Report to Cabinet

Treasury Management Strategy Statement 2020/21

Including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

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Reason for Decision

To present to Cabinet, the strategy for 2020/21 Treasury Management activities including the Minimum Revenue Provision Policy Statement, the Annual Investment Strategy and Prudential Indicators together with linkages to the Capital Strategy.

Executive Summary

The report outlines the Treasury Management Strategy for 2020/21 including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators together with linkages to the Capital Strategy.

The Council is required through regulations supporting the Local Government Act 2003 to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. It is also required to produce an annual Treasury Strategy for borrowing and to prepare an Annual Investment Strategy setting out the Council's policies for managing its investments and for giving priority to security and liquidity of those investments.

The Chartered Institute of Public Finance and Accountancy (CIPFA) Code of Practice on Treasury Management 2017 (the Code) also requires the receipt by full Council of a Treasury Management Strategy Statement.

The Strategy for 2020/21 covers two main areas.

Capital Issues

- The Capital expenditure plans and the associated Prudential Indicators
- The Minimum Revenue Provision (MRP) Policy Statement

Treasury Management Issues:

- The Current Treasury Position
- Treasury Indicators which limit the treasury risk and activities of the Council
- Prospects for Interest Rates
- The Borrowing Strategy
- The Policy on Borrowing in Advance of Need
- Debt Rescheduling
- The Investment Strategy
- The Creditworthiness Policy
- The Policy regarding the use of external service providers.

The report therefore outlines the implications and key factors in relation to each of the above Capital and Treasury Management issues and makes recommendations with regard to the Treasury Management Strategy for 2020/21.

The Audit Committee, the body charged with the detailed scrutiny of Treasury Management activities considered the proposed Treasury Management Strategy report at its meeting on 20 January 2020. It was also presented to the Overview and Scrutiny Performance and Value for Money Select Committee on 23 January 2020. Both the Audit Committee and the Overview and Scrutiny Performance and Value for Money Select Committee were content to commend the report to Cabinet.

As the advice relating to Treasury Management is subject to change especially in relation to the UK having left the EU on 31 January 2020, the report maybe subject to amendments throughout the remainder of the budget process. .

Recommendation

That Cabinet approves and commends to Council the:

1 Capital Expenditure Estimates as per paragraph 2.1.2;
2 MRP policy and method of calculation as per Appendix 1;
3 Capital Financing Requirement (CFR) Projections as per paragraph 2.2.4;
4 Projected treasury position as at 31 March 2020 as per paragraph 2.3.3;
5 Treasury Limit's as per section 2.4;
6 Borrowing Strategy for 2020/21 as per section 2.6;
7 Annual Investment Strategy as per section 2.10 including risk management and the creditworthiness policy at section 2.11; and
8 Level of investment in specified and non-specified investments detailed at Appendix 5.

Treasury Management Strategy Statement 2020/21 Including the Minimum Revenue Provision Policy Statement, Annual Investment Strategy and Prudential Indicators

1 Background

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

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

1.3 The contribution the Treasury Management function makes to the Authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

1.4 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.

1.5 Treasury management is defined 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. "

Source: The Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Service's Code of Practice.

1.6 Reporting Requirements – Capital Strategy

1.6.1 The CIPFA Prudential and Treasury Management Codes (2017) require, all Local Authorities to prepare a capital strategy report, which will provide the following:

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

1.6.2 The Councils capital strategy (elsewhere on the agenda) is therefore prepared following the required Codes of Practice to ensure that all Council Members are presented with the overall long-term capital investment policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.6.3 The Council's capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security of capital, liquidity and yield principles, and the policy around commercial investments, usually driven by expenditure on an asset. Specifically in relation to non-treasury investments, the capital strategy includes, where appropriate:

- The corporate governance arrangements for these type of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution to support the Councils budget;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

1.6.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

1.6.5 The Council will also follow the most recent guidance issued by CIPFA entitled Prudential Property Investment. However, should the Council borrow to fund any non-treasury investment, there will be an explanation if borrowing was required and if the Ministry of Housing Communities and Local Government (MHCLG) Investment Guidance and CIPFA Prudential Code have not been adhered to (note, to date there has been no such borrowing).

1.6.6 If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy (again, to date there have been no such losses).

1.6.7 To demonstrate the proportionality between the treasury operations and the non-treasury operation, high-level comparators are shown throughout this report.

1.7 <u>Treasury Management Reporting</u>

1.7.1 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 which is a forward look to the year ahead 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 to be organised), 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 capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. An annual treasury report

This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.7.2 The above reports are required to be adequately scrutinised before being recommended to the Council. The Overview and Scrutiny Performance and Value for Money (PVFM) Select Committee scrutinised the Treasury Management Strategy Statement for 2020/21 on 23 January 2020 alongside all the other reports which are presented to the annual Budget Council meeting. The Audit Committee, the body charged with the detailed scrutiny of Treasury Management activities also considered the Strategy report on 20 January 2020. The Audit Committee also considers the mid-year and annual review reports prior to presentation to Cabinet and Council.

1.8 Treasury Management Strategy for 2020/21

1.8.1 The strategy for 2020/21 covers two main areas:

1.8.2 Capital issues:

- The capital expenditure plans and the associated prudential indicators;
- The minimum revenue provision (MRP) policy.

1.8.3 Treasury management issues:

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the council;
- Prospects for interest rates;
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- The policy on use of external service providers.

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

1.9 Training

1.9.1 The CIPFA Code requires the responsible officer (in Oldham the Director 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. Training was provided to Audit Committee Members on 1 October 2019. The Audit Committee receive regular updates regarding any issues that affect Treasury Management. Further training will be arranged as required. Training was also provided for Cabinet Members and Senior Officers in October 2018.

1.9.2 The training needs of treasury management officers are periodically reviewed. The team is staffed by professionally qualified accountants with extensive Local Government finance experience. Team members attend all relevant training courses, workshops and events to ensure that their knowledge and skills are up to date and the Council is in a position to address all new technical developments. They all follow a Continuous Professional Development (CPD) Plan as part of their individual accounting body accreditation. The overall responsibility for capital and treasury activities lies with the Council's Section 151 Officer (Director of Finance) who, in accordance with statute, is professionally qualified and is suitably experienced to hold the post.

1.10 Treasury Management Consultants

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

1.10.2 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 advisers.

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

1.10.4 Commercial type investments will require specialist advice that Link Asset Services may not provide. Prior to any commercial investments being made, appropriate external advice will be sought and a due diligence exercise will be undertaken.

2 Capital Plans & Prudential Indicators 2020/21 – 2022/23

2.1 Capital Plans

2.1.1 The Council's capital expenditure plans are the key driver of Treasury Management activity. The output of the capital expenditure plans is reflected in Prudential Indicators, which are designed to assist Members' overview and confirm capital expenditure plans. These indicators as per the Capital Programme include previous years' actual expenditure, forecast expenditure for this current year 2019/20 and estimates for the next three year period, the timeframe required by CIPFA's guidance.

Capital Expenditure Estimates

2.1.2 This first Prudential Indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Cabinet is asked to approve the capital expenditure forecasts included the table below presented to reflect previous years and current Portfolio management arrangements. It is important to note that the level of planned capital expenditure has increased significantly following the approval of two reports by Cabinet, firstly on 16 December 2019 and then on 27 January 2020 which set out the Creating a Better Place strategy. The capital spending plans included in the Capital Strategy and Programme translate the ambition and vision for Oldham that were set out in both Cabinet reports.

Table 1 - Capital Expenditure Estimates

Capital Expenditure / Portfolio	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Corporate Services *	14,525	1,128	6,010		
Children's Services		18,781	15,590	12,305	5,000
Health & Adult Social Care Community Services	2,058	0	0	0	0
Community Services & Adult Social Care	0	2,029	3,400	703	400
People & Place **	28,066	29,910	107,835	104,062	86,710
Reform	169	39	346	400	0
Funds for Emerging Priorities	1,500	1,098	3,440	3,575	4,200
General Fund Services	**46,318**	**52,985**	**136,621**	**121,045**	**96,310**
Housing Revenue Account (HRA)	2,246	1,854	5,538	3,922	6,200
HRA	**2,246**	**1,854**	**5,538**	**3,922**	**6,200**
Commercial Activities / Non-Financial Investments ***	0	9,106	5,000	6,500	0
Commercial Activities / Non-Financial Investments	**0**	**9,106**	**5,000**	**6,500**	**0**
Total	**48,564**	**63,945**	**147,159**	**131,467**	**102,510**

* Excludes commercial activities which are included in the Corporate Services capital programme within the Capital Strategy report.
** Excludes commercial activities which are included in the People & Place capital programme within the Capital Strategy report.
*** Relate to areas such as capital expenditure on investment properties, loans to third parties, purchase of equity shares etc.

