21 is attached in appendix A. Whilst every attempt has been made to minimise the technical content of this report, it is, by its very nature and the need for compliance with associated guidance, technical in parts. A glossary of terms in appendix G should aid members understanding of some technical terms used in the report.

8. The last significant review by CIPFA of its 'Prudential code' and the 'Treasury Management Code of Practice' was in 2017 and the necessary changes to our TMS were made last year.

Recommended changes to the treasury management strategy

9. Council approved the 2019/20 treasury management strategy on 14 February 2019. The proposed strategy for 2020/21 has no significant changes compared to previous year.

Financial implications and risk assessment

10. This report and all associated policies and strategies set out clearly the parameters the council must work within. It is important that the council follows the approved treasury management strategy which is designed to help protect the council's finances by managing its risk exposure.

11. Base rates last rose in August 2018 from 0.5 per cent to 0.75 per cent. This was the first increase in Bank Rate above 0.5 per cent since the financial crash of 2008

12. Link Asset Services forecast that the bank base rate will not increase before March 2021, followed by increases in June 2022, before ending up at 1.25 per cent in March 2023. *Quoted from link Asset Services December 2019*

13. The table below gives an estimate of the investment income achievable for the next five years;

Table 1: Medium term investment income forecast					
	2020/21 £000's	2021/22 £000's	2022/23 £000's	2023/24 £000's	2024/25 £000's
Forecast as at December 2019	2,583	2,365	2,508	2,505	2,439

The 2020/21 budget setting report and medium term financial plan will take into account the latest projections of anticipated investment income.

Legal implications

14. There are no significant legal implications as a result of the recommendations in this report. Compliance with the CIPFA Code of Practice for Treasury Management in the Public Services, the CLG Local Government Investment Guidance provides assurance that the council's investments are, and will continue to be, within its legal powers.

15. The council must approve any amendment to the treasury management strategy and annual investment strategy in accordance with the Local Government Act 2003 (the Act), the CIPFA Code of Practice for Treasury Management in the Public Services and the CLG Local Government Investment Guidance under Section 15(1) (a) Local Government Act 2003 and CIPFA Prudential Code for Capital Finance.

Conclusion

16. This report introduces the treasury management strategy and the annual investment strategy for 2020/21 which are appended to this report, together with the prudential indicators for approval to council. These documents provide the parameters within which the council's treasury management function will operate.

Background papers

- CIPFA Code of Practice on Treasury Management 2017
- CIPFA Prudential Code 2017
- CIPFA Treasury Management in the Public Services Guidance Notes 2018
- CIPFA statement 17.10.18 on borrowing in advance of need and investments in commercial properties
- CIPFA Bulletin 02 Treasury and Capital Management Update October 2018
- Statutory Guidance on Local Government Investments (3rd Edition)
- Statutory Guidance on Minimum Revenue Provision

Appendices

Appendix A Treasury Management Strategy 2020/21
Appendix B Economic Background
Appendix C Risk and performance benchmarking
Appendix D Explanation of Prudential and Treasury Indicators
Appendix E TMP1 extract
Appendix F Extension to the responsibilities of the S151 officer
Appendix G Glossary of terms

Appendix A

Treasury Management Strategy 2020/21

Introduction

1. The first main function of the treasury management services is to ensure the council's 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. The second main function of the treasury management service is the funding of the council's capital plans.

2. Whilst any commercial initiatives or loans to third parties will impact on the treasury function, these activities are generally classed as non-treasury activities, (arising usually from capital expenditure), and are separate from the day to day treasury management activities.

3. CIPFA defines treasury management as:

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

4. Revised reporting was required for the 2019/20 reporting cycle due to revisions of the Ministry of Housing, Communities & Local Government (MHCLG) Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the Chartered Institute of Public Finance & Accountancy (CIPFA) Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes included the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is reported separately.

Treasury Management reporting

5. The Council is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

   a) Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report is forward looking and covers:
      - the capital plans, (including prudential indicators);
      - a minimum revenue provision (MRP) policy, (how residual capital expenditure is charged to revenue over time);
      - the treasury management strategy, (how the investments and borrowings are managed), including treasury indicators; and
      - an investment strategy, (the parameters on how investments are to be managed).

b) A mid-year treasury management report – This is primarily a progress report and will update members on the mid-year treasury performance, amending prudential indicators as necessary, and whether any policies require revision.

c) An annual treasury report – This report reviews performance for the previous financial year and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

6. The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Joint Audit and Governance Committee.

Treasury Management Strategy for 2020/21

7. The strategy for 2020/21 covers the areas below:
   - the capital expenditure plans and the associated prudential indicators;
   - the minimum revenue provision (MRP) policy.
   - 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
   - the policy on use of external service providers.

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

Councillor and officer training

9. The CIPFA Code requires the Interim Head of Finance to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. The training needs of treasury management officers are periodically reviewed.

10. Capita have been contracted to undertake the Treasury Management function since beginning of August 2016. The service is carried out by the financial accounting team which are based in Shepton Mallet. The council still authorise daily dealings and receive regular reports from the team on current and future investments.

Capital Prudential Indicators

11. The Council's capital expenditure plans (as detailed in the council's capital programme) are a 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.

Treasury management advisors

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

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

14. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills, knowledge 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.

Minimum Revenue Provision (MRP) policy statement 2020/21

15. The council's current capital programme will primarily be financed from internal resources. If borrowing is undertaken, then the council will be required by statute to set aside funds in the annual revenue budget to amortise the principal element of any borrowing – this is the MRP. There will also be a requirement to set aside revenue budget for the interest payments on any borrowing raised. Loans will generally be taken over the life of the assets being financed and amortised accordingly.

