

Report to: **Audit Committee**
Date: **22 March 2018**
Title: **2018/19 Treasury Management Strategy**
Portfolio Area: **Support Services – Councillor S Wright**
Wards Affected: **All**
Relevant Scrutiny Committee: **Overview and Scrutiny Panel**
Urgent Decision: **N** Approval and clearance obtained: **Y**
Date next steps can be taken: Full Council

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Recommendations:

That the Audit Committee consider the below and make any comments to Council:-

- 1. The prudential indicators and limits for 2018/19 to 2020/21 contained within Appendix A of the report.**
- 2. The Minimum Revenue Position (MRP) statement contained within Appendix A which sets out the Council's Policy on MRP.**
- 3. The Treasury Management Strategy 2018/19 and the treasury prudential indicators 2018/19 to 2020/21 contained within Appendix B.**
- 4. The Investment Strategy 2018/19 Appendix C and the detailed criteria included in Appendix D and the counter party list in Appendix E**
- 5. To invest £500,000 into CCLA Local Authority Property Fund (LAPF) and £1 million into the CCLA Diversified Income Fund as per Appendix H.**

1. Executive summary

This report seeks approval of the proposed Treasury Management and Investment Strategies together with their associated prudential indicators.

Good financial management and administration underpins the entire strategy. The budget for investment income for 2018/19 has been set at £123,000. This remains the same as the 2017/18 budget.

The following changes have been made to 2018/19 Treasury Management Strategy,

- **Country and sector limits** – the Council has lifted the restriction to only use UK registered banks. This limit has been widened to allow the use of approved counterparties from countries with a minimum sovereign credit rating of AA- (see Appendix C).
- **Counterparty list** – following the lift of the restriction to only use UK registered banks, the Council's approved counterparty list has been included in Appendix E.
- **CCLA Property Investment Funds** – the Council's list of investment vehicles has been updated to allow the future use of CCLA Property Investment Funds. This will be the Council's only Non-Specified Investment and a limit of £2 million has been set for this asset class. There is a recommendation to invest £1.5 million into CCLA as per Appendix H.
- **Capital Strategy** - In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare an additional Capital Strategy report. Details of what this report is intended to provide can be found at point 2.2 of this report. The Council will produce a Capital Strategy in 2018/19.
- **Prudential Indicators** – the estimates of the incremental impact of capital investment decisions on council tax indicator has been removed from the revised 2017 Prudential Code. However, the Council is retaining this as a local indicator to support Member decision making.
The Council's prudential indicators have been revised to reflect the current schedule of borrowing for the leisure investment (see Appendix A).

- **Asset Class** – the current approach means the Council is just dealing with money market instruments, plus the potential to invest in the property fund (CCLA), so there is not much asset diversification currently.

2. Background

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 risk appetite on investments, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. 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.

CIPFA defines treasury management as:

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

2.1 Reporting requirements

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

Prudential and treasury indicators and treasury strategy (this report)

- The first, and most important report covers:

- The capital plans (including prudential indicators);
- A minimum revenue provision (MRP) policy
- 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).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny - The above reports are required to be adequately scrutinised before being recommended to the Council. The reports are presented to the Executive prior to being recommended to Council. The Strategy for 18-19 is being considered by the Executive on 15th March and the Audit Committee on 22nd March. It is within the Terms of Reference of the Audit Committee to scrutinise the Treasury Management Strategy.

2.2 Capital Strategy

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019/20, all local authorities will be required to prepare an additional Capital Strategy report, which is intended to provide the following:-

- A high-level 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 arising from longer term capital objectives

The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by the Capital Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

2.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital issues

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

Treasury management issues

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

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

It is noted that MHCLG released revised Investment and MRP Guidance on 2nd February and the Council will adopt any relevant changes in an updated Strategy during the 2018/19 financial year.

2.4 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This training has recently been widened to include Non-Treasury Investment. Treasury management training will be organised for Members during the 2018-19 financial year.

The training needs of treasury management officers are periodically reviewed. Officers received training on 31st January 2018.

2.5 Treasury management advisors

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

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

3. Outcomes/outputs

The budget for investment income for 2018/19 has been set at £123,000. This remains the same as the 2017/18 budget. However an income target of an extra £25,000 has been set for 2018/19.