2.1.3 The capital expenditure shown above excludes other long-term liabilities, such as Private Finance Initiative (PFI) and leasing arrangements which already include borrowing instruments. It should be noted that any new expenditure commitments are likely to increase the borrowing requirement.

2.1.4 Table 2 below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding need (borrowing).

2.1.5 The borrowing need for capital expenditure in 2020/21 is currently expected to be £99.070m. This will however change if there is a revision to the spending profile of the capital programme.

2.1.6 During 2019/20, the Council purchased an industrial estate in borough, in accordance with the parameters set out in its Commercial Property Investment Strategy (CPIS) following a substantial due diligence process. The purchase will provide a sustainable income stream to offset the costs of the Council in the provision of services. The commercial activities/non-financial investment in Table 1 above from 2020/21 relates to current estimated spend on commercial activities included in the capital programme.

Table 2 - Funding of the Capital Programme

Capital Expenditure	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
General Fund Services	46,318	52,985	136,621	121,045	96,310
HRA	2,246	1,854	5,538	3,922	6,200
Commercial Activities	0	9,106	5,000	6,500	0
Total	**48,564**	**63,945**	**147,159**	**131,467**	**102,510**
Financed by:					
Capital receipts	(14,919)	(13,143)	(9,306)	(7,855)	(7,352)
Capital grants - Ringfenced	(9,250)	(8,310)	(11,209)	(2,397)	(1,250)
Capital grants – Un-ringfenced	(15,613)	(21,578)	(22,031)	(14,258)	(3,202)
Other Resources	(660)	(87)	(5)	(3,935)	0
Revenue	(7,271)	(6)	0	0	0
HRA Resources	(851)	(1,854)	(5,538)	(3,922)	(6,200)
Net financing need for the year	**0**	**18,967**	**99,070**	**99,100**	**84,506**

2.1.7 All other prudential indicators included within this report are based on the above capital estimates.

2.2 The Council's Borrowing Need - the Capital Financing Requirement (CFR)

2.2.1 The second Prudential Indicator is the Council's CFR. The CFR represents total historic outstanding capital expenditure which has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been financed from cash backed resources, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as the Council makes 'prudent' provision for debt repayment which broadly reduces indebtedness in line with each asset's life and so charges the economic consumption of capital assets as they are used. The approach to making prudent provision is set out in the MRP Policy Statement at Appendix 1.

2.2.3 The MRP policy for 2020/21 has not been amended and incorporates the changes agreed in the 2019/20 Treasury Management Strategy report approved at Council on 27 February 2019.

2.2.4 The CFR includes other long term liabilities (e.g. Private Finance Initiative (PFI) schemes, finance leases etc.). Whilst these arrangements increase the CFR, and therefore the Council's borrowing requirement, such schemes also include a 'loan' facility meaning the Council is not required to make separate borrowing arrangements. The Council currently has a net figure of £224.425m of such schemes within the CFR for 2020/21, decreasing to £204.651m in 2022/23. From 2020/21 and future years an estimated of £1m has been included in the CFR to reflect anticipated costs associated with the implementation of IFRS 16 (see paragraph 2.15.3).

Table 3 Capital Financing Requirement (CFR)

	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Capital Financing Requirement (CFR)					
CFR - Services	493,880	483,011	554,242	621,164	679,832
CFR - Commercial Activities	0	8,000	13,000	19,500	19,500
Total CFR	**493,880**	**491,011**	**567,242**	**640,664**	**699,332**
Movement in CFR	**(11,169)**	**(2,869)**	**76,231**	**73,422**	**58,668**
Movement in CFR represented by					
Net financing need for the year	**0**	**18,967**	**99,070**	**99,100**	**84,506**
PFI Repayments	(8,225)	(10,159)	(10,157)	(9,691)	(8,907)
Less MRP/VRP and other financing movements	(2,944)	(11,677)	(12,682)	(15,987)	(16,931)
Movement in CFR	**(11,169)**	**(2,869)**	**76,231**	**73,422**	**58,668**

2.2.5 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the Authority's overall financial position. The capital expenditure figures shown in Table 1 at section 2.1 and the details above demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Council's remaining activity.

2.3 Borrowing

2.3.1 The capital expenditure plans set out in section 2.1 to a large extent drive the borrowing estimates included in this report. The Treasury Management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant Treasury and Prudential Indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Borrowing Portfolio Position

2.3.2 The overall treasury management portfolio as at 31 March 2019 and for the position as at 3 February 2020 are shown below for both borrowing and investments.

Table 4 Current Treasury Position

Treasury Investments	Actual 31/03/2019 £'000	Actual 31/03/2019 %	Current February 2020 £'000	Current February 2020 %
Banks	13,000	15.31%	57,500	49.39%
Building Societies Rated	0	0.00%	0	0.00%
Local Authorities	30,500	35.92%	24,500	16.75%
Public Bodies	0	0.00%	0	0.00%
Money Market Funds	26,400	31.10%	19,420	20.98%
Total Managed in House	**69,900**	**82.33%**	**101,420**	**87.12%**
Property Funds	15,000	17.67%	15,000	12.88%
Total Managed Externally	**15,000**	**17.67%**	**15,000**	**12.88%**
Total Treasury Investments	**84,900**	**100.00%**	**116,420**	**100.00%**
Treasury External Borrowing				
PWLB	15,482	10.47%	35,482	21.14%
LOBO'S	85,500	57.83%	85,500	50.94%
Market	46,600	31.52%	46,600	27.76%
Temporary other	264	0.18%	264	0.16%
Total Treasury External Borrowing	**147,846**	**100.00%**	**167,846**	**100.00%**
Net Treasury Investments / (Borrowing)	**(62,946)**		**(51,426)**	

2.3.3 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, the Treasury Management operations, against the underlying capital borrowing need, the CFR, highlighting any over or under borrowing. Table 5 shows the forecast position of gross borrowing as at 31 March 2020 at £403.338m and an under borrowed position of £87.673m.

Table 5 Current and Forecast Treasury Portfolio

	2018/19 Actual £'000	Forecast position as at 31/3/20 £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
External Debt					
Debt at 1 April	147,851	147,846	167,843	237,599	317,596
Actual/Expected change in debt	(5)	19,997	69,756	79,997	88,397
Debt at 31 March	147,846	167,843	237,599	317,596	405,993
Opening OLTL* at 1 April	256,115	246,610	235,495	224,425	213,563
Expected change in OLTL	(9,505)	(11,115)	(11,070)	(10,862)	(8,912)
Closing OLTL at 31 March	**246,610**	**235,495**	**224,425**	**213,563**	**204,651**
Actual/ Forecast gross debt (borrowing requirement) at 31 March	**394,456**	**403,338**	**462,024**	**531,159**	**610,644**
The Capital Financing Requirement	**493,880**	**491,011**	**567,242**	**640,664**	**699,332**
Under / (over) borrowing	**99,424**	**87,673**	**105,218**	**109,505**	**88,688**

* Other Long Term Liabilities

2.3.4 Table 5 above shows the Council will need to undertake significant additional borrowing in future years if capital programme expenditure matches the anticipated spending profile. The borrowing requirement is a key driver of the borrowing strategy as set out in section 2.6 below. Due to the overall financial position and the underlying need to borrow for capital purposes (the capital financing requirement – CFR), new external borrowing of £20m was undertaken from the PWLB in August 2019. The borrowing was undertaken at the bottom range of interest rates. The timing of any additional borrowing given the amounts indicated in the table above will be closely monitored. Members will recall that capital spending plans have been reprofiled year on year and it is possible that the trend could be repeated in 2020/21 and future years.

2.3.5 There are a number of key Prudential Indicators to ensure that the Council operates its activities within well-defined limits. The Council must ensure that gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes. It is clear from the table above that the Council's gross borrowing position remains within these limits.

2.3.6 The Council has complied with this Prudential Indicator in the current year and does not envisage any difficulties with compliance in the future. This view takes into account current commitments, existing plans, and the proposals set out in this report.

2.3.7 Included within the forecast position of gross borrowing figures in Table 5 is debt that relates to commercial activities / non-financial investment. Table 6 below shows that external debt for commercial activities/non-financial investment that is included in the gross borrowing figures in Table 5. Under the Prudential Code, there is a requirement to provide the information in Table 6 which shows that to date there has been a minimal impact on debt from potential investments in commercial activities compared to the Council's overall borrowing (excluding long-term liabilities).

Table 6 Commercial Activities Debt

	2018/19 Actual £'000	Forecast position as at 31/3/20 £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
External Debt for commercial activities / non-financial investments	0	7,606	12,606	19,106	19,106
Actual / Forecast Debt at 31 March	147,846	167,843	237,599	317,596	405,993
Percentage of total external debt	**0**	**4.53%**	**5.31%**	**6.02%**	**4.71%**

2.4 Treasury Limits for 2020/21 to 2021/22

2.4.1 The Council is required to determine its operational boundary and authorised limit for external debt for the next three financial years.

Operational Boundary

2.4.2 The forecast Operational Boundary for 2019/20 together with the proposed operational boundaries for 2020/21 to 2022/23 are set out in Table 7 below. The boundary reflects the maximum anticipated level of external debt which is not expected to be exceeded. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on levels of actual debt and the ability to fund under-borrowing by other cash resources. This boundary will be used as a management tool for ongoing monitoring of external debt, and may be breached temporarily due to unusual cash flow movements. However, a sustained or regular trend above the Operational Boundary should trigger a review of both the operational boundary and the authorised limit.

Table 7 Operational Boundary

Operational boundary	2019/20 Forecast £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Borrowing	252,000	337,000	413,000	480,500
Other long term liabilities	235,500	224,500	214,500	205,500
Commercial activities / non-financial investments	8,000	13,000	19,500	19,500
Total	**495,500**	**574,500**	**647,000**	**705,500**

Authorised Limit

2.4.3 A further key Prudential Indicator, the Authorised Limit controls the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit may only be determined by the full Council. It reflects the level of external debt which, while not desirable, is affordable in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Councils' plans, or those of a specific Council, although this power has not yet been exercised.

2.4.4 Cabinet is asked to approve the proposed Operational Boundary for each financial year from 2019/20 to 2022/23 as set out in Table 7 above and Authorised Limit as set out in Table 8 below:

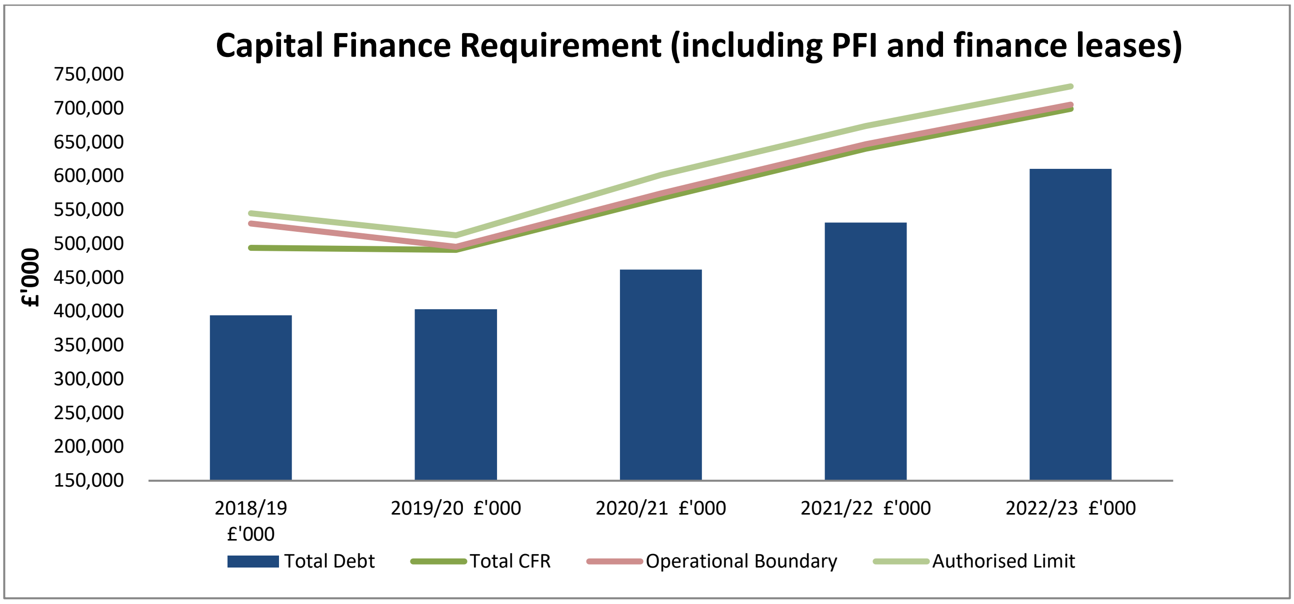
Table 8 Authorised Limit

Authorised Limit	2019/20 Forecast £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Borrowing	262,000	357,000	433,000	500,500
Other long term liabilities	240,500	229,500	219,500	210,500
Commercial activities / non-financial investments	10,000	15,000	21,500	21,500
Total	**512,500**	**601,500**	**674,000**	**732,500**

2.4.5 Table 9 and the graph below show how the two indicators above, the Operational Boundary and the Authorised Limit compare to actual external debt and the CFR.

Table 9 Estimate Capital Financing Requirement, Debt and Treasury Indicators

Capital Financing Requirement (CFR) including PFI and finance leases	Actual 2018/19 £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
General Fund CFR	493,880	483,011	554,242	621,164	679,832
Commercial activity / non-financial investments	0	8,000	13,000	19,500	19,500
Total CFR	**493,880**	**491,011**	**567,242**	**640,664**	**699,332**
External Borrowing	147,846	167,843	237,599	317,596	405,993
Other long term liabilities	246,610	235,495	224,425	213,563	204,651
Total Debt	**394,456**	**403,338**	**462,024**	**531,159**	**610,644**
Operational Boundary	530,000	495,500	574,500	647,000	705,500
Authorised Limit	545,000	512,500	601,500	674,000	732,500



2.5 <u>Prospects for Interest Rate</u>

2.5.1 The Council has appointed Link Asset Services as its Treasury Adviser and part of its service is to assist the Council to formulate a view on interest rates. The table below gives Link Asset Services central view of interest rates from March 2020 to March 2023.

Table 10 Interest Rate Forecast

Timeline	Bank Rate	PWLB Borrowing Rates %			
	%	5 year	10 year	25 year	50 year
March 2020	0.75	2.40	2.70	3.30	3.20
June 2020	0.75	2.40	2.70	3.40	3.30
September 2020	0.75	2.50	2.70	3.40	3.30
December 2020	0.75	2.50	2.80	3.50	3.40
March 2021	1.00	2.60	2.90	3.60	3.50
June 2021	1.00	2.70	3.00	3.70	3.60
September 2021	1.00	2.80	3.10	3.70	3.60
December 2021	1.00	2.90	3.20	3.80	3.70
March 2022	1.00	2.90	3.20	3.90	3.80
June 2022	1.25	3.00	3.30	4.00	3.90
September 2022	1.25	3.10	3.30	4.00	3.90
December 2022	1.25	3.20	3.40	4.10	4.00
March 2023	1.25	3.20	3.50	4.10	4.00

2.5.2 The above forecasts reflect UK's exit from the EU which took place on 31 January 2020. Also reflected is the Governments ambition to secure a trade deal with the EU by 31 December 2020. Given the current level of uncertainties following the result of the Conservative general election victory on 12 December and subsequent developments, the forecasts may need to be materially reassessed in the light of events over the coming weeks or months.

2.5.3 It has been little surprise that the Monetary Policy Committee (MPC) has left Bank Rate unchanged at 0.75% due to the ongoing uncertainty over the impact of Brexit and longer-term implications arising from the outcome of the General Election.

2.5.4 In its meeting on 7 November 2019, the MPC became more dovish due to increased concerns over the outlook for the domestic economy if Brexit uncertainties were to become more entrenched, and for weak global economic growth: if those uncertainties were to materialise, then it is likely the MPC would cut the Bank Rate.

