



**Treasury Management Strategy Statement,  
Minimum Revenue Provision Policy Statement and Annual  
Investment Strategy**

***Updated – February 2019***

<b>1</b>	<b>INTRODUCTION</b> .....	<b>3</b>
1.1	Background .....	3
1.2	Reporting Requirements .....	3
1.3	Treasury Management Strategy .....	4
1.4	Training .....	4
1.5	Treasury management consultants .....	4
<b>2</b>	<b>THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22</b> .....	<b>5</b>
2.1	Capital expenditure .....	5
2.2	The Council’s borrowing need (the Capital Financing Requirement) .....	5
2.3	Core funds and expected investment balances .....	6
<b>3</b>	<b>BORROWING</b> .....	<b>8</b>
3.1	Current portfolio position .....	8
3.2	Treasury Indicators: limits to borrowing activity .....	8
3.3	Prospects for interest rates .....	9
3.4	Borrowing strategy .....	12
3.5	Policy on borrowing in advance of need .....	12
3.6	Debt rescheduling .....	12
3.7	Municipal Bond Agency .....	13
<b>4</b>	<b>ANNUAL INVESTMENT STRATEGY</b> .....	<b>14</b>
4.1	Investment policy .....	14
4.2	Creditworthiness policy .....	14
4.3	Other Considerations .....	15
4.4	Investment strategy .....	16
4.5	End of year investment report .....	17
4.6	External fund managers (if applicable) .....	17
<b>5</b>	<b>APPENDICES</b> .....	
5.1	Prudential and treasury indicators and MRP statement .....	19
5.2	Interest Rate Forecasts 2019 - 2022 .....	21
5.3	Economic Background .....	22
5.4	Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management .....	27
5.5	Approved countries for investments .....	29
5.6	Treasury management scheme of delegation .....	30
5.7	The treasury management role of the section 151 officer .....	31
5.8	Glossary .....	32

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# Treasury Management Strategy Statement 2019/20

## 1 INTRODUCTION

### 1.1 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 low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. 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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

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.

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.

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."

Revised reporting is required for the 2019/20 reporting cycle due to revisions of the MHCLG Investment Guidance, the MHCLG Minimum Revenue Provision (MRP) Guidance, the CIPFA Prudential Code and the CIPFA Treasury Management Code. The primary reporting changes include the introduction of a capital strategy, to provide a longer-term focus to the capital plans, and greater reporting requirements surrounding any commercial activity undertaken under the Localism Act 2011. The capital strategy is being reported separately.

### 1.2 Reporting Requirements

#### 1.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, 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

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	3
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## Treasury Management Strategy Statement 2019/20

- the implications for future financial sustainability

The aim of this capital strategy is to ensure that all elected members on the council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

This 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, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- 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.

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.

Where the Council has borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

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.

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

### 1.2.2 Treasury Management reporting

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.

**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 Policy or MRP (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).

This report is required to be adequately reviewed and scrutinised by the Cabinet before being recommended to the Council.

**A Mid Year Treasury Management Report** – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	4
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

strategy is meeting the strategy or whether any policies require revision. This is included within each of the Council's regular financial monitoring reports presented to the Cabinet.

**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. This is included within the Council's end of year financial monitoring report presented to the Cabinet.

## 1.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

### Capital issues

- the capital plans and the prudential indicators;
- the Minimum Revenue Provision (MRP) strategy.

### Treasury management Issues

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

## 1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Financial training for members is undertaken each year in June.

The training needs of treasury management officers are reviewed annually.

## 1.5 Treasury management consultants

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

The scope of investments within the Council's operations now includes both conventional treasury investments, and more commercial type investments, such as investment properties. The commercial type investments require specialist advisers, and the Council uses Taylor Weaver Ltd in relation to this activity.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	5
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## 2 THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22 & MRP STATEMENT

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

### 2.1 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.

Capital Expenditure	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
<b>Operational Services:</b>					
Operations & Communities	472	1,361	226	541	785
Customer Services & IT	6	-	-	-	-
Regeneration (incl Spinning Point & THI)	6,233	5,780	7,800	-	1,000
Corporate Services and Buildings	149	442	100	70	50
Housing	587	1,888	947	947	947
<b>Commercial Activities: *</b>					
Investment Acquisition (Council July 2018)	-	-	1,300	-	-
<b>Total</b>	<b>7,447</b>	<b>9,471</b>	<b>10,373</b>	<b>1,558</b>	<b>2,782</b>

\* Commercial activities / non-financial investments relate to areas such as capital expenditure on investment properties, loans to third parties etc.