16. The council is required by regulation to approve an annual MRP policy before the start of the year to which it relates. Any in-year changes must also be submitted to the council for approval.

17. A variety of options are provided to councils for the calculation of MRP. The council has chosen the "asset life method" as being most appropriate. Using this method MRP will be based on the estimated life of the asset, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). Repayments included in annual PFI or finance leases are applied as MRP.

18. Currently, the council's MRP liability is nil. This will remain the case unless capital expenditure is financed by external or internal borrowing.

19. The Interim Head of Finance will determine the most appropriate repayment method, term of borrowing and duration of borrowing. As a general illustration, Table 1 below gives an example of the annual revenue costs associated with borrowing an amount of £2.5 million over a 50-year period, based on the current district tax base of 57,849 Band D equivalents:

Table 2: Example MRP and interest calculation	
Loan Amount	£2,500,000
Loan Duration	50 Years
PWLB Interest	3.38%

2020/21 Tax Base	57,849	
	£	£ per Band D
MRP Element	£50,000	0.86
Annual Interest Cost	£84,375	1.46
Total	**£134,375**	**2.32**

Prospects for interest rate forecast and economic rate forecasts

20. The following table gives Link Asset Services central view on expected interest rate movements out to March 2023. It should be read alongside the commentary provided below.

Quoted by link Asset Services December 2019

Bank Rate	NOW	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**0.75%**	0.75%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.25%
Capital Economics	**0.75%**	0.75%	0.75%	0.50%	0.50%	0.50%	-	-	-	-	-	-	-	-	-

5yr PWLB Rate	NOW	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.27%**	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.20%	3.20%
Capital Economics	**2.27%**	2.40%	2.40%	2.40%	2.40%	2.40%	-	-	-	-	-	-	-	-	-

10yr PWLB Rate	NOW	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.46%**	2.60%	2.70%	2.70%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%
Capital Economics	**2.46%**	2.60%	2.60%	2.60%	2.60%	2.60%	-	-	-	-	-	-	-	-	-

25yr PWLB Rate	NOW	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**3.03%**	3.20%	3.30%	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%
Capital Economics	**3.03%**	2.90%	2.90%	2.90%	2.90%	2.90%	-	-	-	-	-	-	-	-	-

50yr PWLB Rate	NOW	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Link Asset Services	**2.87%**	3.10%	3.20%	3.30%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%
Capital Economics	**2.87%**	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-	-	-	-	-

21. *It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% so far in 2019 due to the ongoing uncertainty over Brexit. In its meeting on 1 August, the MPC became more concerned about the outlook for both the global and domestic economies. That's shown in the policy statement, based on an assumption that there is an agreed deal on Brexit, where the suggestion that rates would need to rise at a "gradual pace and to a limited extent" is now also conditional on "some recovery in global growth".*

22. *Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. If there were a no deal Brexit, then it is likely that there will be a cut or cuts in Bank Rate to help support economic growth.*

23. *The September MPC meeting sounded even more concern about world growth and the effect that prolonged Brexit uncertainty is likely to have on growth.*

24. *The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.*

25. *In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.*

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

Treasury Limits for 2020/21 to 2022/23

27. It is a statutory duty, under Section 3 of the Act and supporting regulations for the council to determine and keep under review how much it can afford to borrow. The amount so determined is called the “Affordable Borrowing Limit”. The Authorised Limit is the legislative limit specified in the Act.

28. The council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital expenditure remains within sustainable limits and, that the impact upon its future council tax is ‘acceptable’.

29. The Authorised Limit is set on a rolling basis, for the forthcoming financial year and two successive financial years.

30. The following indicators set the parameters within which we manage the overall capital investment and treasury management functions. There are specific treasury activity limits, which aim to contain the activity of the treasury function in order to manage risk and reduce the impact of an 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 limits are set out in table 2 below.

Cabinet is asked to recommend council to approve the limits:

Table 3: Prudential indicators

	2019/20 Approved	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Debt	**£m**	**£m**	**£m**	**£m**
Authorised limit for external debt				
Borrowing	30	30	30	30
Other long-term liabilities	0	0	0	0
	30	**30**	**30**	**30**
Operational boundary for external debt				
Borrowing	25	25	25	25

Other long-term liabilities	0 **25**	0 **25**	0 **25**	0 **25**
Interest rate exposures				
Maximum fixed rate borrowing	100%	100%	100%	100%
Maximum variable rate borrowing	100%	100%	100%	100%
Investments				
Interest rate exposures				
Limits on fixed interest rates	100%	100%	100%	100%
Limits on variable interest rates	50	50	50	50
Total principal sums invested for periods longer than a year" i.e. +365 days				
Upper limit for principal sums invested +365 days	70	70	70	70

Current position

17. The maturity structure of the council's investments at 30 November 2019 was as follows:

Table 4: maturity structure of investments:	**Total £000's**	**% holding**
Call	500	0%
Money market fund	10,264	6%
Less than 6 months	49,000	30%
6 months to 1 year	50,000	31%
1 year +	34,000	21%
CCLA - Property Fund	6,831	4%
Equities	12,775	8%
Total investments	**163,369**	**100%**

** The figure for total investments shown above excludes the £15 million 20-year loan to SOHA*
made in 2013/14 and the balance outstanding with Kaupthing Singer & Friedlander (KSF).