4. Options available and consideration of risk

In order to maximise investment returns the Council needs to be able to either increase our investment portfolio which could potentially mean increasing the risk factor or maintain the current list of Counter Party's but further increase the limit we can invest in each to avoid using those with the lowest rate of return.

5. Borrowing for the Leisure Investment

The Council is currently modelling its Balance Sheet position for 31/3/18, which will inform the decision as to how to structure the borrowing for the Leisure Investment. The main expenditure occurs in 2018/19. The Council is preparing for the early closedown of its year end Accounts for 31st March 2018 and this work is progressing. A recommendation will be made as part of the Treasury Management Strategy presented to Council on 29th March.

6. New changes affecting the Treasury Management activities

International Financial Reporting Standard 9 – Financial Instruments

From 1 April 2018, new accounting rules will apply to investments, as the Local Authority Accounting Code adopts International Financial Reporting Standard 9 *Financial Instruments*. IFRS 9 was devised to correct the weaknesses in accounting practices that contributed to the global financial crisis. In particular it:

- changes the default accounting treatment for investments from one where gains and losses in value are not recognised as income or expenditure until an investment matures or is disposed of to one where income or expenditure is recognised as gains and losses arise
- changes the model for impairment loss allowances from one based on incurred losses to one based on expected losses

The first of these changes is particularly relevant and would affect a CCLA investment. Where these investments are based on buying shares in funds (such as CCLA), the 1 April 2018 changes in accounting rules will require fair value movements to be debited/credited to revenue as they arise. This is explained further in Appendix H.

There is a risk that if losses arise on this investment, it would result in a charge against revenue in the year it arose and could not be stored up to be offset against potential future gains. Developments in this area will be monitored carefully over the next few months.

MiFID II

The Markets in Financial Instruments Directive (MiFID) is the framework of European Union (EU) legislation for:

- investment intermediaries that provide services to clients around shares, bonds, units in collective investment schemes and derivatives (collectively known as ‘financial instruments’)
- the organised trading of financial instruments

MiFID applied in the UK from November 2007, and was revised by MiFID II, which took effect in January 2018, to improve the functioning of financial markets in light of the financial crisis and to strengthen investor

protection. MiFID II extended the MiFID requirements in a number of areas including:

- new market structure requirements
- new and extended requirements in relation to transparency
- new rules on research and inducements
- new product governance requirements for manufacturers and distributors of MiFID 'products'
- introduction of a harmonised commodity position limits regime

Part of the new legislation required bodies whom perform complex investments to be deemed/classified as professional investment bodies.

Those bodies who decided not to be classified (opt up) or did not meet the requirements to be classified as a professional investment body would be deemed as retail investors. Retail investors are limited on the types of investments they could make, some Money Market Funds would be unavailable to retail investors.

To ensure that the Council could continue to invest in the current manner, the Council opted up to be classed as a professional body. This 'professional body status' has been accepted in all cases of parties with whom the Council currently invests.

7. Proposed Way Forward

It is recommended for the Council to approve the Treasury Management and Investment Strategy.

8. Implications

Implications	Relevant to proposals Y/N	Details and proposed measures to address
Legal/Governance	Y	The elements set out in paragraph 2.2 cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the CIPFA Treasury Management Code, the Department for Communities and Local Government (DCLG) Investment Guidance and the DCLG MRP Guidance. It is within the Terms of Reference of the Audit Committee to scrutinise the Treasury Management Strategy.
Financial	Y	Good financial management and administration underpins the entire strategy. The budget for investment income for 2018/19 is £123,000. A stretched income target of a further £25,000 is being set.