### Long term liabilities

The Council currently has only one long-term liability in the form of a 25-year PWLB loan, for which the annual repayment of principal is £184k.

The table below summarises the above capital expenditure plans and the available capital or revenue resources. Any shortfall of resources results in a funding need (borrowing). The main increases in net financing requirement during 2018/19 are the Council's contribution to Spinning Point Phase 1 project and the purchase of new operational vehicles, all of which will be funded over the economic life of the assets and met from additional operating income and current revenue budgets respectively.

Funded by:	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Capital receipts	2,614	729	77	144	110
Capital grants	3,325	7,495	947	947	947
Earmarked reserves contributions	345	221	8	-	-
In-year Revenue contributions (incl S106)	145	128	100	70	50
<b>Total in-year resources</b>	<b>6,429</b>	<b>8,573</b>	<b>1,132</b>	<b>1,161</b>	<b>1,107</b>
<b>Therefore Net financing need for year</b>	<b>1,018</b>	<b>898</b>	<b>9,241</b>	<b>397</b>	<b>1,675</b>
<b>Commercial Activities included above</b>					
Application of in-year resources	-	-	-	-	-
Net financing need	-	-	1,300	-	-
Percentage of total net financing need	-	-	14.1%	-	-

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	6
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

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

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure 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, and so charges the economic consumption of capital assets to the revenue account as they are used.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases) brought onto the balance sheet. Whilst this increases the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections below:

Capital Financing Requirement (CFR)	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Opening CFR	9,379	9,588	8,992	16,357	16,178
Movement in CFR - Services (see below)	209	(596)	7,365	(179)	1,099
Movement in CFR - Commercial Activities	-	-	1,300	-	-
Closing CFR	9,588	8,992	16,357	16,178	17,277
<b>Movement in CFR is represented by</b>					
Net financing need for the year (see above)	1,018	898	9,241	397	1,675
Less MRP repayments	(809)	(1,494)	(576)	(576)	(576)
Movement in CFR	209	(596)	8,665	(179)	1,099

The movement in the CFR in 2019/20 is £9,241k, which includes the following major projects:

- The acquisition of an investment property valued at £1.3m, approved at the Council meeting in July 2018 subject to the completion of due diligence exercises.
- The Spinning Point Phase 2 development of £7.8m plus spa fit-out of £1m. Funding for this included a 3-year PWLB loan of £7.8m, to be followed by a £1.8m loan over 30 years once the development is completed and a £1m loan for the Spa fit-out.
- The balance of £141k in financing need relates to the operational vehicle replacement plans, which will be met from internal borrowing for which MRP is already included within the budgets.

## 2.3 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments and borrowing unless resources are supplemented each year from new sources (asset sales etc.).

Detailed below are expected opening cash balances and the anticipated cash flow impacts of the MTFs and the Capital Programme.

Responsible Section/Team	Financial Services	Page	7
Responsible Author	Head of Finance	Version	v1
Date last amended	February 2018	Due for review	Feb 2019

## Treasury Management Strategy Statement 2019/20

Cash Flow over the MTFS	2019/20 £000	2020/21 £000	2021/22 £000
<b>Cash Balances at 1st April b/fwd</b>	<b>8,167</b>	<b>8,913</b>	<b>1,706</b>
<b>Non- Cash Budget items:</b>			
Minimum Revenue Provision	576	576	576
Annual Pensions charge	1,500	1,500	1,500
3-yr Pre-payment of Pensions	-	(4,500)	-
Revenue Contribution to Capital Outlay	100	70	50
<b>Application of Reserves</b>			
NNDR	-	-	-
Other Reserves - MTFS *	(511)	(469)	(183)
<b>Capital Programme (CFR net impact)</b>			
Vehicles	(473)	-	-
Spinning Point Ph 2	(3,900)	(3,900)	(1,000)
Investment Property Acquisition	0		
Annual Programme	(130)	(100)	(100)
<b>Use of Grants received in advance</b>			
DFGs	(750)	-	-
Spinning Point Ph 1	(2,400)	-	-
<b>Capital receipts</b>	50	50	50
<b>PWLB:</b>			
Borrowing repayments - current loan	(184)	(184)	(184)
New Borrowing	7,800	0	1,000
<b>Repayment of HCA Grant (part 2)</b>	(682)	-	-
<b>Contingency / Timing</b>	(250)	(250)	(250)
<b>Cash Balances at 31st March c/fwd</b>	<b>8,913</b>	<b>1,706</b>	<b>3,165</b>

\* As per the 2019/20 MTFS.