***£163 million does not represent uncommitted resource the council has at its disposal. This amount includes council tax receipts held prior to forwarding to Oxfordshire County Council and the Police and Crime Commissioner for the Thames Valley, business rate receipts prior to payment to the government and committed capital and revenue balances. Details of the council's uncommitted balances are provided in the annual budget and council tax setting report.*

31. The council holds as above, 88 per cent of its investments in the form of cash deposits, 82 per cent is invested for fixed terms with a fixed investment return and 6 per cent on call accounts, with the remainder held in non-cash deposits. Typically, the council restricts lending activity to UK institutions and the highest rated counterparties

32. The council's considerations for investment will remain security, liquidity and yield – in that order. Officers undertaking Treasury Management will work towards the optimum profile distribution.

Investment performance for the year to 30 November 2019

33. The council's budgeted investment return for 2019/20 is £2.807 million, and the actual interest received to date is shown as follows:

Table 5: Investment interest earned by investment type				
		Interest Earned		
Investment type	**Annual Budget £000's**	**Actual to date £000's**	**Annual Forecast £000's**	**Forecast Variation £000's**
Fixed term and call cash	1,429	837	1,602	**(173)**
SOHA	623	312	623	**0**
CCLA	299	150	299	**0**
Unit Trusts	456	148	592	**(136)**
Total interest	**2,807**	**1,447**	**2,683**	**(309)**

Borrowing Strategy 2020/21

34. The annual treasury management strategy has to set out details of the council's borrowing requirement, any maturing debt which will need to be re-financed, and the effect this will have on the treasury position over the next three years. This council currently has no external debt and in general, the council will borrow for one of two purposes:

- to support cash flow in the short-term;
- To fund capital investment over the medium to long term.

35. Any borrowing undertaken will be within the scope of the boundaries given in the prudential indicators shown in Table 2, which allow for the council to borrow up to a maximum of £30 million, if such a need arose. This also allows short-term borrowing for the cash flow management activities of the authority.

36. The existing capital programme can be financed from internal resources. If additional expenditure was committed in the future a decision would have to be made at the time as to how it would be funded taking into account the prudential borrowing criteria. Any decision on borrowing will be taken by the Interim Head of Finance based on the optimum cost to the council.

37. Any borrowing for capital financing purposes will be assessed by the Head of Finance to be prudent, sustainable and affordable

38. This strategy allows the Interim Head of Finance to determine the most suitable repayment terms of any borrowing to demonstrate affordability and sustainability in the medium term financial plan if required. As a rule, the term of any borrowing will not be longer than the expected life of the capital asset being created.

Policy on borrowing in advance of need

39. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

40. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

Annual investment strategy 2020/21

41. The MHCLG and CIPFA have extended their definition of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (a separate report).

42. The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

43. The Council's investment priorities will be security first, portfolio liquidity second and then yield, (return).

44. The primary aim of the council's investment strategy is to maintain the security and liquidity of its investments; yield or return on the investment will be a secondary consideration, subject to prudent security and liquidity. The council will ensure:

- It has sufficient liquidity in its investments to cover cash flow. For this purpose, it has set out parameters for determining the maximum periods for which funds may prudently be committed.

- It maintains a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security.

45. The strategy aims to provide a high degree of flexibility to take appropriate lending decisions, with a view to producing a portfolio with an even spread of maturity periods. This aim is to provide a more even and predictable investment return in the medium term.

46. The council's Interim Head of Finance will ensure a counterparty list (a list of named institutions) is maintained in compliance with the recommended credit rating criteria (table 5) and will revise the criteria and submit any changes to the credit rating criteria to council for approval as necessary.

Investment types

47. The types of investment that the council can use are summarised below. These are split under the headings of 'specified' and 'non-specified' in accordance with the statutory guidance.

Specified investment instruments

48. These are sterling investments of not more than one-year maturity, or those where the council has the right to be repaid within 12 months if it wishes. These would include sterling investments with:

- UK government Debt Management Agency Deposit Facility (DMADF)
- UK government – treasury stock (Gilts) with less than one year to maturity
- Supranational bonds of less than one year's duration
- Deposits with UK local authorities
- Pooled investment vehicles such as Money Market Funds (MMF) (AAA rated)
- Deposits with banks and building societies (minimum F1/A- rated)
- Certificates of deposits issued by banks and building societies (minimum rating as above)

Non-specified investment instruments

49. These are any other type of investment (i.e. investments not defined as specified, above). Examples of non-specified investments include any sterling investments with:

- Supranational bonds of 1 to 10 years to maturity
- UK treasury stock (Gilts) with a maturity of 1 to 10 years
- Unrated building societies (minimum asset value £1 billion)
- Bank and building society cash deposits up to 5 years (minimum F1/A- rated)
- Deposits with UK local authorities up to 25 years to maturity
- Corporate bonds
- Pooled property, pooled bond funds and UK pooled equity funds
- Diversified Income Fund
- Multi-Asset Fund
- Ultra-Dated/Short dated bond
- Non-UCITS Retail Schemes (NURS)

Other Non-specified investment instruments.

50. Other non-specified investment instruments include:

- Fixed term deposits with variable rate and variable maturities

Approach to investing

51. The council holds approximately £111 million core cash balances which are available to invest for more than one year. This is expected to reduce over the medium term as the approved capital expenditure is incurred and to fund the revenue budget shortfall. In addition, the council has funds that are available on a temporary basis to invest. These are held pending payment over to another body

such as precept payments and council tax. The amount can vary between £5 million and £15 million throughout the year and should only be invested short term (under one year). Investments will be made with reference to known cash flow requirements (liquidity).