		As at 31/3/17 (Balance Sheet position), the Council had £29.175 million in investments. See comments in Appendix H regarding the investment of £1.5 million into CCLA.
Risk	Y	The security risk is the risk of failure of a counterparty. The liquidity risk is that there are liquidity constraints that affect the interest rate performance. The yield risk is regarding the volatility of interest rates/inflation. The Council has adopted the CIPFA Code Of Practice for Treasury Management and produces an Annual Treasury Management Strategy and Investment Strategy in accordance with CIPFA guidelines. The Council engages a Treasury Management advisor and a prudent view is always taken regarding future interest rate movements. Investment interest income is reported quarterly to SLT and the Executive as part of budget reports
Comprehensive Impact Assessment Implications		
Equality and Diversity	N	N/a
Safeguarding	N	N/a
Community Safety, Crime and Disorder	N	N/a
Health, Safety and Wellbeing	N	N/a
Other implications	N	none

Supporting Information

Appendices:

- Appendix A - The Capital Prudential indicators 2018/19 to 2020/21.
- Appendix B - The Treasury Management Strategy 2018/19
- Appendix C – The Investment Strategy
- Appendix D - Treasury Management Practice (TMP 1) – Credit and Counterparty Risk Management
- Appendix E – Counterparty List as at 16th February 2018
- Appendix F - Treasury Management Scheme of delegation
- Appendix G - Glossary of Terms Appendix
- Appendix H – CCLA Investment Options
- Appendix I – LAPF Factsheet (CCLA Option)
- Appendix J – DIF Brochure (CCLA Option)

Background Papers:

- Executive: 9/03/17 - TMS & Annual Investment Strategy 2017-18
- Executive: 07/12/17 - TMS (Mid Year Update)
- Executive: 15/3/18 – Treasury Management Strategy 2018-19

APPENDIX A

THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21

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

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total	3,023	3,413*	7,492	2,464	410

*Note – This figure is £2,415,000 as per the Council report on 9 February 2017, plus £0.998 million for Leisure Investment in 17/18. In July 2016 (Minute 33/16) the Council agreed to undertake prudential borrowing of £6.337 million for the new leisure contract, with a further £1.5 million of prudential borrowing for a loan facility being subject to a business case. The remaining leisure investment occurs in 18/19 and 19/20.

The table 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 borrowing need.

Capital expenditure (£m)	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total	3,023	3,413	7,492	2,464	410
Financed by:					
Capital receipts	665	877	1,111	TBA	TBA
Capital grants	1,166	613	700	TBA	TBA
Reserves (including New Homes Bonus Reserve)	1,192	925	744	TBA	TBA
Net financing need for the year (This is the prudential borrowing required for capital investment in Leisure)	Nil	998	4,937	TBA	TBA

The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). It is essentially a measure of the Council's underlying need to borrow. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the indebtedness in line with each assets life.

In July 2016 (Minute 33/16) the Council agreed to undertake prudential borrowing of £6.337 million for the new leisure contract. There is predicted to be £1 million of Leisure investment in 2017/18 (this is shown in the movement in CFR). The remaining leisure investment occurs in 18/19 and 19/20.

The Council is asked to approve the CFR projections below:

	2016/17 Actual £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Capital Financing Requirement (CFR)					
Total CFR	- 98	900	5,797	5,676	5,396
Movement in CFR	Nil	998	4,897	-121	-280
Movement in CFR represented by:					
Net Financing need for the year	Nil	998	4,937	159	Nil
Less MRP and other financing movements	Nil	Nil	-40	-280	-280
Net borrowing requirement	Nil	998	4,897	-121	-280

Minimum revenue provision (MRP) policy statement

Regulation 28 of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2003 states that 'A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent'. The provision is made from revenue in respect of capital expenditure financed by borrowing or credit arrangements.

With all options MRP should normally commence in the financial year following the one in which expenditure was incurred. Regulation 28 does not define 'prudent'. However MRP guidance has been issued, which makes recommendations to authorities on the interpretation of that term. Authorities are legally obliged to 'have regard' to the guidance.

The first recommendation given by the guidance is to prepare, before the start of each financial year, an annual statement of the policy on making MRP in respect of that financial year and submit this to Full Council for approval. The guidance aims to ensure that the provision for the repayment of borrowing which financed the acquisition of an asset should be made over a period bearing some relation to that over which the asset continues to provide a service.

The MRP policy to be adopted is as below:-

Borrowing	MRP Methodology
Leisure Investment	<p>Asset Life Method MRP is charged using the Asset Life method – based on the estimated life of the asset. (For the Leisure investment, MRP will be charged over the 25 years – therefore 4% per annum).</p> <p>This option provides for a reduction in the borrowing need over approximately the asset's life.</p>

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. The Council 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. It is calculated by dividing investment income and interest received by the Council's Net Budget Requirement.