Detailed below are estimates of the year end balances for each resource following the anticipated cash flow requirements above.

Year-end Resources	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
General Fund balance	1,000	1,000	1,000	1,000	1,000
Earmarked reserves	6,874	5,276	4,785	3,885	3,393
Capital receipts	1,762	1,137	1,134	1,040	980
Government Grants Unapplied	929	857	57	25	25
Additional Resources to fund the MTFS	-	-	576	576	576
<b>Total Reserves</b>	<b>10,565</b>	<b>8,270</b>	<b>7,552</b>	<b>6,526</b>	<b>5,974</b>
(Under)/over borrowing (see 3.1)	(6,460)	(6,048)	(4,497)	(4,502)	(4,785)
Expected resources	4,105	2,222	3,055	2,024	1,189
<b>Cash Balances (see 2.3) #</b>	<b>6,556</b>	<b>7,417</b>	<b>12,557</b>	<b>3,683</b>	<b>4,717</b>
Working capital *	2,451	5,195	9,502	1,659	3,528

\* Working capital balances shown are estimated year end; these may be higher mid-year

# Given the Council's current banking portfolio, the Cash and Cash Equivalents has been combined with Investments, rather than being shown as part of the working capital

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	8
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019



# Treasury Management Strategy Statement 2019/20

## 2.4 Minimum Revenue Provision Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the Minimum Revenue Provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

DCLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement :

Since the 1st April 2008 all unsupported borrowing (including PFI and finance leases when applicable) has been repaid using the following MRP policy:

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);

This provides for a reduction in the borrowing need over approximately the same term as the asset's life.

**MRP Overpayments** - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory Minimum Revenue Provision (MRP), Voluntary Revenue Provision (VRP) or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. At the time of writing this report the total VRP overpayments were £657k, made entirely in 2018/19 as approved by Cabinet within the Q1 monitoring report.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	9
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

## 3 BORROWING

The capital expenditure plans set out in Section 2 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 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.

### 3.1 Current Portfolio Position

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

Borrowing Position	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Debt at 1 <sup>st</sup> April	3,312	3,128	2,944	11,860	11,676
Debt Repayments	(184)	(184)	(184)	(184)	(184)
New Debt	-	-	9,100	-	1,000
<b>Debt at 31<sup>st</sup> March</b>	<b>3,128</b>	<b>2,944</b>	<b>11,860</b>	<b>11,676</b>	<b>12,492</b>
<b>Commercial Activities included above</b>					
Debt at 31st March	-	-	1,300	-	-
Percentage of Total External Debt	0.00%	0.00%	10.96%	0.00%	0.00%
Capital Financing Requirement (CFR)	9,588	8,992	16,357	16,178	17,277
<b>Under / (over) borrowing</b>	<b>6,460</b>	<b>6,048</b>	<b>4,497</b>	<b>4,502</b>	<b>4,785</b>

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt, does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 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 purposes.

The Head of Financial Services reports that the Council complied with this prudential indicator in 2018/19. Given the MTFS cash-flow impacts of current commitments, existing plans, and the proposals in the main budget report, as explained at 2.3 above, the Head of Financial Services recommends that the limits to borrowing activity are increased as indicated below.

### 3.2. Treasury Indicators: Limits to Borrowing Activity

**The Operational Boundary.** This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary	2017/18 £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Services Debt	4,500	9,500	11,200	11,200	11,200
Commercial Debt	-	-	1,300	1,300	1,300
Total External Debt	4,500	9,500	12,500	12,500	12,500

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	10
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