52. While rates remain historically low the council will aim to keep investments relatively short term but will continue to look for opportunities to fix lending in the medium term with highly rated institutions when possible for core cash balances. The aim is to increase the weighted average maturity of the portfolio in order to reduce maturity risk.

53. Officers will continue to provides tight controls on the investments placed. Where possible, opportunities to spread the investment risk over different types of instruments will be considered.

54. Should market conditions deteriorate suddenly to the extent that the council is unable to place money with institutions with the necessary credit rating, it will make use of the UK Government deposit account (DMADF).

55. The council has the authority to lend to other local authorities at market rates. Whilst investments with other local authorities are considered to be supported by central government, officers will consider the financial viability and sustainability of the individual local authority before any funds are advanced.

56. Further investment in property funds will be looked at in more detail for consideration. In 2013/14 the council invested £5 million in the Churches Charities and Local Authorities pooled property investment fund (CCLA).

57. Money market funds are mainly used for liquidity; they also provide security and spread portfolio risk. Officers will always monitor the council's exposure to these funds in order to manage our security risk.

58. Currently the council does not make use of an external fund manager. Whilst there are presently no plans for this situation to change, this will continue to be kept under review.

59. Bond funds can be used to diversify the portfolio, whilst maintaining an element of liquidity and security. These will be considered and reviewed as an investment possibility to spread portfolio risk.

60. One option to offer diversification in the council's investment portfolio would be to make use of Ultra Short Dated / Short Dated Bond Funds (USDBF / SDBFs). Possible use of such funds would be intended for longer term investments than with traditional money market funds (i.e. for possible investment durations of three – six months).

61. Unlike money market funds USDBF/SDBF have a variable net asset value (VNAV). This means the assets are 'marked to market' (re-valued to current market value) on a daily basis and the fund unit price adjusted accordingly. Under this calculation basis the unit price fluctuates and could, therefore, be higher or lower than the original investment when it is redeemed. Any use of the above funds would be restricted to the high-quality counterparty credit criteria as set out in Table 5 below.

62. The council does not currently make use of certificates of deposit. Consideration will be given to their use to assist diversification of the investment portfolio. Certificates of deposit have the same level of ranking and security as ordinary fixed term deposits but have the option of being traded before maturity. Certificates of deposit are bought and sold on the stock market and their price can go up or down prior to their redemption date. If held to maturity the investment will return their issue value. The council would only normally look to enter such investments on a held to maturity basis.

Counterparty selection

63. Treasury management risk is the risk of loss of capital to the council. To minimise this risk, the council uses credit rating information when considering who to lend to. Link Asset Services provide the council with credit rating updates from all three ratings agencies – Standard & Poors, Fitch and Moodys.

64. The council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies in evaluating investment opportunity. This is because adopting this approach could leave the council with too few counterparties for the strategy to be workable. Instead, counterparty investment limits will be set by reference to all of the assigned ratings.

65. Where counterparties fail to meet the minimum required criteria (Table 5 below) they will be omitted from the counterparty list. Any rating changes and rating watches (notification of a rating change under consideration) are provided to officers almost immediately after they occur, and this information is considered before any deal is entered into. Extreme market movements may result in a downgrade of an institution or removal from the council's lending list.

66. Additional requirements under the CIPFA Treasury Management Code require the council to supplement the credit rating data with operational market information such as credit default swaps (CDS), negative watches and outlooks, which are considered when assessing the security of counterparties. This additional information is used so that the council does not rely solely on the current credit ratings of counterparties.

67. Where it is felt the council would benefit from utilising government guarantees provided by countries with an AAA rating, the council may lend to institutions covered by such guarantees. Any decision to lend in this way will be subject to consultation with the agreement of the cabinet member responsible for finance.

Country and sector considerations

68. The council has determined that it will only use approved counterparties outside the UK from countries with a minimum sovereign credit rating of AAA from Fitch Ratings.

Counterparty limits

69. In the normal course of the council's cash flow operations it is expected that both specified and non-specified investments will be used for the control of liquidity as both categories allow for short term investments. The use of longer term instruments (greater than one year from inception to repayment) will fall in the non-specified

investment category. These instruments will be used where the council's liquidity requirements are safeguarded. The council will lend to institutions that meet the following criteria:

Table 6: Counterparty Limits

Counterparty	Minimum Fitch Long term Rating (or equivalent)	Counterparty Limit £m	Max. maturity period	Maximum % of total investments
Institutions with a minimum rating:	F1+ / AA-	£15.0m	4 years	25%
Institutions with a minimum rating:	F1+ / A+	£15.0m	3 years	25%
Institutions with a minimum rating:	F1 / A	£15.0m	2 years	30%
Institutions with a minimum rating:	F1 / A-	£15.0m	1 year	50%
Banks - part nationalised UK	UK sovereign	£20.0m	4 years	100%
Building societies - assets > £5bn	n/a	£10.0m	12 months	70%
Building societies - assets > £3bn	n/a	£8.0m	12 months	60%
Building societies - assets > £1bn	n/a	£6.0 m	12 months	50%
Building Societies	BBB+	£15.0m	12 Months	50%
Local authorities, parish councils	n/a	£20.0m	25 years	50%
Money Market funds	AAA	£20.0m	liquid	100%
Pooled bond fund	F1+/A+	£5.0m	Variable	10%
Pooled property fund	n/a	£10.0m	Variable	15%
CCLA Diversified Income Fund	n/a	£10.0m	Variable	15%
Multi - Asset Funds	n/a	£10.0m	Variable	15%
Ultra-Dated/Short dated bonds	n/a	£10.0m	Variable	15%
Property related Investments	n/a	£30.0m	Variable	80%
Corporate Bonds	F1+/A+	£5.0m	Variable	10%
Non-UCITS Retail Scheme (NURS)	n/a	£5.0m	Variable	50%
Managed Bond Funds	F1/A-	£15.0m	Variable	15%
Share capital / Equities (UK)	n/a	£10.0m	Variable	20%
Supranational	AAA	£10.0m	Variable	20%
UK Government - gilts	UK sovereign	£15.0m	15 years	10%
UK Government - DMADF	UK sovereign	No limit	n/a	100%
UK Government - Treasury Bills	UK sovereign	£15.0m	15 years	10%