2.5.5 However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent". Brexit uncertainty has had a dampening effect on UK GDP growth in 2019, especially around mid-year. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020 due to continuing uncertainty over whether there could effectively be no workable trade deal with the EU by December 2020. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise Bank Rate.

Bond yields / PWLB rates.

2.5.6 There has been much speculation recently that the world economy is currently in a bond market bubble. However, given the context that there are heightened expectations that the US could be heading for a recession, and a general background of a downturn in world economic growth, together with inflation generally at low levels in most countries and expected to remain subdued, economic conditions support low bond yields.

2.5.7 While inflation targeting by the major central banks has been successful over the last thirty years in lowering inflation expectations, the real equilibrium rate for central interest rates has fallen considerably due to the high level of borrowing by consumers: this means that central banks do not need to raise rates as much now to have a major impact on consumer spending, inflation, etc.

2.5.8 This has pulled down the overall level of interest rates and bond yields in financial markets over the last thirty years. Over the last year, many bond yields up to ten years in the Eurozone actually turned negative. In addition, there has, at times, been an inversion of bond yields in the US whereby ten-year yields have fallen below shorter-term yields. In the past, this has been the precursor of a recession.

2.5.9 The other side of this coin is that bond prices are elevated, as investors would be expected to be moving out of riskier assets i.e. shares, in anticipation of a downturn in corporate earnings and so selling out of equities. However, stock markets are also currently at high levels as some investors have focused on chasing returns in the context of ultra-low interest rates on cash deposits.

2.5.10 During the first half of 2019/20 to 30 September, gilt yields reduced significantly causing a near halving of longer term PWLB rates to completely unprecedented historic low levels. *(See paragraph 2.5.17 for comments on the increase in the PWLB rates margin over gilt yields of 100bps introduced on 9 October 2019)*

2.5.11 There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts. At various times this correlation has been strong but at other times weak. However, forecasting the timing of this and the strengthen of the correlation is likely to be very difficult to forecast with any degree of confidence. Changes in UK Bank Rate will also impact on gilt yields.

2.5.12 One potential risk that may pre-occupy investor's minds is that Japan has become mired in twenty-years of failing to generate economic growth and inflation up off the floor, despite a combination of massive monetary and fiscal stimulus by both the Central Bank and Government. Investors may be concerned that this condition might affect other western economies.

2.5.13 Another risk is that unconventional monetary policy post 2008, (ultra-low interest rates plus quantitative easing), may cause more harm than good through prolonged use.

2.5.14 Low interest rates have encouraged a debt-fuelled boom that now makes it harder for central banks to raise interest rates. Negative interest rates could damage the profitability of commercial banks and so impair their ability to lend and / or incentivise riskier lending.

2.5.15 Banks could also end up holding large amounts of their Government's bonds and so create a potential doom loop. (A doom loop would occur where the credit rating of the debt of a nation was downgraded which would cause bond prices to fall, causing losses on debt portfolios held by banks and insurers, so reducing their capital and forcing them to sell bonds – which, in turn, would cause further falls in their prices etc.). In addition, the financial viability of pension funds could be damaged by low yields on holdings of bonds.

2.5.16 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 developments, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

2.5.17 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 100 basis points (bps) within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9 October 2019.

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

Investment and borrowing rates

2.5.19 Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress is made with an EU trade deal, then there is upside potential for earnings.

2.5.20 Borrowing interest rates were on a major falling trend during the first half of 2019/20 but then increased up by 100 bps following H.M. Treasury decision to increase the margin on PWLB borrowing on 9 October 2019.

2.5.21 While the Council may not be able to avoid borrowing to finance new capital expenditure, and the use of internal cash resources that have supported the under borrowed position, there will be a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new short or medium-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

2.6 Borrowing strategy

2.6.1 The factors that influence the 2020/21 strategy are:

- The movement in CFR as set out in Table 3 above;
- Forthcoming ‘Option’ dates on £39m of Lender Option Borrower Option loans (LOBO’s) in 2020/21;
- The interest rate forecasts (set out in Table 10 above);
- Aiming to minimise revenue costs to reduce the impact on the Council Tax Requirement; and
- The impact of the Council’s Capital and Property Investment Programmes.

2.6.2 The Council is currently maintaining an under-borrowed position. This means that the CFR has not been fully funded with loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

2.6.3 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Treasury Management team will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances so that:

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

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

2.6.4 The forecast gross borrowing requirement in Table 5 at 2.3.4 above shows, based on current estimates, that the Council will need to drawdown a significant amount of new borrowing, to support the capital programme. Any additional borrowing will be completed with regard to the limits, indicators and interest rate forecasts set out above. As noted previously, initial estimates of borrowing have changed in previous years due to the reprofiling of the capital programme once the financial year has begun.

2.6.5 During 2020/21, £39m of LOBO (Lender Option Borrower Option) debt will reach the option renewal date. Table 11 below, sets out the maturity structure of fixed rate debt. At the renewal date the loans will either:

- Move to the option rate of interest, which in all cases will be the same as the current rate or:
- Be offered at a rate above the option rate, in which case the Council has the option to repay. This would then require refinancing at the prevailing market rates.

Table 11 Maturity Structure of Fixed Rate Debt

Maturity Structure of fixed interest rate debt	2020/21 Actual
under 12 months	23.39%
12 months and within 24 months	9.08%
24 months and within 5 years	22.70%
5 years and within 10 years	4.47%
10 years to 20 years	7.59%
20 years to 30 years	2.98%
30 years to 40 years	2.98%
40 years to 50 years	14.89%
50 years to 60 years	11.92%
60 years and above	0.00%

2.6.6 Due to the current interest rate forecast it is not anticipated that any of these LOBO loans will be called.

2.6.7 The 2020/21 capital programme now shows anticipated prudential borrowing of £99.070m with £99.100m in 2021/22, £84.506m in 2022/23. These figures have been reflected in this report and factored into the borrowing strategy for 2020/21 and future years.

2.6.8 Members are advised that indicators for interest rate exposure are no longer a requirement under the Treasury Management Code however as interest rate exposure risk is an important issue. Officers will monitor the balance between fixed and variable interest rates for borrowing and investments. This will aim to ensure the Council is not exposed to adverse fluctuations in fixed or variable rate interest rate movements.

2.6.9 This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investments are expected to rise.

2.6.10 The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions.

2.7 Policy on Borrowing in Advance of Need

2.7.1 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 CFR 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. Any borrowing will follow the most recent guidance issued by CIPFA entitled Prudential Property Investment.

2.7.2 Borrowing in advance will be made within the constraint that the Council would not look to borrow more than 24 months in advance of need.

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

2.8 Debt Rescheduling

2.8.1 Rescheduling of current borrowing in our debt portfolio is unlikely to occur as the 100 bps increase in PWLB rates only applied to new borrowing rates and not to premature debt repayment rates.

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

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

2.8.3 All re-scheduling will be reported to the Audit Committee, Cabinet and Council at the earliest meeting following its action.

2.9 New Financial Institutions as a Source of Borrowing

2.9.1 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 basis points to 180 basis points (net of the 20 basis point reduction for the Certainty Rate) on loans to Local Authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

- Local Authorities (primarily shorter dated maturities);
- Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates);

- UK Municipal Bonds Agency (which has recently negotiated its first bond issue). Members will recall that the Council has invested £0.100m in the UKMBA and would seek to make use of this new source of borrowing as and when appropriate.

2.9.2 The degree which any of these options proves cheaper than the PWLB Certainty Rate is still evolving however, all funding options will be fully evaluated, and the most appropriate option will be taken. Link Asset Services the Council's treasury advisors will keep the Council informed regarding different options available when borrowing is undertaken.

2.10 Annual Investment Strategy

Investment Policy – Management of Risk

2.10.1 The MHCLG and CIPFA have extended the meaning 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 elsewhere on the agenda.

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

2.10.2 The Council's investment priorities will be:
- firstly, the security of capital;
- secondly, the liquidity of its investments;
- thirdly, the optimum return on its investments commensurate with proper levels of security and liquidity;
- finally, ethical investments.

2.10.3 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

- Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

- Other information: ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

- Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

2.10.4 This report defines the list of types of investment instruments that the treasury management team are authorised to use. There are two lists in Appendix 5 under the categories of 'specified' and 'non-specified' investments.