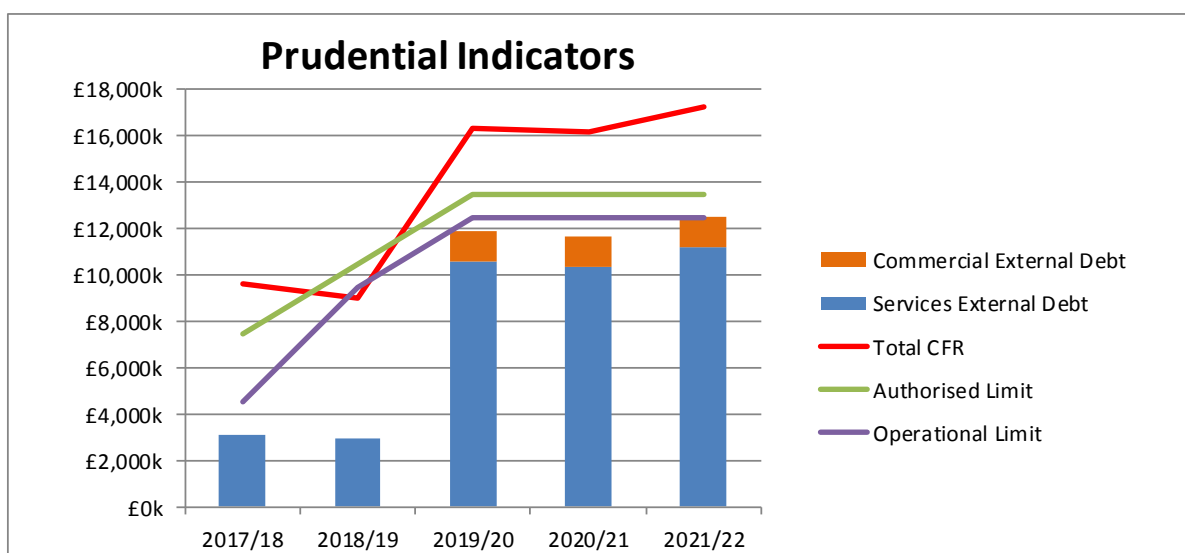
## Treasury Management Strategy Statement 2019/20

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

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 this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit	2017/18 £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Services Debt	7,500	10,500	12,200	12,200	12,200
Commercial Debt	-	-	1,300	1,300	1,300
Debt	7,500	10,500	13,500	13,500	13,500

In graphical terms the relationship between the total CFR, the current external borrowing and the suggested authorised and operational debt boundaries can be shown as follows. The prudent level of future potential borrowing is clearly visible as the gap between the predicted CFR and the current external borrowing level.



### 3.3. Prospects for Interest Rates (from Link Asset Services on 31/01/2018).

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

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	11
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## Treasury Management Strategy Statement 2019/20

Link Asset Services Interest Rate View													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%

The flow of generally positive economic statistics after the quarter ended 30 June 2018 meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. Growth became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis and emerging market developments. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	12
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

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

- Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2018-19 and while they were on a rising trend during the first half of the year, they have backtracked since then until early January. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of 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.

## 3.4 Borrowing Strategy

The Council has been maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), 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 was prudent in the past, however, reserves and cash are being used to support the MTFS and the Capital Programme, leading to an increasing need for future borrowing.

Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt 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 borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
- *if it was felt 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. Most likely, fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.*

Any decisions will be reported to Cabinet at the next available opportunity.

## 3.5 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:

- It will be limited to no more than 100% of the expected increase in borrowing need (CFR) over the three year planning period; and

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	13
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## Treasury Management Strategy Statement 2019/20

- 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.

### 3.6 Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Cabinet, at the earliest meeting following its action.

### 3.7 Municipal Bond Agency

It is likely 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 consider use of this new source of borrowing as and when appropriate.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	14
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

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## 4 ANNUAL INVESTMENT STRATEGY

### 4.1 Investment Policy

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, (a separate report).

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

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

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: -

1. 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.
2. **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.

Investment instruments identified for use in the financial year are listed in appendix 5.4 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

### 4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the Specified and Non-Specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	15
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## Treasury Management Strategy Statement 2019/20

procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

The criteria for providing a pool of high quality investment counterparties (both Specified and Non-specified investments) is:

- Banks 1 - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AAA  
and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
    - i. Short term - F1
    - ii. Long term – A
- Banks 2 – Part nationalised UK banks –Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation -. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Local authorities, parish councils etc
- Money Market Funds – using only those with AAA long-term rating backed up with lowest volatility rating (MR1+)
- Supranational institutions
- Rossendale Leisure Trust to a maximum of £100k
- Other related parties (where a charge can be placed on land or equity to preserve the Council's rights to its resources).

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	16
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019



# Treasury Management Strategy Statement 2019/20

## UK banks – ring fencing

- 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 by 1st 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. Several banks are very close to the threshold already and so may come into scope in the future regardless.
- 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.
- 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.