70. The criteria for choosing counterparties provides a sound approach to investment. Whilst councillors are asked to approve the criteria in table 5, under exceptional market conditions the interim head of finance may temporarily restrict further investment activity to those counterparties considered of higher credit quality than the minimum criteria set out for approval.

Fund managers

71. The council does not currently employ any external fund managers. However, in the event of such an appointment, appointees will comply with this and subsequent treasury strategies. This strategy empowers the Section 151 officer to appoint such an external manager to manage a proportion of the council's investment portfolio if

this is advantageous. Situations in which this might be advantageous include benchmarking the performance of the treasury team; benefiting from the often-extensive credit risk and economic modelling resources of external fund managers and resources necessary to hold liquid instruments for trading.

Risk and performance benchmarks

72. A requirement of the Code is that security and liquidity benchmarks are considered and approved. This is in addition to yield benchmarks which are used to assess performance. The benchmarks are guidelines (not limits) so may be breached depending on the movement in interest rates and counterparty criteria. Their purpose is to allow officers to monitor the current trend position and amend the operational strategy depending on any changes. Any breach of the benchmarks will be reported, with an explanation in the mid-year or annual report to audit and corporate governance committee. Detailed information for the assessment of risk is shown in appendix C.

73. Performance indicators are set to assess the adequacy of the treasury function over the year. These are distinct historic performance indicators, as opposed to the predominantly forward looking prudential indicators. The indicators used to assess the performance of the treasury function are:

- Cash investments - 3-month LIBID rate.
- Property related investments – IPD Balance Property Unit Trust Index.
- Equities – FTSE all shares index

74. The results of these indicators will be reported in both the annual mid-year and year end treasury reports.

Policy on the use of treasury management advisors

75. The council has a joint contract for treasury management advisors with Vale of White Horse District Council. Link Asset Services (was Capita Asset Services) provides a range of services which include:

- technical support on treasury matters, capital finance issues, statutory reports;
- economic forecasts and interest rate analysis;
- credit ratings / market information service involving the three-main credit rating agencies;
- strategic advice including a review of the investment and borrowing strategies and policy documents.

76. The council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills, resources and up to date market information.

Treasury management scheme of delegation and the role of the Section 151 officer

77. **Council**
    - receiving and reviewing reports on treasury management policies, practices and activities;
    - approval of annual strategy.

78. **Joint Audit and Governance Committee/ Cabinet**
    - approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
    - receiving and reviewing regular monitoring reports and acting on recommendations;
    - Ensuring effective scrutiny of the treasury management function

79. **Section 151 Officer/ Interim Head of Finance**
    - recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
    - submitting regular treasury management policy reports;
    - submitting budgets and budget variations;
    - reviewing the performance of the treasury management function;
    - ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
    - ensuring the adequacy of internal audit, and liaising with external audit;
    - Approving the selection of external service providers and agreeing terms of appointment.

80. The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management), this is detailed in appendix F.

Summary

81. Prior to the beginning of each financial year the council must approve the treasury management strategy. The strategy sets the parameters within which officers can manage the council's cash flows and invest any surplus funds.

82. This strategy provides a commentary on the current financial climate and sets out the council's lending strategy in response to this.

Appendix B

ECONOMIC BACKGROUND

UK. 2019 has been a year of upheaval on the political front as Theresa May resigned as Prime Minister to be replaced by Boris Johnson on a platform of the UK leaving the EU on 31 October, with or without a deal. However, MPs blocked leaving on that date and the EU has agreed an extension to 31 January 2020. In addition, a general election has been called for December. At the time of writing (30 October), the whole Brexit situation could still change at any time. Given these circumstances and the uncertainty about the result of the general election, any interest rate forecasts are subject to material change as the situation evolves. If Parliament fully approves the Withdrawal Bill, then it is possible that growth could recover relatively quickly. The MPC could then need to address the issue of whether to raise Bank Rate at some point in the coming year when there is little slack left in the labour market that could cause wage inflation to accelerate; this would then feed through into general inflation. On the other hand, if there was a no deal Brexit and there was a significant level of disruption to the economy, then growth could weaken even further than currently: the MPC would then be likely to cut Bank Rate in order to support growth. However, with Bank Rate still only at 0.75%, the MPC has relatively little room to make a big impact and it would probably suggest that it would be up to the Chancellor to provide help to support growth by way of a fiscal boost by e.g. tax cuts, increases in the annual expenditure budgets of government departments and services and expenditure on infrastructure projects, to boost the economy. The Government has already made moves in this direction.

The first half of 2019 saw UK **economic growth** falling to -0.2% in quarter 2 as Brexit uncertainty took a toll. In its Inflation Report of 1 August, the Bank of England was notably downbeat about the outlook for both the UK and major world economies. The **MPC** meeting of 19 September reemphasised their concern about the downturn in world growth and also expressed concern that prolonged Brexit uncertainty would contribute to a build-up of spare capacity in the UK economy, especially in the context of a downturn in world growth. This mirrored investor concerns around the world which are now expecting a significant downturn or possibly even a recession in some major developed economies. It was therefore no surprise that the Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% throughout 2019, so far, and is expected to hold off on changes until there is some clarity on what is going to happen over Brexit. However, it is also worth noting that since Boris Johnson became Prime Minister, the government has made significant statements on various spending commitments and a relaxation in the austerity programme. This will provide some support to the economy and, conversely, take some pressure off the MPC to cut Bank Rate to support growth.

As for **inflation** itself, CPI has been hovering around the Bank of England's target of 2% during 2019, but fell to 1.7% in August and September. It is likely to remain close to 2% over the next two years and so it does not pose any immediate concern to the MPC at the current time. However, if there was a no deal Brexit, inflation could rise towards 4%, primarily because of imported inflation on the back of a weakening pound.

With regard to the **labour market,** despite the contraction in quarterly GDP growth of -0.2% q/q, (+1.3% y/y), in quarter 2, employment continued to rise, but at only a muted rate of 31,000 in the three months to July after having risen by no less than 115,000 in quarter 2 itself. However, in the three months to August, employment swung into negative with a fall of 56,000, the first fall for two years. Unemployment duly rose from a 44 year low of 3.8% on the Independent Labour Organisation measure in July to 3.9%. Wage inflation also edged down slightly from a high point of 3.9% to 3.8% in August, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates higher than CPI inflation), earnings grew by about 2.1%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The quarter 2 GDP statistics also included a revision of the savings ratio from 4.1% to 6.4% which provides reassurance that consumers' balance sheets are not over stretched and so will be able to support growth going forward. This would then mean that the MPC will need to consider carefully at what point to take action to raise

Bank Rate if there is an agreed Brexit deal, as the recent pick-up in wage costs is consistent with a rise in core services inflation to more than 4% in 2020.

In the **political arena**, if there is a general election soon, this could result in a potential loosening of monetary policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up although, conversely, a weak international backdrop could provide further support for low yielding government bonds and gilts.

USA. President Trump's massive easing of fiscal policy in 2018 fuelled a temporary boost in consumption in that year which generated an upturn in the rate of growth to a robust 2.9% y/y. **Growth** in 2019 has been falling back after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2. Quarter 3 is expected to fall further. The strong growth in employment numbers during 2018 reversed into a falling trend during 2019, indicating that the economy is cooling, while inflationary pressures are also weakening.

The Fed finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August, (reducing its holdings of treasuries etc). It then cut rates again in September to 1.75% - 2.00% and is thought likely to cut another 25 bps in December. At its September meeting it also said it was going to **start buying Treasuries again**, although this was not to be seen as a resumption of quantitative easing but rather an exercise to relieve liquidity pressures in the repo market. Despite those protestations, this still means that the Fed is again expanding its balance sheet holdings of government debt. In the first month, it will buy $60bn , whereas it had been reducing its balance sheet by $50bn per month during 2019. As it will be buying only short-term (under 12 months) Treasury bills, it is technically correct that this is not quantitative easing (which is purchase of long term debt).

Investor confidence has been badly rattled by the progressive ramping up of increases in tariffs President Trump has made on Chinese imports and China has responded with increases in tariffs on American imports. This **trade war** is seen as depressing US, Chinese and world growth. In the EU, it is also particularly impacting Germany as exports of goods and services are equivalent to 46% of total GDP. It will also impact developing countries dependent on exporting commodities to China.

EUROZONE. Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Growth was +0.4% q/q (+1.2% y/y) in quarter 1 and then fell to +0.2% q/q (+1.0% y/y) in quarter 2; there appears to be little upside potential to the growth rate in the rest of 2019. German GDP fell by -0.1% in quarter 2; industrial production was down 4% y/y in June with car production down 10% y/y. Germany would be particularly vulnerable to a no deal Brexit depressing exports further and if President Trump imposes tariffs on EU produced cars.

The European Central Bank (ECB) ended its programme of quantitative easing purchases of debt in December 2018, which then meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets by quantitative easing purchases of debt. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, (but it aims to keep it near to 2%), has prompted the ECB to take new measures to stimulate growth. At its March meeting it said that it expected to leave interest rates at their present levels "at least through the end of 2019", but that was of little help to boosting growth in the near term. Consequently, it announced a **third round of TLTROs**; this provides banks with cheap borrowing every three months from September 2019 until March 2021 which means that, although they will have only a two-year maturity, the Bank was making funds available until 2023, two years later than under its previous policy. As with the last round, the new TLTROs will include an incentive to encourage bank lending, and they will be capped at 30% of a bank's eligible loans. However, since then, the downturn in EZ and world growth has gathered momentum; at its meeting on 12 September, it cut its deposit rate further into negative territory, from -0.4% to -0.5%, and announced a **resumption of quantitative easing purchases of debt;** (at its October meeting it said this would start in November at €20bn per month - a relatively small amount compared to the previous buying programme). It also increased the maturity of the third round of TLTROs from two to three years. However, it is doubtful whether this loosening of monetary policy will have much impact on growth and, unsurprisingly, the ECB stated that governments will need to help stimulate growth by 'growth friendly' fiscal policy.

On the political front, Austria, Spain and Italy have been in the throes of **forming coalition governments** with some unlikely combinations of parties i.e. this raises questions around their likely endurance. The latest results of two German state elections will put further pressure on the frail German CDU/SDP coalition government.