	2016/17	2017/18	2018/19	2019/20	2020/21
	Actual	Estimate	Estimate	Estimate	Estimate
Ratio of net financing cost to net revenue stream.	(1.8)%	(1.1)%	1.0%	4.1%	4.3%

This is a surplus in 16/17 and 17/18 but it becomes a net financing cost from 2018/19 onwards.

APPENDIX B

TREASURY MANAGEMENT STRATEGY (BORROWING)

Introduction

The capital expenditure plans set out in Appendix A provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. 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 / prudential indicators, the current and projected debt positions and the annual investment strategy.

Treasury Indicators: Limits to borrowing activity

The Operational Boundary – This is the limit beyond which external debt is not normally expected to exceed. This is the maximum level of external debt for cash flow purposes.

Operational Boundary	2017/18	2018/19	2019/20	2020/21
	Estimate	Estimate	Estimate	Estimate
Borrowing	5,000,000	9,000,000	10,000,000	10,000,000
Other long term liabilities	-	-	-	-
Total	5,000,000	9,000,000	10,000,000	10,000,000

The Authorised Limit for External Debt – A further key prudential indicator represents a control on the overall level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This provides headroom over and above the operational boundary for unusual cash movements. This is the maximum amount of money that the Council could afford to borrow.

1. 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 no control has yet been exercised.

2. The Council is asked to approve the following Authorised Limit:

Authorised limit	2017/18	2018/19	2019/20	2020/21
	Estimate	Estimate	Estimate	Estimate
Borrowing	10,000,000	14,000,000	15,000,000	15,000,000
Other long term liabilities	-	-	-	-
Total	10,000,000	14,000,000	15,000,000	15,000,000

Prospects for interest rates

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

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

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

Investment and borrowing rates

Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again. Apart from that, there has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

Borrowing Strategy

In July 2016 (Minute 33/16) the Council agreed to undertake prudential borrowing of £6.337 million for the new leisure contract, with a further £1.5 million of prudential borrowing for a loan facility being subject to a business case.

There is predicted to be £1 million of Leisure investment in 2017/18 (this is shown in the movement in CFR). The remaining leisure investment occurs in 18/19 and 19/20.

Treasury management limits on activity

There are two related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of an adverse movement in interest rates. However if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance.

The indicators are:

- Upper limits on fixed interest rate exposure – This covers a maximum limit on fixed interest rates.
- Upper limits on variable interest rate exposure – This covers a maximum limit for variable interest rates.

The Council is asked to approve the following treasury indicators and limits:

Interest rate Exposures	2018/19	2019/20	2020/21
	Upper	Upper	Upper
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	50%	50%	50%
Limits on fixed interest rates: Debt only	12,500,000	12,500,000	12,500,000
Limits on variable interest rates: Debt only	2,500,000	2,500,000	2,500,000
Maturity Structure of fixed interest rate borrowing 2018/19			
	Lower	Upper	
Under 12 months	0%	10%	
12 months to 2 years	0%	10%	
2 years to 5 years	0%	30%	
5 years to 10 years	0%	50%	
10 years and above	0%	100%	

Policy On Borrowing In Advance Of Need

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

Borrowing in advance will be made within the constraints that:

- The Council would not look to borrow more than 18 months in advance of need.

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

If the Council had to borrow temporarily for cash flow purposes only in an emergency, then the S151 Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks. A report will subsequently be reported to Council. In all other circumstances, approval to borrow money will always be a decision that can only be made by Full Council and a full report will be brought to Members.

Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLb). This Authority may make use of this new source of borrowing as and when appropriate.

Investment policy

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

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

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 this end 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.

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

Creditworthiness policy

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

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

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

- Yellow 5 years *
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

** Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt –see appendix D.*

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

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

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

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

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

Country and sector limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA-.

Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and to rise to 1.25% by quarter 1 2021.

Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

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

- 2017/18 0.40%
- 2018/19 0.60%
- 2019/20 0.90%
- 2020/21 1.25%

The overall balance of risks to these forecasts is currently probably slightly skewed to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

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

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

Maximum principal sums invested > 365 days			
£m	2018/19	2019/20	2020/21
Principal sums invested > 365 days	£6m	£6m	£6m

Icelandic bank investments

The Council placed a deposit of £1,250,000 on 25th September 2008 with the Heritable Bank which is a subsidiary of Landsbanki, one of the Icelandic Banks that was affected by the world economic crisis. Of this amount £1,227,517 (98%) has already been repaid to the Council by the Administrators. As at today, the Council has £22,483 frozen in the Heritable Bank.