## 4.3 Other Considerations

### Country and sector considerations

Due care will be taken to consider the country, group and sector exposure of the Council’s investments. For the foreseeable future this Council will only invest in UK based institutions.

### Use of additional information other than credit ratings.

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

### Time and monetary limits applying to investments.

All investments will be made for no more than 365 days, i.e short-term.

The proposed criteria for Specified and Non-Specified investments are shown in Appendix 5 for approval.

## 4.4 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).

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	17
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

## Investment returns expectations.

Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

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

	<b>Average</b>
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are dependent on how strong GDP growth turns out, how slowly inflation pressures subside, 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: -

<b>Maximum principal sums invested &gt; 365 days</b>	<b>2019/20 £m</b>	<b>2020/21 £m</b>	<b>2021/22 £m</b>
Principal sums invested > 365 days	Nil	Nil	Nil

## 4.5 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Financial Monitoring.

## 4.6 External fund managers

The Council does not currently use external fund managers.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	18
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

# Treasury Management Strategy Statement 2019/20

## 5 APPENDICES

- 5.1 Prudential and treasury indicators
- 5.2 Interest rate forecasts
- 5.3 Economic background
- 5.4 Treasury Management practice - specified and non specified investments and limits
- 5.5 Approved countries for investments
- 5.6 Treasury management scheme of delegation
- 5.7 The treasury management role of the section 151 officer and other officers
- 5.8 Glossary

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	19
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

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## Treasury Management Strategy Statement 2019/20

### 5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2021/22 AND MRP STATEMENT

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.

#### 5.1.1 Capital expenditure

Capital Expenditure	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
<b>Operational Services:</b>					
Operations & Communities	472	1,361	226	541	785
Customer Services & IT	6	-	-	-	-
Regeneration ( <i>incl Spinning Point &amp; THI</i> )	6,233	5,780	7,800	-	1,000
Corporate Services and Buildings	149	442	100	70	50
Housing	587	1,888	947	947	947
<b>Commercial Activities: *</b>					
Investment Acquisition (Council July 2018)	-	-	1,300	-	-
<b>Total</b>	<b>7,447</b>	<b>9,471</b>	<b>10,373</b>	<b>1,558</b>	<b>2,782</b>

#### 5.1.3 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:

##### a. 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.

Ratio of financing costs to net revenue stream	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Interest Payable - Services	149	140	255	247	238
Interest Payable - Commercial Activities	-	-	32	32	32
Interest Receivable	(72)	(51)	(51)	(51)	(51)
<b>Net cost of capital</b>	<b>77</b>	<b>89</b>	<b>236</b>	<b>228</b>	<b>219</b>
Net Revenue Stream	9,241	9,182	10,070	9,595	10,287
<b>Ratio of financing costs to net revenue stream</b>	<b>0.83%</b>	<b>0.97%</b>	<b>2.35%</b>	<b>2.38%</b>	<b>2.13%</b>

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

#### 5.1.4 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.

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

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	20
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

## Treasury Management Strategy Statement 2019/20

Treasury indicators and limits	2019/20	2020/21	2021/22
<b>Interest rate Exposures</b>	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	0%	0%	0%
<b>Limits on fixed interest rates:</b>			
• <i>Debt only</i>	100%	100%	100%
• <i>Investments only</i>	90%	90%	90%
<b>Maturity Structure of fixed interest rate borrowing 2019/20</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	30%	
12 months to 2 years	0%	10%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years and above	0%	100%	
<b>Maturity Structure of variable interest rate borrowing 2019/20</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	0%	
12 months to 2 years	0%	0%	
2 years to 5 years	0%	0%	
5 years to 10 years	0%	0%	
10 years and above	0%	0%	

### 5.1.5. Control of interest rate exposure

Please see paragraphs 3.3, 3.4 and 4.4.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	21
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	February 2018	<b>Due for review</b>	Feb 2019