- Specified investments are those with a high level of credit quality and subject to a maturity limit of one year.

- Non-specified investments are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.

2.10.5 For non-specified investments, the Council has determined that it will limit the maximum total exposure to non-specified investments as being 50% of the total investment portfolio.

2.10.6 Lending limits, (amounts and maturity), for each counterparty, will be set through applying the matrix table in paragraph 2.11.3.

2.10.7 Transaction limits are set for each type of investment in 2.11.3.

2.10.8 The Council has set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 2.13.9.)

2.10.9 Investments will only be placed with counterparties from countries with a specified minimum sovereign rating, (see paragraph 2.12.3) and Appendix 6.

2.10.10 The Council has engaged external consultants, (see paragraph 1.10), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the Council in the context of the expected level of cash balances and need for liquidity throughout the year.

2.10.11 All investments will be denominated in sterling.

2.10.12 As a result of the change in accounting standards for 2019/20 under IFRS 9, consideration will be given to the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, MHCLG concluded a consultation for a temporary override to allow English Local Authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from April 2018).

2.10.13 However, the Council will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 2.14). Regular monitoring of investment performance will be carried out during the year.

2.10.14 The risk management criteria are unchanged from last year.

2.11 Creditworthiness policy

2.11.1 Oldham Council utilises the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor. The credit ratings of counterparties are supplemented with the following overlays:

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

2.11.2 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the duration and maximum investment value for each counterparty.

2.11.3 Institutions are split into colour bandings and the Council will therefore use counterparties within these colours, durational bands and investment limits. Table 12 below shows these limits.

Table 12 Investment Criteria

Counter Party	Link Colour Band and Long Term Rating where applicable	Maximum Duration	Maximum Principal Invested per Counterparty
Banks	Yellow (Note 1)	5 Years	£10m
Banks	Dark Pink (Note 2)	5 Years	£10m
Banks	Light Pink (Note 3)	5 Years	£10m
Banks	Purple	2 Years	£20m
Banks	Blue (Note 4)	1 Year	£20m
Banks	Orange (Note 5)	1 Year	£15m
Banks	Red	6 months	£10m
Banks	Green	100 days	£10m
Banks	No Colour	Not to be used	Not to be used
Local Authorities/ Public Bodies	Internal Due Diligence	5 Years	£10m
GMCA	Internal Due Diligence (Note 6)	5 Years	£30m
Debt Management Account Deposit Facility (DMADF)	UK Sovereign rating	6 months	£20m
	Fund Rating	**Maximum Duration**	**Maximum Principal Invested per Counterparty**
Money Market Fund			
Constant	AAA	Liquid	£20m
Low Volatile	AAA	Liquid	£20m
Variable	AAA	Liquid	£20m

Note 1 – UK Government debt or equivalent

Note 2 – Enhanced money market funds (EMMF) with a credit score of 1.25

Note 3 – Enhanced money market funds (EMMF) with a credit score of 1.5

Note 4 – Blue Institutions only applies to nationalised or semi nationalised UK Banks, which currently include the RBS Group (Royal Bank of Scotland, NatWest Bank and Ulster Bank).

Note 5 - Includes the Council's banking provider (currently Barclays), if it currently falls into category below this colour band.

Note 6 – The higher maximum principal is to facilitate joint initiatives and activities related to the devolution agenda.

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

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

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

- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn or notice given to withdraw immediately.

- In addition to the use of credit ratings the Council will be advised of information in movements in the Credit Default Swap Index against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in the downgrading of an institution or its removal from the Council's lending list.

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

<u>UK banks – ring fencing</u>

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

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

2.11.10 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

2.12 Country and Sector Limits

2.12.1 It is not proposed to restrict the Council's investment policy to only UK banks and building societies. In addition to the credit rating criteria set out above consideration will be given to the sovereign rating of the country before any investment is made.

2.12.2 In February 2013 the UK lost its AAA rating and moved to an AA rating. The Council will continue to invest with UK Banks, providing the individual institutions still meet the relevant criteria.

2.12.3 The Council has determined that it will only use approved counterparties from the UK and from other countries with a minimum sovereign credit rating of AAA from Fitch (or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy, therefore for illustrative purposes the appended list is extended to also show AA- i.e. the countries currently assessed to be in the rating below those that currently qualify. It is important to note that although able to, the Council has chosen not to invest overseas in recent years.

2.13 Investment Strategy

2.13.1 Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required to manage the ups and downs of cash flow, any cash identified that could be invested for longer periods will be carefully assessed.

- If it is thought that bank rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that bank rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

2.13.2 The Council currently has investments totalling £25m which span the financial year as shown in Table 13. These investments are current as at February 2020.

Table 13 Investments maturing in 2020/21

Counterparty	Amount	Maturity Date	Rate
Standard Chartered Bank	£5,000,000	03/04/2020	0.88%
Goldman Sachs	£2,000,000	03/04/2020	0.90%
Goldman Sachs	£3,000,000	03/04/2020	0.90%
Thurrock Council	£5,000,000	06/04/2020	0.80%
Ashford Borough Council	£5,000,000	06/04/2020	0.82%
Standard Chartered Bank	£5,000,000	05/05/2020	0.92%
Total	**£25,000,000**		

2.13.3 On the assumption that the UK and EU agree a trade deal by the end of 2020 or soon after, then Bank Rate is forecast to increase slowly over the next few years to reach 1.00% by quarter 1 2023. Bank rates forecasts for financial year ends are:

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.00%

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

- 2019/20 0.75%
- 2020/21 0.75%
- 2021/22 1.00%
- 2022/23 1.25%
- 2023/24 1.50%
- 2024/25 1.75%
- Later years 2.25%

2.13.5 The overall balance of risks to economic growth in the UK are probably to the downside due to the weight of all the uncertainties over the UK's relationship with the EU, as well as a softening global economic picture.

2.13.6 The balance of risks to increases in bank rate and shorter term PWLB rates, are broadly similarly to the downside.

2.13.7 In the event that a UK trade deal is agreed with the EU and approved by Parliament, the balance of risks to economic growth and to increase in Bank Rate is likely to change to the upside.

2.13.8 Funds available for investment are likely to be lower than in recent years due to a budget proposal to pay employer superannuation contributions up-front to the Greater Manchester Pension Fund. This budget proposal is included within the report on the Revenue Budget 2020/21 and the Medium Term Financial Strategy 2020/21 to 2024/25 (elsewhere on the agenda.)

Investment Treasury Indicator and Limit

2.13.9 This indicator considers total principal funds invested for greater than 365 days. These limits have regard to the Council's liquidity requirements and reduce the need for the early redemption of investments, and are based on the availability of funds after each year end.

Table 14 – Maximum principal sum invested greater than 365 days

Upper Limit for principal sums invested for longer than 365 days	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Principal sums invested for longer than 365 days	£50m	£50m	£50m	£50m
Current investments as at January 2020 in excess of 1 year	£15m	£15m	£15m	£15m

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

2.14 Investment Risk Benchmarking

2.14.1 These benchmarks provide simple guides to maximum risk, and may be breached from time to time, depending on movements in interest rates and counterparty criteria. These benchmarks provide officers with a baseline against which current and trend positions can be monitored. It may be necessary to amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report to Members.

Liquidity – in respect of this area the Council seeks to maintain:

- A Bank overdraft facility of £0.100m
- Liquid short term deposits of at least £10m available with a week's notice.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID (London Interbank Bid Rate) rate multiplied by 5%
- Investments – internal returns above the 1 month LIBID rate multiplied by 5%
- Investments – internal returns above the 3 month LIBID rate multiplied by 5%
- Investments – internal returns above the 6 month LIBID rate multiplied by 5%
- Investments – internal returns above the 12 month LIBID rate multiplied by 5%

2.14.2 At the end of the financial year, the Council will report on its investment activity as part of the Annual Treasury Report, which is in accordance with required practice and is presented to Cabinet and then Council for approval.

2.15 Other Treasury Management Issues

Legal Action being taken by the Council

2.15.1 The Council is currently involved in legal action against Barclays Bank with regards to certain Lender Option Borrower Option (LOBO) transactions. This is based on the Bank's involvement in manipulation of the LIBOR benchmark rate and the subsequent impact on the Council's financial position. This matter is on-going.

Brexit

2.15.2 The Council is mindful of the UK's recent exit from the EU and will continue to ensure that treasury activity is managed to minimise any risk to the Council.