At the time the deposit was placed, the risk rating of Heritable was 'A' (long term deposits) and F1 (short term deposits). Both ratings indicated low risk and were within the deposit policy approved by the Council. Heritable Bank is registered in Scotland with an address in Edinburgh. Heritable Bank Plc is authorised and regulated by the Financial Services Authority and is on the FSA Register. The bank's shares are owned by Icelandic bank, Landsbanki.

Administrators have kept the bank trading and are winding down the business over a period of years. The Administrators have paid fifteen dividends amounting to 98% of the original deposit. The timescale for receiving the final amount outstanding has not been confirmed. The administrators estimate that the return to all unsecured creditors is now between 98-100 pence in the pound.

End of year investment report

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

APPENDIX D

Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

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

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.
5. A body that is considered of a high credit quality (such as a bank or building society)

Non-specified investments: These are any investments which do not meet the Specified Investment criteria.

CCLA Property Fund investment will be the Council's only Non-Specified Investment and there is a limit of £2 million for this asset class.

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:

	Minimum credit criteria / colour band	Max % of total investments / £ limit per institution	Max. maturity period
DMADF – UK Government	N/A	100%	6 months
Money Market Funds	AAA	£6 million	Liquid
Ultra Short Dated Bond Funds	AAA	£6 million	T + 2
Local authorities	N/A	£6 million	5 years
Property Investment Funds – CCLA	N/A	£2 million	No fixed maturity date but will generally be up to 7 years

Term deposits with banks and building societies	Yellow	£6 million (£7 million for Lloyds plc – see note)	Up to 5 years
	Purple		Up to 2 years
	Blue		Up to 1 Year
	Orange		Up to 1 Year
	Red		Up to 6 months
	Green		Up to 100 days
	No Colour		Not for use
The Council is not recommending using the following investment vehicles and this is reflected by showing 0% against the limit per institution.			
UK Government gilts	AAA	0%	Yellow (5 years)
UK Government Treasury bills	AAA	0%	6 months
Bonds issued by multilateral development banks	AAA	0%	Yellow (5 years)
CDs or corporate bonds with banks and building societies	Yellow	0%	Up to 5 years
	Purple		Up to 2 years
	Blue		Up to 1 year
	Orange		Up to 1 year
	Red		Up to 6 months
	Green		Up to 100 days
	No colour		Not for use

SPECIFIED INVESTMENTS:

All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable

	Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	-	In-house
Term deposits – local authorities	-	In-house
Term deposits – banks and building societies	Green	In-house

Term deposits with nationalised banks and banks and building societies

	Minimum Credit Criteria	Use	Max % of total investments	Max. maturity period
Lloyds Bank plc*	Blue	In-house	£7 million	Up to 1 year
Other UK part nationalised banks	Blue	In-house	£6 million	Up to 1 year

Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -		
1. Government Liquidity Funds	MMF Rating	In-house
2. Money Market Funds	MMF Rating	In-house
3. Ultra Short Dated Bond Funds	EMMF	In-house

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

A Guide to Money Market Funds	
Definition	A pool of cash managed by an independent fund management company. Frequently these are well known banks or investment houses
Investment	Investors purchase units (shares) of the fund which are held on their behalf in a custody account.
Returns	Returns in line with either 7-day or 1-month LIBID are targeted by most funds.
Liquidity	The funds are very liquid. Shares can be purchased and sold on the same day if necessary and without penalty. Deals are subject to a cut-off time which varies from manager to manager but can be as late as 2pm.
Variety	Two types of classes exist – <ol style="list-style-type: none"> 1) Stable Net Asset Value (SNAV) – the most common variety. Prices are fixed and interest is credited to investors in the form of a dividend. 2) Accumulating Net Asset Value (ANAV) – interest is credited to the shares and the price rises to reflect the return achieved.
Accounting	Purchases of MMF shares do not score as capital expenditure. Sales do not score as capital receipts.
Legality	Local authorities are permitted to invest in sterling denominated funds with an AAA credit rating and domiciled in the EU.
Regulation	UK-based Funds are regulated by the Financial Services Authority. Those domiciled in other EU zones (the majority) are regulated via the Undertakings for Collective Investment in Transferable Securities (UCITS) Code. The Code lays down strict common standards of investment and management.
Portfolio holdings	Cash is invested in a selection of high quality, high liquidity securities including: time deposits, certificates