Treasury Management Strategy Statement 2019/20

**APPENDIX 5.2 Interest Rate Forecast 2018-2022**

<b>Link Asset Services Interest Rate View</b>													
	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
<b>Bank Rate View</b>	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
<b>Bank Rate</b>													
Link Asset Services	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
Capital Economics	0.75%	1.00%	1.25%	1.50%	1.70%	1.75%	2.00%	2.00%	-	-	-	-	-
<b>5yr PWLB Rate</b>													
Link Asset Services	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
Capital Economics	2.03%	2.15%	2.40%	2.65%	2.70%	2.75%	2.80%	2.85%	-	-	-	-	-
<b>10yr PWLB Rate</b>													
Link Asset Services	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
Capital Economics	2.43%	2.55%	2.80%	3.05%	3.05%	3.05%	3.05%	3.05%	-	-	-	-	-
<b>25yr PWLB Rate</b>													
Link Asset Services	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.96%	3.08%	3.33%	3.58%	3.53%	3.48%	3.43%	3.38%	-	-	-	-	-
<b>50yr PWLB Rate</b>													
Link Asset Services	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.78%	2.90%	3.15%	3.40%	3.40%	3.40%	3.40%	3.40%	-	-	-	-	-

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	22
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v3
<b>Date last amended</b>	February 2017	<b>Due for review</b>	Feb 2018

## APPENDIX 5.3 Economic Background

**GLOBAL OUTLOOK.** World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China and the eurozone, overall world growth is likely to weaken.

**Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to an acceleration of wage inflation. The US Fed has therefore increased rates nine times and the Bank of England twice. However, the ECB is unlikely to start raising rates until late in 2019 at the earliest.

### KEY RISKS - central bank monetary policy measures

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

**The key issue now** is that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period is well advanced in the US, and started more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy and of unemployment falling to such low levels, that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This meant that both asset categories were exposed to the risk of a sharp downward correction and we did, indeed, see a sharp fall in equity values in the last quarter of 2018. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.** At the time of writing, (early January 2019), financial markets are very concerned that the Fed is being too aggressive with its policy for raising interest rates and is likely to cause a recession in the US economy.

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt (currently about \$50bn per month). In addition, the European Central Bank ended its QE purchases in December 2018.

**UK.** The flow of positive economic statistics since the end of the first quarter of 2018 has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	23
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Treasury Management Strategy Statement 2019/20

to 0.4% in quarter 2 and by a strong performance in quarter 3 of +0.6%. However, growth in quarter 4 is expected to weaken significantly.

At their November quarterly Inflation Report meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary or contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years' time, but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor could potentially provide fiscal stimulus to support economic growth, though at the cost of increasing the budget deficit above currently projected levels.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring 2019. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019, (on the assumption that a Brexit deal is agreed by both the UK and the EU). The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

**Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.1% in December 2018. In the November Bank of England quarterly Inflation Report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate.

As for the **labour market** figures in October, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.3%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 1.2%, the highest level since 2009. This 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. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, the Brexit deal put forward by the Conservative minority government was defeated on 15 January. It is unclear at the time of writing, how this situation will move forward. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit though the risks are increasing that it may not be possible to get full agreement by the UK and EU before 29 March 2019, in which case this withdrawal date is likely to be pushed back to a new date. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	24
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020



## Treasury Management Strategy Statement 2019/20

**USA.** President Trump's massive easing of fiscal policy is fuelling a (temporary) boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2% (annualised rate) in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. The strong growth in employment numbers and the reduction in the unemployment rate to 3.9%, near to a recent 49 year low, has fed through to an upturn in wage inflation which hit 3.2% in November. However, CPI inflation overall fell to 2.2% in November and looks to be on a falling trend to drop below the Fed's target of 2% during 2019. The Fed has continued on its series of increases in interest rates with another 0.25% increase in December to between 2.25% and 2.50%, this being the fifth increase in 2018 and the ninth in this cycle. However, they did also reduce their forecast for further increases from three to two. This latest increase compounded investor fears that the Fed is over doing the speed and level of increases in rates and that it is going to cause a US recession as a result. There is also much evidence in previous monetary policy cycles of the Fed's series of increases doing exactly that. Consequently, we have seen stock markets around the world falling under the weight of fears around the Fed's actions, the trade war between the US and China and an expectation that world growth will slow.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation if an agreement is not reached soon between the US and China.

**Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this was probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of its manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank ended all further purchases in December 2018. The ECB is forecasting inflation to be a little below its 2% top limit through the next three years so it may find it difficult to warrant a start on raising rates by the end of 2019 if the growth rate of the EU economy is on a weakening trend.