International Financial Reporting Standard (IFRS) 16 – Leases

2.15.3 IFRS 16 is a new standard for lease accounting which came into force in January 2019. The changes apply to the accounting arrangements for lease agreements that organisations take out property, plant and equipment (PPE). The standard for the public sector will commence from 1 April 2020. Previously, leases were split into finance leases and operating leases however, from 1 April 2020 they will now be accounted for as finance leases. Under the current regime, operating leases were not included in Balance Sheets as assets and expenditure were charged to Comprehensive Income and Expenditure Statement in the Council's accounts. Under IFRS 16 all leases must now be accounted for on the Balance Sheet. Work is currently ongoing to assess the full impact, but an estimate has been included in the Council's CFR so that the Council's prudential indicators are not adversely affect by the implementation of IFRS 16.

3 Options/Alternatives

3.1 In order to comply with the CIPFA Code of Practice on Treasury Management, the Cabinet has no option other than to consider and approve the contents of the report. Therefore no options/alternatives have been presented.

4 Preferred Option

4.1 The preferred option is that the contents of this report are approved by Cabinet and commended to Council .

5 Consultation

5.1 There has been consultation with Link Asset Services, the Council's Treasury Management Advisors. The consideration of the Treasury Management Strategy for 2020/21 by the Audit Committee on 20 January 2020 and the Overview and Scrutiny Performance and Value for Money Select Committee on 23 January 2020 is also a key strand in the consultation process. Both the Audit Committee and the Select Committee were content to commend the report to Cabinet and Council.

6 Financial Implications

6.1 Financial Implications are detailed within the report.

7 Legal Services Comments

7.1 There are no legal implications.

8 Co-operative Agenda

8.1 The Treasury Management strategy embraces the Council's cooperative agenda. The Council will develop its investment framework to ensure it complements the co-operative ethos of the Council.

9 Human Resources Comments

9.1 There are no Human Resource Implications.

10 Risk Assessments

10.1 There are considerable risks to the security of the Authority's resources if appropriate Treasury Management strategies and policies are not adopted and followed. The Council has established good practice in relation to Treasury Management which has previously been acknowledged in the Internal and External Auditors' reports presented to the Audit Committee. An issue dependent upon market developments which may need to be considered in the future is refinancing some of the long term loans. This can be mitigated by effective monitoring of the market.

11 IT Implications

11.1 There are no IT Implications.

12 Property Implications

12.1 There are no Property Implications.

13 Procurement Implications

13.1 There are no Procurement Implications.

14 Environmental and Health & Safety Implications

14.1 There are no Environmental and Health & Safety Implications.

15 Equality, community cohesion and crime implications

15.1 There are no Equality, community cohesion and crime implications.

16 Equality Impact Assessment Completed?

16.1 No

17 Key Decision

17.1 Yes

18 Key Decision Reference

18.1 FCS 13-19

19 Background Papers

19.1 The following is a list of background papers on which this report is based in accordance with the requirements of Section 100(1) of the Local Government Act 1972. It does not include documents which would disclose exempt or confidential information as defined by the Act:

File Ref:	Background papers are provided in Appendices 1 - 8
Officer Name:	Lee Walsh / Talei Whitmore
Contact No:	0161 770 6608/ 4924

20 Appendices

Appendix 1	Minimum Revenue Provision (MRP) Policy Statement
Appendix 2	Prudential and Treasury Indicators 2020/21 – 2022/23
Appendix 3	Link Asset Services - Treasury Advisor's Interest Rate Forecast 2019-20221
Appendix 4	Economic Background
Appendix 5	Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management
Appendix 6	Approved Countries for Investments
Appendix 7	Treasury Management Scheme of Delegation
Appendix 8	Treasury Management Role of the Statutory Chief Finance Officer (Director of Finance)

Appendix 1 – Minimum Revenue Provision (MRP) Policy Statement

1.1 General Principles and Practices

1.1.1 Local Authorities are required to set aside 'prudent' provision for debt repayment where they have used borrowing or credit arrangements to finance capital expenditure. Ministry for Housing, Communities and Local Government (MHCLG) regulations require the full MRP Statement to be decided upon at least annually and reported to the Council Meeting. The Council has to ensure that the chosen options are prudent.

1.2 Link to Asset Life/Economic Benefit

1.2.1 Where capital expenditure on an asset is financed wholly or partly by borrowing or credit arrangements, MRP will normally be determined by reference to asset life, economic benefit or MHCLG Guidance.

1.2.2 To the extent that expenditure cannot be linked to the creation/enhancement of an asset and is of a type that is subject to estimated life periods that are referred to in the MHCLG guidance (paragraph 24), these periods will generally be adopted by the Council.

1.2.3 Where certain types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure.

1.2.4 Whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

1.3 Methods for Calculating MRP

1.3.1 Any of the methods for calculating MRP that are set out below may be used. MRP will commence in the financial year after the completion of assets rather than when expenditure is incurred. All methods, with the exception of the approach taken to Previously Supported General Fund Borrowing are based on Asset Life/Economic Benefit. These methods include but are not limited to:

The Annuity Method

1.3.2 This calculation seeks to ensure the revenue account bears an equal annual charge (for principal and interest) over the life of the asset by taking account of the time value of money. Since MRP relates only to 'principal', the amount of provision made annually gradually increases during the life of the asset. The interest rate used in annuity calculations will be referenced to either prevailing or average PWLB rates.

Equal Instalments of Principal

1.3.3 MRP is an equal annual charge calculated by dividing the original amount of borrowing by the useful life of the asset.

Previously Supported General Fund Borrowing

1.3.4 General Fund Borrowing that was previously supported through the Revenue Support Grant (RSG) system will be provided for in equal annual instalments over a 50 year period commencing 1 April 2016. As at 1 April 2016, the value of this borrowing equalled

£134,376,866 and results in an equal annual minimum revenue provision of £2,742,385; the final instalment of which will be provided for by no later than 31 March 2066. In the event of:

- transfers of Capital Financing Requirement between the General Fund element and Housing element;
- additional voluntary revenue provision being made

the annual MRP charge will be adjusted to ensure that full provision will continue to be made by no later than 31 March 2066.

Bespoke Repayment Profiles:

1.3.5 With regard to credit arrangements that are implicit in Finance Lease or PFI arrangements, any 'debt' repayment element (notional or otherwise) included in charges associated with these arrangements will be classified as MRP.

1.4 Voluntary Revenue Provision

1.4.1 The Council has the option of making additional Voluntary Revenue Provision (VRP) in addition to MRP. The Council may treat VRP as 'up-front' provision (having a similar impact to the early repayment of debt) and thus recalculate future MRP charges accordingly. Where the Council has made additional VRP's for debt repayment in previous years, in year MRP charges may be adjusted to reflect this provided it does not result in a negative MRP charge. To the extent charges are adjusted, current and future year's charges will be recalculated to ensure the Council continues to make prudent provision for debt repayment in relation to historic capital expenditure. The Council may in some circumstances apply VRP to relatively short-life assets/expenditure in order to facilitate a reduction in the future base revenue budget needed to fund capital financing costs.

1.5 Local Exceptions to the Guidance

1.5.1 The Council reserves the right to determine useful life periods and prudent MRP in certain circumstances or where the recommendations of the MHCLG guidance are not appropriate to local circumstances. Examples include:

Assets Under Construction

1.5.2 No MRP charge will be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use.

Local Authority Mortgage Scheme (LAMS)

1.5.3 The Council operated a Local Authority Mortgage Scheme (LAMS) using the cash backed option. The mortgage lenders require a five year deposit from the Local Authority to match the five year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending and is treated as capital expenditure and a loan to a third party. The CFR will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the Local Authority, the returned funds are classed as a capital receipt, which will be applied to reduce the CFR. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside MRP to repay the debt liability in the interim period. All previous LAMS schemes are now completed, with the deposits repaid in full. However, the option is still available should the Council see it as a corporate priority.

Loans to Third Parties

1.5.4 The Council has considered the Statutory Guidance, which recommends a 25 year repayment charge for loans to third parties, and concluded that provision is not necessary. The Council considers an MRP charge is not necessary in respect of any loans made to third parties as the debt liability is covered by the existence of a debtor and the associated obligation to make repayments. Any loans given are subject to substantial due diligence process by both internal officers and were appropriate external advisors.

1.6 Borrowing in Lieu of Capital Receipts

1.6.1 The Council has concluded that MRP provision is not necessary for capital expenditure incurred in lieu of capital receipts. Any such schemes will be classified by the Capital Investment Programme Board (CIPB) as 'Borrowing in Lieu of Capital Receipts'. CIPB will also determine which capital receipts will be allocated to the scheme and as the receipts are achieved they will be applied to repay the debt.

The Application of Capital Receipts in Lieu of MRP

1.6.2 Where the Council has received uncommitted and unapplied Capital Receipts, it retains the option to set aside those Capital Receipts as part of its arrangements for making 'prudent' provision for debt repayment rather than using them for capital financing purposes.

1.6.3 As Capital Receipts may form part of the Councils arrangements for making 'prudent' provision, setting aside Capital Receipts in this manner can be carried out in lieu of MRP whereby the MRP charge will be reduced by an amount equal to that set aside from Capital Receipts.

1.7 HRA Capital Financing Requirement (CFR)

1.7.1 MRP will equal the amount determined in accordance with the former regulations 28 and 29 of the 2003 Regulations (SI 2003/3146) as if they had not been revoked. This approach is consistent with paragraph 7 of the MHCLG Guidance on MRP.

1.7.2 The basic MRP charge relating to the HRA CFR is therefore nil. However, the Council may make 'Voluntary Revenue Provision' provided such an approach is prudent and appropriate in the context of financing the HRA capital programme and is consistent with the delivery of the HRA Business Plan.

Appendix 2 Prudential and Treasury Indicators 2020/21 – 2022/23

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

Capital expenditure

Capital Expenditure	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
Corporate Services *	14,525	1,128	6,010		
Children's Services		18,781	15,590	12,305	5,000
Health & Adult Social Care Community Services	2,058	0	0	0	0
Community Services & Adult Social Care	0	2,029	3,400	703	400
People & Place **	28,066	29,910	107,835	104,062	86,710
Reform	169	39	346	400	0
Funds for Emerging Priorities	1,500	1,098	3,440	3,575	4,200
General Fund Services	**46,318**	**52,985**	**136,621**	**121,045**	**96,310**
Housing Revenue Account (HRA)	2,246	1,854	5,538	3,922	6,200
HRA	**2,246**	**1,854**	**5,538**	**3,922**	**6,200**
Commercial Activities / Non-Financial Investments ***	0	9,106	5,000	6,500	0
Commercial Activities / Non-Financial Investments	**0**	**9,106**	**5,000**	**6,500**	**0**
Total	**48,564**	**63,945**	**147,159**	**131,467**	**102,510**

* Excludes commercial activities which are included in the Corporate Services capital programme within the Capital Strategy report.
** Excludes commercial activities which are included in the People & Place capital programme within the Capital Strategy report.
*** Relate to areas such as capital expenditure on investment properties, loans to third parties, purchase of equity shares etc.

Affordability prudential indicators

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

Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital, (borrowing and other long-term obligation costs net of investment income), against the net revenue stream.

	2018/19 Actual £'000	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000
General Fund excluding DSG*	10.00%	13.30%	14.02%	15.54%	15.83%

*Dedicated Schools Grant

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

Maturity structure of borrowing

Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

Cabinet is asked to approve the following treasury indicators and limits:

Maturity Structure of fixed interest rate debt 2020/21	Lower Limit	Upper Limit
Under 12 months	0.00%	40.00%
12 months and within 24 months	0.00%	40.00%
24 months and within 5 years	0.00%	40.00%
5 years and within 10 years	0.00%	40.00%
10 years to 20 years	0.00%	50.00%
20 years to 30 years	0.00%	50.00%
30 years to 40 years	0.00%	50.00%
40 years to 50 years	0.00%	50.00%
50 years to 60 years	0.00%	50.00%

Control of interest rate exposure

Members are advised that indicators for interest rate exposure are no longer a requirement under the new Treasury Management Code however as interest rate exposure risk is an important issue. Officers will monitor the balance between fixed and variable interest rates for borrowing and investments. This will aim to ensure the Council is not exposed to adverse fluctuations in fixed or variable rate interest rate movements.

This is likely to reflect higher fixed interest rate borrowing if the borrowing need is high or fixed interest rates are likely to increase, or a higher variable rate exposure if fixed interest rates are expected to fall. Conversely if shorter term interest rates are likely to fall, investments may be fixed earlier, or kept shorter if short term investments are expected to rise.

The balance between variable rate debt and variable rate investments will be monitored as part of the overall treasury function in the context of the overall financial instruments structure and any under or over borrowing positions.

Appendix 3 – Link Asset Services Interest rate forecast 2019 – 2022

PWLB rates and forecast shown below take into account the 20 basis point certainty rate reduction effective as of the 1st November 2019 for 2019/20 and 2020/21.

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	**2.36%**	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	**2.36%**	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	**2.61%**	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	**2.61%**	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	**3.18%**	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	**3.18%**	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	**3.04%**	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	**3.04%**	3.00%	3.00%	3.00%	3.00%	3.00%	-	-	-	-	-	-		-	-

Appendix 4: Economic Background

Set out below is a more detailed analysis of the Economic Background used to support the preparation of the 2020/21 Treasury Management Strategy Statement.

UK

Brexit. 2019 was 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 2019, with or without a deal. However, MPs blocked leaving on that date and the EU agreed an extension to 31 January 2020. In late October, MPs approved an outline of a Brexit deal to enable the UK to leave the EU on 31 January. Now that the Conservative Government has gained an overall majority in the general election on 12 December, this outline deal has been passed by Parliament and the UK has now left the EU. However, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the current end of the transition period in December 2020, which the Prime Minister has pledged he will not extend. This could prove to be an unrealistically short timetable for such major negotiations that leaves open two possibilities; one, the need for an extension of negotiations, probably two years, or, effectively a no deal Brexit in December 2020.

GDP growth took a hit from Brexit uncertainty during 2019; quarter three 2019 surprised on the upside by coming in at +0.4% quarter to quarter (q/q), +1.1% year on year (y/y). However, the peak of Brexit uncertainty during the final quarter appears to have suppressed quarterly growth to probably around zero. The economy is unlikely to change significantly in 2020, with limited growth around about 1% until there is more certainty after the trade deal deadline is passed.

While the Bank of England went through the routine of producing another quarterly Inflation Report, (now renamed the Monetary Policy Report), on 7 November 2019, its value may be questionable when faced with the current uncertainties. The Bank made a change in Brexit assumptions to now include a deal being eventually passed. Possibly the biggest message that is worth taking note of from the Monetary Policy Report, was an increase in concerns among MPC members around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain Bank Rate at 0.75% but two members were sufficiently concerned to vote for an immediate Bank Rate cut to 0.5%. The MPC warned that if global growth does not pick up or Brexit uncertainties intensify, then a rate cut was now more likely. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises. The speed of recovery will depend on the extent to which uncertainty dissipates over the final terms for trade between the UK and EU and by how much global growth rates pick up. The Bank revised its inflation forecasts down – to 1.25% in 2019, 1.5% in 2020, and 2.0% in 2021; hence the MPC views inflation as causing little concern in the near future.

The **MPC meeting of 19 December** 2019 repeated the vote of the previous month of 7-2 to keep Bank Rate on hold. Their key view was that there was currently 'no evidence about the extent to which policy uncertainties among companies and households had declined' i.e. they were going to wait and see how the economy goes in the next few months. The two members who voted for a cut were concerned that the labour market was faltering. On the other hand, there was a clear warning in the minutes that the MPC were concerned that domestic "unit labour costs have continued to grow at rates above those consistent with meeting the inflation target in the medium term".

If economic growth were to weaken considerably, the MPC has relatively little room to make a big impact with Bank Rate still only at 0.75%. It would therefore, 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 and it made significant promises in its election manifesto to increase government spending by up to £20bn p.a., (this would add about 1% to GDP growth rates), by investing primarily in infrastructure. This is likely to be announced in the next Budget which will be held on 11 March 2020. The Chancellor has also amended the fiscal rules in November to allow for an increase in government expenditure.

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

With regard to the **labour market,** growth in numbers employed was quite resilient through 2019 until the three months to September where it fell by 58,000. However, there was an encouraging pick up again in the three months to October to growth of 24,000 which showed that the labour market was not about to head into a major downturn. The unemployment rate held steady at a 44 year low of 3.8% on the Independent Labour Organisation measure in October. Wage inflation has been steadily falling from a high point of 3.9% in July to 3.5% in October (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 2.0%. As the UK economy is very much services sector driven, an increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. The other message from the fall in wage growth is that employers are beginning to find it easier to hire suitable staff, indicating that supply pressure in the labour market is easing.

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 after a strong start in quarter 1 at 3.1%, (annualised rate), to 2.0% in quarter 2 and then 2.1% in quarter 3. The economy looks likely to have maintained a growth rate similar to quarter 3 into quarter 4; fears of a recession have largely dissipated. The strong growth in employment numbers during 2018 weakened during 2019, indicating that the economy had been cooling, while inflationary pressures were also weakening. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in gasoline prices.

The US Federal Reserves (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 by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75%. At its September meeting it also said it was going to start buying Treasury bills 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). The Fed left rates unchanged in December. However, the accompanying statement was more optimistic about the future course of the economy so this would indicate that further cuts are unlikely.

Investor confidence has been hit 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.

However, in early November / December, progress has been made on agreeing a phase a phase one deal between the US and China to roll back some of the tariffs; this gives some hope of resolving this dispute.

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, +0.2% q/q (+1.2% y/y) in quarter 2 and then +0.2% q/q, +1.1% in quarter 3; there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and 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 in December 2020 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 Target Long Term Repurchase Operations (TLTROs); this provides banks with cheap borrowing every three months from September 2019 until March 2021 that 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 for an unlimited period;** (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.

There were no policy changes in the December meeting which was chaired for the first time by the new President of the ECB, Christine Lagarde. However, the outlook continued to be down beat about the economy; this makes it likely there will be further monetary policy stimulus to come in 2020. She did also announce a thorough review of how the ECB conducts monetary policy, including the price stability target. This review is likely to take all of 2020.

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 opportunity to defend their position, in terms of monetary policy measures, when rates are already very low in most countries, (apart from the US). There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. 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 2.5.1 are **predicated on the assumption of a trade agreement being reached between the UK and the EU.** On this basis, while GDP growth is likely to be subdued in 2020 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 in December 2020**, 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 in December 2020**, 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.

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The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably even, but dependent on a successful outcome of negotiations on a trade deal.
- 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 trade deal was agreed with the EU, 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, longer-term it was 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 support of the SPD party, as a result of the rise in popularity of the AfD party. The CDU has done badly in recent state elections, but the SPD has done particularly badly, and this 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.
- 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 $19 trillion 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 $15 trillion 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 a trade agreement was reached by December 2020 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 5: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

Specified Investments: All such investments will be sterling denominated, with **maturities up to a maximum of 1 year**, meeting the minimum 'high' quality criteria where applicable.

Non-specified Investments: These are any investments which do not meet the specified investment criteria. A maximum of 50% will be held in aggregate in non-specified investment

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Specified Investments

	Minimum credit criteria / colour band	** Max % of total investments/ £ limit per institution	Max. maturity period
DMADF – UK Government Debt Management Account Deposit Facility	N/A	100%	6 months
UK Government gilts	UK sovereign rating	£20m	12 months
UK Government Treasury bills	UK sovereign rating	£20m	12 months
Bonds issued by multilateral development banks	AAA	£10m	6 months
Money Market Funds Constant Net Asset Value (CNAV)	AAA	£20m	Liquid
Money Market Funds Low Volatility Net Asset Value (LVNAV)	AAA	£20m	Liquid
Money Market Funds Variable Net Asset Value (VNAV)	AAA	£20m	Liquid
Enhanced Cash Funds with a credit score of 1.25	AAA	£20m	Liquid
Enhanced Cash Funds with a credit score of 1.5	AAA	£20m	Liquid
Local Authorities	Yellow	£10m	12 months
Public Bodies	N/A	£10m	12 months
Term deposits with banks and building societies	Blue Orange Red Green No Colour	£20m £15m £10m £10m Not for use	12 months 12 months 6 months 100 days Not for use
CDs or corporate bonds with banks and building societies	Blue Orange Red Green No Colour	£20m £15m £10m £10m Not for use	12 months 12 months 6 months 100 days Not for use
Gilt funds	UK sovereign rating	£10m	12 months

REPO's (Collateralised deposit)	100% Collateral	£5m	12 months
GMCA	Internal Due Diligence	£30m	12 months
GM Public Bodies	Internal Due Diligence	£30m	12 months

Accounting treatment of investments. The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue implications, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

Non-specified Investments: A maximum of 50% will be held in aggregate in non-specified investments

Maturities in excess of 1 year

	* Minimum Credit Criteria	Use	£ limit per institution	Max. maturity period
Term deposits – local authorities and other public institutions	Yellow	In-house	£10m	5 years
Term deposits – banks and building societies	Yellow Purple	In-house	£10m £10m	5 years 2 years
Certificates of deposit issued by banks and building societies	Yellow Purple	In-house	£10m £10m	5 years 2 years
Certificates of deposit issued by banks and building societies	Short-term F1 Long-term AA	Fund Managers	£5m	2 years
Collateralised deposit	UK sovereign rating	In-house and Fund Managers	£5m	2 years
UK Government Gilts	UK sovereign rating	In-house and Fund Managers	£10m	5 years
Bonds issued by multilateral development banks	AAA	In-house and Fund Managers	£10m	3 years
Sovereign bond issues (other than the UK Government)	AAA	In-house and Fund Managers	£5m	2 years
Corporate bonds	Short-termF1 Long-term AA	In-house and Fund Managers	£5m	5 years
Green Energy Bonds	Internal Due Diligence	In-house and Fund Managers	£10m	10 years
Property Funds	Internal Due Diligence	In-house	£30m	10 years
Floating Rate Notes	Long Term A	In-house	£5m	5 years
REPO’s (Collateralised deposit)	100% Collateral	In-house	£5m	5 years
GMCA	Internal Due Diligence	In-house	£30m	5 years
Covered Bonds	Long term A	In-house	£5m	5 years
UK Municipal Bonds Agency	Internal Due Diligence	In-house	£1m	10 years
Local Authority Fixed Income Fund	Internal Due Diligence	In-house	£5m	10 years
Unrated Bonds, backed by securitised Assets	Internal Due Diligence	In-house and fund managers	£5m	5 years
Asset Backed Pooled Investment Funds	Internal Due Diligence	In-house and fund managers	£5m	5 years
Fixed term deposits with variable rate and variable maturities	Internal Due Diligence	In-house and External Advice	£20m	50 years
Debt Financing	Internal Due Diligence & External Advice	In-house and External Advice	£30m	10 years

Appendix 6: Approved Countries for Investments (as at February 2020)

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Sweden
- Switzerland

AA+

- Finland
- U.S.A.

AA

- France
- U.K.

AA-

- Belgium

Appendix 7: Treasury Management Scheme of Delegation

The scheme of delegation is as follows:

Full Council is the responsible body for:

- receiving and reviewing reports on Treasury Management policies, practices and activities;
- the approval of the annual strategy, mid-year review and outturn report.
- approval of/amendments to the organisation's Treasury Management Policy Statement;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;

Cabinet is the responsible body for:

- considering the Treasury Management Policy and Procedures and making recommendations to the responsible body.
- considering Treasury Management reports and commending to Council.

Audit Committee is responsible for scrutiny:

- reviewing the Treasury Management Policy and Procedures and making recommendations to the responsible body.
- Reviewing Treasury Management reports and making recommendations to the responsible body.

Cabinet Member for Finance and and Corporate Services is responsible for:

- approving the selection of external service providers and agreeing terms of appointment

Note : The Overview and Scrutiny Performance and Value for Money Select Committee reviews and scrutinises the Annual Treasury Management Strategy report along with the suite of other budget reports (including the Capital Strategy)

Appendix 8: The Treasury Management Role of the Statutory Chief Finance Officer (Director of Finance)

The Statutory Chief Financial Officer will discharge the Treasury Management role by:

- recommending Treasury Management Policy/Practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular Treasury Management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing Treasury Management information reports;
- reviewing the performance of the Treasury Management function;
- ensuring the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function;
- ensuring the adequacy of internal audit processes, and liaising with external audit;
- recommending the appointment of external service providers.
- 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
- ensuring 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
- the 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
- the 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;

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