<p>Credit rating</p>	<p>of deposit, short-dated gilts, corporate bonds and notes, commercial paper etc.</p> <p>Local authorities are empowered to place funds in investment schemes with a high credit rating. Money Market Funds fall into this category and are all rated by one or more of the three rating agencies. Credit Quality – measures the financial strength of the fund (not the manager) and the probability of it defaulting.</p>
<p>Risk management</p>	<p>The funds eligible for local authority investment score highly on credit quality and low volatility. All have an AAA rating which means that the chances of default are considered minimal.</p> <p>1) Rating requirements – in order to maintain an AAA rating fund managers must adhere to requirements specified by the rating agencies. These include:</p> <ul style="list-style-type: none"> • A maximum exposure to any one counterparty (concentration ratio) between 5% & 10% • A maximum weighted average maturity (WAM) for the entire fund – typically 60 days • A minimum level of overnight investments to ensure high liquidity • A lower limit on quality of investment counterparty <p>2) Ring fencing – monies received from share purchases are invested in financial instruments by the managing organisation. Deposits/security investments are held in custody by a non-related company that specialises in custody services. Counterparty exposure of the fund (and of the investor) is to the underlying securities and not to the management company.</p>
<p>Exposure limits</p>	<p>In view of the funds’ low concentration ratios; quality of asset holdings; maximum WAM and ring-fencing arrangements, counterparty risk is spread widely. MMFs possess the same status as external fund managers operating cash/gilt funds for local authorities. They should have their own counterparty limit which can be considerably greater than that accorded to individual investment counterparties.</p>

COUNTERPARTY LIST

APPENDIX E

Counterparty as at 16th Feb 2018		Fitch Rating				Moody's Ratings				S&P Ratings		Suggested Duration			
		Long Term	Short Term	Viability	Support	Long Term	Short Term	Long Term	Short Term						
United Kingdom															
	Collateralised LA Deposit*											Y - 60 mths			
	Debt Management Office											Y - 60 mths			
	Multilateral Development Banks											Y - 60 mths			
	Supranationals											Y - 60 mths			
	UK Gilts											Y - 60 mths			
Banks	Abbey National Treasury Services	PW	A	F1		1	SB	Aa3		P-1		R - 6 mths			
	Bank of Scotland PLC	SB	A+	F1	a	5	SB	Aa3		P-1	PO	A	A-1	R - 6 mths	
	Barclays Bank PLC	PW	A	F1	a	5	NO	A1		P-1	SB	A	A-1	R - 6 mths	
	Close Brothers Ltd	SB	A	F1	a	5	SB	Aa3		P-1				R - 6 mths	
	Goldman Sachs International Bank	SB	A	F1			SB	A1		P-1	SB	A+	A-1	R - 6 mths	
	HSBC Bank PLC	SB	AA-	F1+	a+	1	NO	Aa3		P-1	SB	AA-	A-1+	O - 12 mths	
	Lloyds Bank Plc	SB	A+	F1	a	5	SB	Aa3		P-1	PO	A	A-1	R - 6 mths	
	Santander UK PLC	PW	A	F1	a	2	SB	Aa3		P-1	SB	A	A-1	R - 6 mths	
	Standard Chartered Bank	SB	A+	F1	a	5	SB	A1		P-1	SB	A	A-1	R - 6 mths	
	Sumitomo Mitsui Banking	SB	A	F1		1	SB	A1		P-1	SB	A	A-1	R - 6 mths	
	UBS Ltd.	SB	AA-	F1+		1	SB	A1		P-1	SB	A+	A-1	O - 12 mths	
Building Societies	Coventry Building Society	SB	A	F1	a	5	SB	A2		P-1				R - 6 mths	
	Leeds Building Society	SB	A-	F1	a-	5	SB	A3		P-2				G - 100 days	
	Nationwide Building Society	NO	A+	F1	a	5	SB	Aa3		P-1	SB	A	A-1	R - 6 mths	
	Skipton Building Society	SB	A-	F1	a-	5	SB	Baa1		P-2				G - 100 days	
	Yorkshire Building Society	SB	A-	F1	a-	5	SB	A3		P-2				G - 100 days	
Nationalised and Part Nationalised Banks	National Westminster Bank	PW	BBB+	F2	bbb+	5	PW	A2		P-1	PO	BBB+	A-2	B - 12 mths	
	Royal Bank of Scotland Group Plc	SB	BBB+	F2	bbb+	5	SB	Baa3		P-3	SB	BBB-	A-3	B - 12 mths	
	The Royal Bank of Scotland Plc	SB	BBB+	F2	bbb+	PW	5	NW	A2	NW	P-1	SB	BBB+	A-2	B - 12 mths