**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 credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

**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. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

**Emerging countries.** Argentina and Turkey are currently experiencing major headwinds and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	25
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 3.2 are **predicated on an assumption of an agreement being reached on Brexit between the UK and the EU**. On this basis, while GDP growth is likely to be subdued in 2019 due to all the uncertainties around Brexit depressing consumer and business confidence, an agreement is likely to lead to a boost to the rate of growth in 2020 which could, in turn, increase inflationary pressures in the economy and so cause the Bank of England to resume a series of gentle increases in Bank Rate. Just how fast, and how far, those increases will occur and rise to, will be data dependent. The forecasts in this report assume a modest recovery in the rate and timing of stronger growth and in the corresponding response by the Bank in raising rates.

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

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

### The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

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 for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** 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**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. The EU rejected the initial proposed Italian budget and demanded cuts in government spending which the Italian government initially refused. However, a fudge was subsequently agreed, but only by *delaying* the planned increases in expenditure to a later year. This can has therefore only been kicked down the road to a later time. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	26
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Treasury Management Strategy Statement 2019/20

hold it. Unsurprisingly, investors are becoming increasingly concerned by the words and actions of the Italian government and consequently, Italian bond yields have risen – at a time when the government faces having to refinance large amounts of debt maturing in 2019.

- **Weak capitalisation of some European banks.** Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018, (a new party leader has now been elected). However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Ireland, the Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with. The Belgian coalition collapsed in December 2018 but a minority caretaker government has been appointed until the May EU wide general elections.
- **Austria, the Czech Republic and Hungary** now form a strongly anti-immigration bloc within the EU while **Italy**, in 2018, also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. Throughout the last quarter of 2018, we saw sharp falls in equity markets interspersed with occasional partial rallies. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks**, especially 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 both sides were to agree by 29 March a compromise that quickly removed all threats of economic and political disruption and so led to an early boost to UK economic growth.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	27
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Treasury Management Strategy Statement 2019/20

- **The Fed causing a sudden shock in financial markets** through misjudging the pace and strength of increases in its Fed Funds Rate and in the pace and strength of reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The **Bank of England is too slow** in its pace and strength of increases in Bank Rate and, therefore, allows inflation 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.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	28
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Appendix 5.4 Treasury Management Practice (TMP1) – specified and non specified investments and limits

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 24<sup>th</sup> February 2010 and will apply its principles to all investment activity. In accordance with the Code, the Head of Financial Services has produced its Treasury Management Practices (TMPs). This part, TMP 1, covering investment counterparty policy requires approval each year.

### Annual Investment Strategy

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

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

The investment policy proposed for the Council is:

### Strategy Guidelines

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

### Specified Investments

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

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, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated A by Standard and Poor's, Moody's or Fitch rating agencies.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	29
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Treasury Management Strategy Statement 2019/20

5. A body that is considered of a high credit quality, such as a bank or building society. For category 5 this covers bodies with a minimum short term rating of A (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. The limit with any one bank is 12 months and up to £8m, or 50% of the resources available at the time of investing, whichever is the larger.

### **Non Specified Investments**

In response to falling bank interest rates and the challenges of the MTFs, the Head of Finance will explore alternative investment opportunities in order to save ongoing revenue costs or earn additional revenue incomes/interest. The counterparties in these cases will generally be related parties (as defined in the Accounting Code of Practice applicable to the year in which the investment decision was made), such as Rossendale Leisure Trust, Rossendale Transport Ltd and the Lancashire county Pension Fund.

In any case, a full business case for the investment, setting out the advantages, risks and rewards and assets securities, will be presented to Cabinet for consideration and subsequently to full Council for a decision.

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Head of Financial Services, and if required new counterparties which meet the criteria will be added to the list.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	30
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

# Treasury Management Strategy Statement 2019/20

## APPENDIX 5.5 Approved countries for investments

*Based on lowest available rating*

### AAA

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

### AA+

- Finland
- U.S.A.

### AA

- Abu Dhabi (UAE)
- France
- Hong Kong
- U.K.

### AA-

- Belgium
- Qatar

In practice officers intend to only use UK banks

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	31
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## APPENDIX 5.6 Treasury management scheme of delegation

### (i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy;
- approval of individual non-specified investment decisions during the financial year.

### (ii) Cabinet

- 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 recommendations;
- approving the selection of external service providers and agreeing terms of appointment;
- reviewing the treasury management policy and procedures and making recommendations to the responsible body;
- consideration and recommendation of individual non-specified investment decisions during the financial year.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	32
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020



## APPENDIX 5.7 The treasury management role of the Section 151 officer and other officers

### The S151 (responsible) 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.

### Additional roles regarding the capital strategy and commercial activities

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities.)
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following (TM Code p54): -

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	33
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## Treasury Management Strategy Statement 2019/20

- Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
- Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
- Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
- Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
- Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

### **The Deputy S151 officer (being the Finance Manager)**

In the absence of the S151 officer, the Deputy S151 officer will take over the responsibilities noted above.

### **The Finance Officer (Exchequer Services)**

- Transfer of Funds between the Council's approved call accounts.

### **Authorised Signatories**

The following posts have been designated as those authorised to act as bank signatories for the Council.

- Head of Finance
- Finance Manager
- Finance Officer (Exchequer Services)
- Senior Accountant
- Accounts Technician

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	34
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

## APPENDIX 5.8 Glossary

### Authorised Limit for External Debt

The Authorised Limit, like all other prudential indicators, has to be set and revised by elected members. It should not be set so high that it would never in any possible circumstances be breached but rather reflect a level of borrowing which while not desired, could be afforded but may not be sustainable

**bp** – basis points (in relation to, inter alia, bank base rates)

### Capital Expenditure

Expenditure on the acquisition of a fixed asset or expenditure which adds to and not merely maintains the value of an existing fixed asset.

### Capital Financing Requirement

This important component of an authority's capital strategy is the amount of capital spending that has not been financed by capital receipts, capital grants, and contributions from revenue. It is a measure of the underlying need to borrow for capital purposes.

**CIPFA** – Chartered Institute of Public Finance and Accountancy.

**CPI** – Consumer Price Index

### Debt Rescheduling

Similar to re-mortgaging a house, in so far as, loans are repaid before maturity, and replaced with new loans, usually at a more advantageous rate of interest.

**DCLG** - Department of Communities and Local Government.

**ECB** – European Central Bank

**GDP** – Gross Domestic Product

**IMF** – International Monetary Fund

**LIBOR** – London Inter Bank Offer Rate

### Liquidity

Access to cash deposits at very short notice.

### Long term Investments

Investments with a duration of more than one year.

### Market Loans

Loans borrowed from financial institutions such as banks and building societies.

### Maturity

The date at which loans are due for repayment.

### Net Borrowing Requirement

The Council's borrowings less cash and short term investments.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	35
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
<b>Date last amended</b>	Feb 2019	<b>Due for review</b>	Feb 2020

# Treasury Management Strategy Statement 2019/20

## **Operational Boundary for External Debt**

This indicator is, as its name suggest, the focus of day to day treasury management activity within the authority. It is a means by which the authority manages its external debt to ensure that it remains within the self imposed 'Authorised Limit'. However it differs from the 'Authorised Limit' in being based on expectations of the maximum external debt of the authority according to probable- not simply possible-events and being consistent with the maximum level of external debt projected by the estimates.

## **Prudential Borrowing**

This is borrowing wholly supported by the Council and would include 'invest to save projects'. Market conditions permitting it may well be cheaper to borrow rather than lease vehicles and or plant.

## **Public Works Loan Board**

A Government agency that provides longer term loans to local authorities.

## **Ratio of Financing costs to Net Revenue Stream**

This is the proportion of interest payments plus debt repaid less interest receipts expressed as a proportion of the revenue stream. In the case of General Fund the revenue stream equates to the net budget requirement of £10.6m less £0.5m use of internal reserves (as funded by external income from Business Rates and Council Tax).

## **Repurchase Rate (Repo)**

This is equivalent to the Bank of England base rate.

## **Short-term investment**

Investments with a duration of less than or equal to 365 days.

## **Supported Borrowing**

This is borrowing that is supported by the government through the revenue support grant and housing subsidy grant.

## **Term Deposit**

Investments for a pre-defined period of time at a fixed interest rate.

## **Upper Limit for fixed/variable interest rate exposure**

This relates to the limit in loans which can be held in either fixed interest rates or variable interest rates. Whilst fixed interest-rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance may justify, or even demand, retaining a degree of flexibility through the use of variable interest rates.

## **Volatility**

Sudden upward or downward movements in interest rates in reaction to economic, market and political events.

<b>Responsible Section/Team</b>	Financial Services	<b>Page</b>	36
<b>Responsible Author</b>	Head of Finance	<b>Version</b>	v1
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