CHINA. Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and shadow banking systems. In addition, there still needs to be a greater switch from investment in industrial capacity, property construction and infrastructure to consumer goods production.

JAPAN - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

WORLD GROWTH. Until recent years, world growth has been boosted by increasing globalisation i.e. countries specialising in producing goods and commodities in which they have an economic advantage and which they then trade with the rest of the world. This has boosted worldwide productivity and growth, and, by lowering costs, has also depressed inflation. However, the rise of China as an economic superpower over the last thirty years, which now accounts for nearly 20% of total world GDP, has unbalanced the world economy. The Chinese government has targeted achieving major world positions in specific key sectors and products, especially high tech areas and production of rare earth minerals used in high tech products. It is achieving this by massive financial support (i.e. subsidies) to state owned firms, government directions to other firms, technology theft, restrictions on market access by foreign firms and informal targets for the domestic market share of Chinese producers in the selected sectors. This is regarded as being unfair competition that is putting western firms at an unfair disadvantage or even putting some out of business. It is also regarded with suspicion on the political front as China is an authoritarian country that is not averse to using economic and military power for political advantage. The current trade war between the US and China therefore needs to be seen against that backdrop. It is, therefore, likely that we are heading into a period where there will be a **reversal of world globalisation and a decoupling of western countries** from dependence on China to supply products. This is likely to produce a backdrop in the coming years of weak global growth and so weak inflation. Central banks are, therefore, likely to come under more pressure to support growth by looser monetary policy measures and this will militate against central banks increasing interest rates.

The trade war between the US and China is a major concern to **financial markets** due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming up in the US, though this is probably overblown. These concerns resulted in **government bond yields** in the developed world falling significantly during 2019. If there were a major worldwide downturn in growth, central banks in most of the major economies will have limited ammunition available, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks. The latest PMI survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.3 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in subsequent years which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

- In the event of an **orderly non-agreement exit**, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall.
- If there was a **disorderly Brexit**, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. Quantitative easing could also be restarted by the Bank of England. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

However, there would appear to be a majority consensus in the Commons against any form of non-agreement exit so the chance of this occurring has diminished.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably to the downside due to the weight of all the uncertainties over Brexit, as well as a softening global economic picture.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates are broadly similarly to the downside.
- In the event that a Brexit deal was agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increases in Bank Rate is likely to change to the upside.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis.** In 2018, Italy was a major concern due to having a populist coalition government which made a lot of anti-austerity and anti-EU noise. However, in September 2019 there was a major change in the coalition governing Italy which has brought to power a much more EU friendly government; this has eased the pressure on Italian bonds. Only time will tell whether this new coalition based on an unlikely alliance of two very different parties will endure.
- Weak capitalisation of some **European banks**, particularly Italian banks.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the

fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. The SPD has done particularly badly in state elections since then which has raised a major question mark over continuing to support the CDU. Angela Merkel has stepped down from being the CDU party leader but she intends to remain as Chancellor until 2021.

- **Other minority EU governments.** Austria, Sweden, Spain, Portugal, Netherlands and Belgium also have vulnerable minority governments dependent on coalitions which could prove fragile.
- **Austria, the Czech Republic, Poland and Hungary** now form a strongly anti-immigration bloc within the EU. There has also been rising anti-immigration sentiment in Germany and France.
- In October 2019, the IMF issued a report on the World Economic Outlook which flagged up a synchronised slowdown in world growth. However, it also flagged up that there was **potential for a rerun of the 2008 financial crisis**, but his time centred on the huge debt binge accumulated by corporations during the decade of low interest rates. This now means that there are corporates who would be unable to cover basic interest costs on **some $19trn of corporate debt in major western economies,** if world growth was to dip further than just a minor cooling. This debt is mainly held by the shadow banking sector i.e. pension funds, insurers, hedge funds, asset managers etc., who, when there is $15trn of corporate and government debt now yielding negative interest rates, have been searching for higher returns in riskier assets. Much of this debt is only marginally above investment grade so any rating downgrade could force some holders into a fire sale, which would then depress prices further and so set off a spiral down. The IMF's answer is to suggest imposing higher capital charges on lending to corporates and for central banks to regulate the investment operations of the shadow banking sector. In October 2019, the deputy Governor of the Bank of England also flagged up the dangers of banks and the shadow banking sector lending to corporates, especially highly leveraged corporates, which had risen back up to near pre-2008 levels.
- **Geopolitical risks,** for example in North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- **Brexit** – if agreement was reached all round that removed all threats of economic and political disruption between the EU and the UK.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- **UK inflation,** whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Appendix C

Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service.

1. These benchmarks are targets and so may be exceeded from time to time. Any variation will be reported, along with supporting reasons, in the Annual Treasury Report.

2. **Yield**. The local benchmark currently used to assess the performance of cash investments is the level of returns contrasted against the London Interbank Bid (LIBID) three month rate. This is the interest rate a bank would be willing to pay to borrow from another bank for three months.
Property related investments are benchmarked against the IPD Balanced Property Unit Trust Index.

3. **Liquidity**. Liquidity is defined as the council "having adequate, though not excessive, cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice).

4. In respect of this area, the council shall seek to:

- maintain a minimal balance held in the council's main bank account at the close of each working day. Transfers to the councils call accounts, MMF and investments will be arranged in order to achieve this, while maintaining access to adequate working capital at short notice.
- use the authorised bank overdraft facility or short term borrowing where there is clear business case for doing so, to cover working capital requirements at short notice

5. **Security of the investments**.

In the context of benchmarking, assessing security is very much more a subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poor's). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch long term rating category over the last 20-30 years.

Average defaults for differing periods of investment

Long term rating	1 year	2 years	3 years	4 years	5 years
AA	0.04%	0.10%	0.18%	0.27%	0.36%
A	0.05%	0.15%	0.28%	0.42%	0.59%
BBB	0.16%	0.44%	0.77%	1.15%	1.55%

6. The council's minimum long term (i.e. plus 365 day duration) rating criteria is currently "A-". For comparison, the average expectation of default for a two year investment in a counterparty with an "A" long term rating would be 0.15 per cent of the total investment (e.g. for a £1m investment the average loss would be £1,500). **This is an average** - any specific counterparty loss is likely to be higher. These figures act as a proxy benchmark for risk across the portfolio.

Appendix D

Explanation of Prudential and Treasury Indicators

Prudential borrowing permits local government organisations to borrow to fund capital spending plans provided they could demonstrate their affordability. Prudential indicators are the means to demonstrate affordability.

Authorised limit for external debt – this is the maximum limit for external borrowing. This is the statutory limit determined under section 3(1) of the Local Government Act 2003. This limit is set to allow sufficient headroom for day to day operational management of cash flows.

Operational boundary for external debt – this is set as the more likely amount that may be required for day to day cash flow.

Upper limit for fixed and variable interest rate exposure – these limits allow the council flexibility in its investment and borrowing options.

Upper limit for total principal sums invested for over 365 days – the amount it is considered can be prudently invested for periods in excess of a year

Appendix E

Treasury Management Practice (TMP) 1 – credit and counterparty risk management

The CLG issued Investment Guidance in 2010, and this forms the structure of the council's policy below.

The key aim of the guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective, the guidance requires this council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. In accordance with the code, the interim head of finance has produced its treasury management practices (TMPs). This part, TMP1(1), covering investment counterparty policy requires approval each year

The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- the strategy guidelines for decision making on investments, particularly non-specified investments.
- the principles to be used to determine the maximum periods for which funds can be committed.
- specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

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

- UK government Debt Management Agency Deposit Facility (DMADF)
- UK government – treasury stock (Gilts) with less than one year to maturity
- Supranational bonds of less than one year's duration
- Deposits with UK local authorities
- Pooled investment vehicles such as Money Market Funds (MMF) (AAA rated)
- Deposits with banks and building societies (minimum F1/A-)

- Certificates of deposits issued by banks and building societies (minimum rating as above) covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's and / or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the council has set additional criteria to set the time and amount of monies which will be invested in these bodies. These criteria are as stated in table 5 to this report.

Non-specified investments
These are any other type of investment (i.e. not defined or specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are as set out in Table 5.

Implementation in 2018/19
In December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances.

The 2017 CIPFA Code of Practice on Treasury Management abolished the treasury indicators on limits for fixed and variable rate exposure. However, this was on the basis that authorities would explain in words how they control interest rate risk.

IFRS 9
Risk management will need to take account of the 2018/19 Accounting Code of Practice proposals for the valuation of investments. Key considerations are:

- Expected credit loss model. Whilst this should not be material for ordinary treasury investments such as bank deposits, this is likely to be challenging for some funds e.g. property funds, (and also for non-treasury management investments dealt with in the capital strategy e.g. longer dated service investments, loans to third parties or loans to subsidiaries).
- The valuation of investments previously valued under the available for sale category e.g. equity related to the "commercialism" agenda, property funds, equity funds and similar, will be changed to Fair Value through the Profit and Loss (FVPL).

Following the consultation undertaken by the Ministry of Housing, Communities and Local Government, [MHCLG], on IFRS9 the Government has introduced a mandatory statutory override for local authorities to reverse out all unrealised fair value movements resulting from pooled investment funds. This will be effective from 1 April 2018. The statutory override applies for five years from this date. Local authorities are required to disclose the net impact of the unrealised fair value movements in a separate unusable reserve throughout the duration of the override in order for the Government to keep the override under review and to maintain a form of transparency.

Appendix F

Extension to the specific responsibilities of the S151 officer as per the Treasury Management code

The below list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management);

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long-term timeframe.
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following
    - *Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;*

    - *Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;*

    - *Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;*

    - *Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;*

- *Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.*

Appendix G

GLOSSARY OF TERMS

Authorised Limit	The maximum amount of external debt at any one time in the financial year.
Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Base Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre-agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore, the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.

ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2 per cent. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Enhanced Cash Funds	A pooled investment fund. Longer dated investment than a MMF and, unlike a MMF, enhanced cash funds have variable asset value. Assets are marked to market on a daily basis and the unit prices vary accordingly. Investments can be withdrawn on a notice basis (the length of which depends on the fund) although such funds would typically be used for investments of 3 to 6 month duration.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.
Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Mark to Market Accounting	Accounting on the basis of the “fair value” of an asset or liability, based on the current market price. As a result, values will change with market conditions.
Minimum Revenue Provision	This is a prudent sum set aside each year to offset the principal repayment of any loan to smooth the impact on the local taxpayer.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust, however a MMF relies on loans to companies rather than share holdings.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1 per cent of a central target of 2.5 per cent in two years’ time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Non-UCITS Retail Scheme (NURS) –	Undertakings for collective investments are funds authorised to be sold in the UK that are required to meet standards set by the UK services regulator. An example is property funds.
Operational Boundary	The most likely, prudent but not worst case scenario of external debt at any one time.
Other Bonds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.

Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states but excluding UK government bonds.
Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield (“spread”) given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.