Key	
Watches and Outlooks	Duration
SB Stable Outlook	Yellow - Y 60 Months
NO Negative Outlook	Blue - B 12 Months
NW Negative Watch	Orange - O 12 Months
PO Positive Outlook	Red - R 6 Months
PW Positive Watch	Green - G 100 Days
EO Evolving Outlook	
EW Evolving Watch	

Treasury Management Scheme of Delegation

Full Council:

- Receiving and reviewing reports on treasury management policies, practices and activities
- Approval of annual strategy
- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- Budget consideration and approval
- Approval of the division of responsibilities
- Receiving and reviewing regular monitoring reports and acting on the recommendations
- Approving the selection of external service providers and agreeing terms of appointment

The treasury management role of the Section 151 Officer:

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- Submitting regular treasury management policy reports
- Submitting budgets and budget variations
- Receiving and reviewing 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, and liaising with external audit
- Recommending the appointment of external service providers
- To ensure that members with responsibility for treasury management receive adequate training in treasury management.
- To review the training needs of treasury management officers periodically

GLOSSARY OF TERMS

Basis Point

1/100th of 1%, i.e., 0.01%

Base Rate

Minimum lending rate of a bank or financial institution in the UK

Benchmark

A measure against which the investment policy or performance of a fund manager can be compared

Bill of Exchange

A financial instrument financing trade

Callable Deposit

A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre-agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen, the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower

Cash Fund Management

Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio

Certificate of Deposit (CD)

Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD

Commercial Paper

Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing

Corporate Bond

Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies

Counterparty

Another (or the other) party to an agreement or other market contract (e.g., lender/ borrower/writer of a swap, etc)

CPI

Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time.

CDS

Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap

Derivative

A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g., an option is a derivative because its value changes in relation to the performance of an underlying stock.

DMADF

Deposit Account offered by the Debt Management office, guaranteed by the UK government

ECB

European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle

EMU

European Monetary Union

Equity

A share in a company with a limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain

Fed.

Federal Reserve Bank of America – sets the central rates in the USA

Floating Rate Notes

Bonds on which the rate of interest is established periodically with reference to short-term interest rates

Forward Deal

The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed date

Forward Deposits

Same as forward dealing (above)

FSA (Financial Services Authority)

Body responsible for overseeing financial services

Fiscal Policy

The Government policy on taxation and welfare payments

Gilt

Registered British Government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent

Gilt Funds

Pooled fund investing in bonds guaranteed by the UK government

Money Market Fund (MMF)

A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF

Monetary Policy Committee (MPC)

Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two year's time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment

Open Ended Investment Companies

A well diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread

Other Bond Funds

Pooled funds investing in a wide range of bonds

Reverse Gilt Repo

This is a transaction as seen from the point of view of the party which is buying the gifts. In this case, one party buys gifts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gifts on a specified future date, or at call, at a specified price

Retail Price Index (RPI)

Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person

Sovereign Issues (Ex UK Gilts)

Bonds issued or guaranteed by nation states, but excluding UK government bonds

Supranational Bonds

Bonds issued by supranational bodies, e.g., European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield (“spread”) given their relative illiquidity when compared with gilts

Term Deposit

A deposit held in a financial institution for a fixed term at a fixed rate

Treasury Bill

Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value

WARoR

Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate

WAM

Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount

WATT

Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount