READING BOROUGH COUNCIL

REPORT BY ASSISTANT DIRECTOR OF FINANCE

TO:	**AUDIT & GOVERNANCE COMMITTEE**		
DATE:	**30 JANUARY 2020**		
TITLE:	**TREASURY MANAGEMENT STRATEGY STATEMENT (2020/21); MINIMUM REVENUE PROVISION POLICY (2020/21); ANNUAL INVESTMENT STRATEGY (2020/21)**		
LEAD COUNCILLOR:	**COUNCILLOR EMBERSON**	**AREA COVERED:**	**COUNCIL WIDE**
SERVICE:	**FINANCE**	**WARDS:**	**BOROUGHWIDE**
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1. Introduction

1.1 In accordance with the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 and the CIPFA Prudential and Treasury Management Code (2017), the Council is required to approve a Treasury Management Strategy before the start of each financial year. This report fulfils that obligation.

1.2 The Council's Treasury Management Strategy Statement (TMSS), attached at Appendix A, sets out the parameters for the Council's planned treasury activity during 2020/21 under which the Council's treasury team will manage day to day activity. The TMSS reflects the Council's Draft Capital Programme 2020/21 – 2022/23.

1.3 The successful identification, monitoring and control of financial risk are central to the Strategy. 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 day to day treasury management activity.

1.4 The CIPFA 2017 Prudential and Treasury Management Code also requires the Council to prepare a Capital Strategy report which sets out the Council's capital requirements arising from policy objectives, as well as the associated governance procedures and risk appetite.

1.5 The Capital Strategy is reported separately from the Treasury Management Strategy Statement and includes non-treasury investments.

2. RECOMMENDATIONS

That the Committee endorse and recommend that Council approve the:

- **Treasury Management Strategy Statement for 2020/21 as set out in Appendix A;**
- **Treasury Management Policy for 2020/21 as set out in Appendix A;**
- **Minimum Revenue Provision (MRP) Policy for 2020/21 as set out in Appendix A;**
- **Annual Investment Strategy for 2020/21 as set out in Appendix A; and**
- **The Prudential and Treasury Management indicators as set out in Appendix A.**

Appendices:

Appendix A - Treasury Management Strategy Statement 2020/21 (including the Borrowing & Investment Strategy, Treasury Management Indicators and Prudential Indicators); Treasury Management Policy (2020/21); Minimum Revenue Provision (2020/21); Annual Investment Strategy (2020/21).

3. Economic background

3.1 The UK has had two extensions to its exit from the European Union, the latest extension is until 31st January 2020. In light of the outcome of the general election on 12 December, it is expected that the latest outline deal agreed by the Prime Minister will be passed by Parliament by that date. Despite this, there will still be much uncertainty as the detail of a trade deal will need to be negotiated by the end of the transition period in December 2020, which the Prime Minister has pledged will not be extended.

3.2 Growth in gross domestic product has taken a hit from Brexit uncertainty during 2019 and the economy is likely to tread water in 2020, with tepid growth of around 1% until there is more certainty after the trade deal deadline is passed.

3.3 The Bank of England Monetary Policy Committee (MPC) made a change to its Brexit assumptions to include a deal being eventually passed following the 12 December election, but the Committee expressed increased concern around weak global economic growth and the potential for Brexit uncertainties to become entrenched and so delay UK economic recovery. Consequently, the MPC voted 7-2 to maintain the Bank Rate at 0.75%. The MPC indicated that a rate cut would be more likely if global growth does not pick up or Brexit uncertainty intensifies. Conversely, if risks do recede, then a more rapid recovery of growth will require gradual and limited rate rises.

3.4 If economic growth were to weaken considerably, the MPC has relatively little room to make an impact with the Bank Rate still only at 0.75%. It would therefore, be up to the Chancellor to provide help to support growth by way of a fiscal boost to the economy through tax cuts, increases in the annual expenditure budgets of government departments and expenditure on infrastructure projects.

3.5 Inflation (CPI) has been hovering around the Bank of England's target of 2% for most of 2019, but fell in both October and November to a three-year low of 1.5%. If there was a hard or no deal Brexit, inflation could rise significantly, primarily because of imported inflation on the back of a weakening pound. However, the Bank of England revised its inflation forecasts down to 1.4% in 2019, 1.5% in 2020, and 2.0% in 2021; hence, the MPC views inflation as causing little concern in the near future.

3.6 In the United States (US) of America, growth reduced after a strong start from 3.1% to around 2% annualised by the end of the year. Growth in employment numbers and inflationary pressures weakened in 2019 compared to prior years, indicating that the economy has been cooling. However, CPI inflation rose from 1.8% to 2.1% in November, a one year high, but this was singularly caused by a rise in fuel prices.

3.7 The Federal Reserve Bank (The Fed), finished its series of increases in rates to 2.25 – 2.50% in December 2018. In July 2019, it cut rates by 0.25% as a 'midterm adjustment' but flagged up that this was not intended to be seen as the start of a series of cuts to ward off a downturn in growth. It also ended its programme of quantitative tightening in August 2019. In response to signs of a weakening economy, the Fed cut rates by 0.25% again in September and by another 0.25% in its October meeting to 1.50 – 1.75% - rates were left unchanged in December.

3.8 EUROZONE (EZ) – Growth has been slowing from +1.8 % during 2018 to around half of that in 2019. Annual growth hovered around +1.2% year on year, so there appears to be little upside potential in the near future. German GDP growth has been struggling to stay in positive territory in 2019 and fell by -0.1% in quarter 2; annual industrial production was down 4% in June 2019 with car production down 10%. Germany would be particularly vulnerable to a no deal Brexit depressing exports further especially if the USA imposes tariffs on EU produced cars.

3.9 The European Central Bank (ECB) ended its programme of quantitative easing in December 2018, which meant that the central banks in the US, UK and EU had all ended the phase of post financial crisis expansion of liquidity supporting world financial markets. However, the downturn in EZ growth in the second half of 2018 and into 2019, together with inflation falling well under the upper limit of its target range of 0 to 2%, has prompted the ECB to take new measures to stimulate growth in 2019.

3.10 The trade war between the US and China is a major concern to financial markets due to the synchronised general weakening of growth in the major economies of the world, compounded by fears that there could even be a recession looming in the US. These concerns resulted in government bond yields in the developed world falling significantly during 2019. There are also concerns about how much distortion of financial markets has already occurred with the current levels of quantitative easing purchases of debt by central banks and the use of negative central bank rates in some countries. The latest Purchasing Managers' Index (PMI) survey statistics of economic health for the US, UK, EU and China have all been predicting a downturn in growth; this confirms investor sentiment that the outlook for growth during the year ahead is weak.

4. Borrowing

4.1 Under the Prudential Code, the Council can borrow to fund capital expenditure if such borrowings are sustainable, affordable and prudent.

4.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR is the total historic capital expenditure which has not yet been paid for from either revenue or capital resources – it is the Council's underlying need to borrow. Whereas usable reserves and working capital are the underlying resources available for investment.

4.3 Historically the Council has borrowed to pay for new assets including schools, roads and community facilities etc. The value of the Council's assets is circa £1.1bn which includes £551m of Housing assets. As at 30th November 2019, the Council had £399m of loans outstanding in respect of these assets for both the General Fund and the Housing Revenue Account (HRA).

4.4 The Council took out several tranches of new borrowing totalling £30m in 2019 to fund Capital Programme commitments. By taking out new long term loans, the Council was able to de-risk its exposure to long term interest rate increases. Shortly, after the last of these loans was approved, HM Treasury increased interest rates on all PWLB loans by1%. By taking out the loans before the increase, the Council saved £0.3m a year in interest costs going forward.

4.5 With an orderly exit from Europe, market projections indicate that long term borrowing costs will increase gradually and remain relatively low for some time compared to historic averages. Consequently, the Council does not intend to borrow until it needs to, thereby avoiding the "cost of carry" (the difference between the cost of borrowing and return on investing the funds until such time as the capital expenditure is incurred).

4.6 Based on its proposed Capital Programme over the period 2020/21 – 2022/23 the Council has a projected increase in its CFR of £261m. The Programme aims to improve the infrastructure, asset base and effectiveness of service provision for the residents of Reading.

4.7 The Capital Programme, after specific grants, s106 contributions and capital receipts has a borrowing requirement of £293m, £262m General Fund and £31m Housing Revenue Account. The majority of General Fund borrowing, relates to invest to save projects or those that generate a financial return, such as commercial investment. The remainder is to facilitate improved service provision. The cost of borrowing together with any associated revenue savings is included within the Council's Medium Term Financial Strategy 2020/21 – 2022/23.

4.8 The Executive Director of Resources has delegated responsibility for borrowing and works closely with the Council's treasury management team and advisors, Link Asset Services, on borrowing decisions taking into account several factors including:

- The cost of borrowing short or long-term
- Anticipated changes in the cost of borrowing
- The level of cash balances held under investment
- The return on invested balances

4.9 The Council's long-term borrowing (loans over 12 months in length) is from two sources: the Public Works Loans Board (PWLB) and private banks for debt relating to Lender Option Borrower Option loans (LOBO loans currently stand at £25m). For short term borrowing the Council will continue to use other sources of finance, e.g. loans from other local authorities that it can borrow from at lower rates of interest than PWLB.

4.10 The framework for taking borrowing decisions in the coming year is set out in the Council's TMSS, attached at Appendix A. The Council may increase its longer term PWLB borrowing to cover new capital project expenditure in advance of need to minimise the risk of interest rate fluctuations.

4.11 The Council's self-imposed limits on sustainable, affordable and prudent borrowing and investment, the prudential and treasury management indicators that need to be approved by Council are set out in Appendix A.

5. Investment

5.1 The Council's investments for Treasury Management purposes seek to manage in year fluctuations in cash-flow. Treasury investments can be called on at short-notice and in the main are held in Money Market Funds. These are low-risk investments and give higher rates of interest compared to leaving balances in the Council's bank account. Other investments include the CCLA property fund and loans to the Council's wholly owned companies.

5.2 The level of investments fluctuates throughout the year dependent on cash balances. The balance of investments was £73m at the end of November 2019 with an average weighted rate of return of 0.9%. This will earn approximately £0.6m for the Council and is built into the revenue budget.

5.3 The Council can legally invest in the following funds and instruments:

- Deposits (Government and public sector bodies)
- Deposits (Banks and Building Societies)
- Callable deposits (Banks and Building Societies)
- Money Market Funds
- Certificates of Deposit (tradable term deposits)
- Governments Gilts and Treasury Bills
- Corporate Bonds
- Derivatives (where used for risk management)

5.4 The Ministry for Housing Communities & Local Government (MHCLG) published updated guidance on investments in February 2018. The previous edition covered treasury investments only, but the latest edition focuses on non-treasury investments. These are commercial investments such as the purchase of investment properties, investments in subsidiaries or investments for service objectives including regeneration.

5.5 Commercial Investments are part of the Capital Programme approved by Members. The borrowing to fund the investments is undertaken under the Treasury Management Strategy.

6. Markets in Financial Instruments Directive (MiFID) II

6.1 MiFID II is the EU directive regulating the provision of financial services within the European Economic Area and became effective on 3 January 2018. The objective of MFIS II is to provide greater safeguards for non-professional clients who invest or trade in financial instruments.

6.2 Local authorities are now classified as retail clients by default, unless they exercise the option to 'opt-up' to 'elective professional client status' subject to meeting certain qualitative and quantitative tests.

6.3 The Council has successfully opted up to professional client status which means it can maintain its ability to maximise interest on its balances and not have to limit its current range of investments. This status has to be agreed individually with each financial institution, broker and adviser and certain conditions have to be met relating to the quantity of transactions carried out and the experience and knowledge of those carrying out those transactions.

6.4 Under the legislation, professional status requires the Council to assume more direct responsibility for its investment decisions. Effectively this is incorporated into the due diligence the Council already undertakes before making any investment.

7. Approved Investments and Counterparties

7.1 The counterparty criteria are kept under regular review and are detailed in annexe A of the appendix to this report. The criteria set out the value and duration limits which are applied in the day to day investment of the Council's cash balances.

7.2 The value and duration limits as well as the minimum credit ratings required of individual institutions seek to minimise the Council's exposure to counterparty risk, i.e. limit any potential loss due to the failure of any single institution or group.

7.3 The credit ratings agencies' criteria are relative measures of financial strength, any changes are notified to the Council's Treasury team on the same day by our treasury advisor, Link Asset Services. Over recent years the agencies have downgraded many financial institutions by removing the implied sovereign support. However, financial institutions have improved their capital ratios to meet new regulatory standards to enable them to withstand market shocks like that experienced during the financial crisis in 2008. This requirement for increased resilience is designed to give higher assurance that institutions will be going concerns in the medium to long term.

7.4 In addition, central banks such as the Bank of England and European Central Bank provide financial support to financial institutions through Term Funding Schemes (TFS) that ensures they have access to enough liquidity at low rates.

The TFS was launched in 2016 and provides funding to banks and building societies at rates close to Base Rate.

8. Risk Controls

Investment Risk

8.1 The main risk of investing with others is that the borrower or counterparty defaults on the loan and cannot repay it.

8.2 The main controls on investment risk are the application of counterparty criteria which limit the amount and duration of investments with both individual and groups of related counterparties. The criteria are generally based on rating agency evaluations as detailed in Appendix A.

Borrowing Risk

8.3 The main risk when deciding to borrow is around the timing of the decision. There is a risk that interest rates will increase before any planned borrowing is taken. The Council receives regular interest rate forecasts which are used to inform decisions on the timing of external borrowing.

8.4 The latest guidance requires the use of other information as well as rating agency evaluations. When ratings change, the Treasury team are notified on the same day by our treasury advisors. There are regular internal and external meetings the Treasury team attend to keep abreast of latest topics. The monthly updates from Link Asset Services include other market sources of information, such as the prices of financial instruments and shares. In addition, professional publications and sector specific reports are reviewed by the team to ensure that any decision to borrow is based a broad array of available information.

8.5 The Treasury Management policies deal with risk controls, decision making and reporting processes, along with high level administration of the Treasury Management activities.

9. FINANCIAL IMPLICATIONS

9.1 Financial implications are contained in the body of this report

10. LEGAL IMPLICATIONS

10.1 This report assists the Council in fulfilling its statutory obligation to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy for the coming year setting out the Council's policies for managing its borrowing and investments and giving priority to the security and liquidity of those investments.

11. ENVIRONMENTAL IMPLICATIONS

11.1 There are no environmental implications arising from this report.

12. BACKGROUND INFORMATION

- CIPFA Code of Practice for Treasury Management in the Public Services 2017
- CIPFA The Prudential Code 2017
- MHCLG guidance February 2018
- CIPFA Bulletin Treasury and Capital Management Update October 2018

1. INTRODUCTION

Background

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

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

1.3 The treasury management function makes a critical contribution to the effective management of the Council's financial position, 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 operation, debt financing costs and investment income arising from cash deposits will impact on the Council's budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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

1.5 The Chartered Institute of Public Finance and Accountancy (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."*

Reporting Requirements

1.6 The CIPFA 2017 Prudential and Treasury Management Codes require all local authorities to prepare a number of treasury management related strategies and policies for approval by Council.

1.7 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, including:

a. The first (this report), which is forward looking and covers:

- the Council's capital plans, (including prudential indicators);
- a Minimum Revenue Provision (MRP) Policy, (how residual capital expenditure is charged to revenue over time);

- the Treasury Management Strategy (TMSS) – how investments and borrowing is to be organised, including treasury indicators; and
- an Investment Strategy – the parameters within which investments are to be managed.

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

c. An annual treasury report – This is a backward looking review document and provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the Strategy

Capital Strategy

1.8 The CIPFA Code also requires the Council to prepare a Capital Strategy Report which includes the following:

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

1.9 The Capital Strategy is reported separately from the TMSS; 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 commercial 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 (Minimum Revenue Provision Policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

1.10 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.

Non Financial Investments

1.11 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.

1.12 If any non-treasury investment is found to have sustained a loss during preparation of final accounts/audit process, the strategy and revenue implications will be reported through the same procedure as the capital strategy.

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

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

2 Treasury Management Strategy for 2020/21

2.1 **The strategy for 2020/21 covers two main areas:**

a. Capital issues

- the capital expenditure plans and the associated prudential indicators;
- the Minimum Revenue Provision (MRP) Policy.

b. Treasury management issues

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

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

Training

2.3 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. Training will be arranged for members of the Audit and Governance Committee as necessary in line with the requirements of the Code.

2.4 Staff regularly attend training courses and seminars provided by the Council's external treasury management advisers and CIPFA. Staff are also encouraged to study professional qualifications from CIPFA, or other appropriate organisations. The Council reviews the training needs of treasury management officers periodically to ensure that staff receive necessary training to properly discharge their duties.

Treasury management consultants

2.5 The Council uses Link Asset Services as its external treasury management advisors.

2.6 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

2.7 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 subject to regular review.

2.8 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 appoints advisers on a case by case baisis.

3 THE CAPITAL PRUDENTIAL INDICATORS 2020/21 – 2022/23

3.1 The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators below.

Capital expenditure

3.2 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 as set out in Table 1 below.

Table 1 – Capital Expenditure (2018/19 – 2022/23)

Capital expenditure	2018/19	2019/20	2020/21	2021/22	2022/23
£m	Actual	Estimate	Estimate	Estimate	Estimate
DACHS – Adults Services	1.108	0.150	1.405	5.000	1.000
DCEECHS – Childrens Services	4.822	14.243	14.088	4.200	1.870
DEGNS – Environment & Neighbourhood	43.364	44.346	60.506	32.864	32.414
DORS – Resources	1.451	45.093	86.513	58.128	57.599
Others - Corporate	12.016	7.070	1.320	0.685	0.000
Non-Housing Revenue Account Total	62.761	110.992	163.832	100.877	92.883
Housing Revenue Account	15.481	18.977	31.777	24.882	11.503
Council Total	**78.242**	**129.879**	**195.609**	**125.699**	**104.386**

Note: The above financing need excludes other long-term liabilities, such as PFI and leasing arrangements that already include borrowing instruments

3.3 Table 2 below summarises how the above capital expenditure plans are expected to be financed by capital or revenue resources. Any shortfall results in a borrowing need.

Table 2 – Financing of Capital Expenditure (2018/19 – 2022/23)

Financing of capital expenditure £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital receipts	20.081	13.341	13.304	10.206	4.101
Capital grants	18.995	43.662	47.690	11.910	11.069
Capital reserves	7.403	9.264	8.064	8.064	8.064
Revenue	0.097	0.111	0.604	0.000	0.000
Net financing (Borrowing) requirement	**31.666**	**71.402**	**142.044**	**107.088**	**84.591**

3.4 A key aspect of the regulatory and professional guidance is that elected members are aware of the size and scope of any commercial activity in relation to the authority's overall financial position. The planned commercial investment capital expenditure figures demonstrate the scope of this activity and, by approving these figures, consider the scale proportionate to the Authority's other remaining activity.

3.5 Capital expenditure figures relating to commercial activities included in Table 1 is shown below. Table 3 also sets out the net financing required to fund planned commercial activity as a percentage of the Council's overall net financing need.

Table 3 – Non-Financial Investments (2018/19 – 2022/23)

Commercial activities / non-financial investments - £m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Expenditure / Net financing need	0.000	32.914	75.000	50.000	50.000
Financing costs	22.135	25.309	23.339	27.725	31.343
Net financing need for the year	31.666	71.402	142.044	107.088	84.591
Percentage of total net financing need %	0%	46%	53%	47%	59%

3.6 Whilst a high percentage of non-financial investments are financed through borrowing, they are generally invest to save assets which means that they make a net contribution to the Council's revenue budget

Capital Financing Requirement

3.7 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the capital expenditure incurred which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need.

3.8 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 as they are used.

3.9 The CFR includes other long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes. The Council currently has £25.94m of such schemes netted off within the CFR.

3.10 The CFR projections are set out in Table 4 below:

Table 4 – CFR Movement Analysis

£m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement					
CFR – non housing	361.220	415.446	530.093	611.390	676.089
CFR – housing	186.800	194.701	210.798	222.367	225.806
Total CFR	**548.020**	**610.147**	**740.891**	**833.757**	**901.895**
Movement in CFR	23.061	62.127	130.744	92.866	68.138
Movement in CFR represented by					
Net financing need for the year (above)	31.666	71.402	142.044	107.088	84.591
Less MRP and other financing movements	(8.605)	(9.275)	(11.300)	(14.222)	(16.453)
Movement in CFR	23.061	62.127	130.744	92.866	68.138

4 Minimum revenue provision (MRP) policy statement

4.1 The Council is under a duty to annually set aside revenue funds for the prudential repayment of outstanding capital borrowing in accordance with provisions set out in CIPFA's Prudential Code and Ministry of Housing, Communities and Local Government's (MHCLG) Statutory Guidance on Minimum Revenue Provision. The setting aside of revenue funds for the future repayment of outstanding borrowing is referred to as a Minimum Revenue Provision (MRP) charge. The Council is also allowed to undertake additional voluntary payments if requried.

4.2 As part of the regulatory framework, Full Council is required to approve a Minimum Revenue Provision (MRP) Policy.

4.3 The MRP policy, in accordance with proper practice, considers outstanding capital borrowing to be the Council's Capital Financing Requirement (CFR) rather than external loans taken out to finance capital expenditure. Accordingly, any reference in this policy to the repayment of capital borrowing relates to the setting aside of resources to reflect movements within the Council's CFR rather than to the physical repayment of external debt.

General

4.4 Provision for the repayment of outstanding capital borrowing will generally be made in accordance with the guidance and regulations to reflect the estimated life over which the capital assets acquired are anticipated to provide useful economic benefit. A schedule setting out expected lives of standard categories of assets is provided below. However, this may be adjusted on an individual asset by asset basis depending on the specific circumstances. The Council's statutory s151 officer will, as necessary determine individual asset lives for MRP purposes (in accordance with the overriding requirement to allow for the prudent provision for repayment of debt).

Standard Expected Asset Lives

• Major New Builds	40-50 Years
• Freehold Land	50 Years
• Major Extensions	20-40 Years
• Major Refurbishments	20 Years
• Major Transport Infrastructure / Regeneration	30 Years
• Other Transport Schemes	20 Years
• Other Small Capital Schemes	10 Years
• Large Vehicles (Refuse Freighters/Buses etc.)	7-8 Years
• Other Vehicles	5 Years
• Software Licenses	Life of License
• Share Capital	20 Years
• Capital Grants / Loans to Others	Expected Life of asset Held by third party

4.5 Of the four standardised methods set out as examples in the statutory regulations for the calculation of MRP, the Council has adopted the "Asset Life Method - Annuity" as the one which best allows for the prudent repayment of capital borrowing over the life of individual capital assets. MRP is the principal element for the repayment of borrowing. The annuity is the repayment profile determined by the useful life of the asset and an appropriate interest rate.

4.6 Assets acquired and with notional outstanding capital borrowing will continue to have an annual MRP charge levied at 2% of the identified capital debt balance at 31 March 2011.

4.7 Assets under construction which have yet to fully deliver their expected benefits will not be subject to MRP charges to the Revenue Account until such time as they become operational for a full accounting year. Accordingly, on becoming operational, the charge for MRP will not commence until the following financial year.

4.8 Any prior error or change in assumption as to expected future asset life may be adjusted for in the current (or future) financial year, subject to any constraints on such adjustment as set out in the Prudential Code or Statutory Regulations.

4.9 Whilst the above sets out the Council's general MRP principles and policy, a number of specific instances and circumstances require separate treatment with regard to MRP in order to ensure the charge to revenue is both prudent for the repayment of debt and accurately reflects the economic benefits being realised. These are set out below:

Specific MRP Cases

4.10 Capital expenditure financed by finance lease or other service concessions (including Private Finance Initiative schemes) include within their annual payments both an interest and principal repayment element. The principal element included within these payments will be used to represent the MRP charge in accordance with the contractual agreement rather than separately calculating an MRP charge under the usual annuity method.

4.11 Capital loans to third parties with terms that include annual principal repayment (either equal instalment or annuity-based) will not be charged a separately calculated MRP charge as the annual principal repayments will be used to reduce the CFR and accordingly reduce the overall capital borrowing.

4.12 Short term loans for capital purposes (those with a full repayment date of five years or less) will generate a receipt on their maturity which for capital accounting purposes counts as a capital receipt. On the basis that such capital receipts will be applied to reduce the Capital Financing Requirement – and as such deemed to repay the capital borrowing – no MRP charge will be made on such loans.

4.13 Capital loans to wholly-owned subsidiaries will not be subject to MRP charges in circumstances where the net worth of the subsidiary is (or is reasonably expected to be in the short to medium term) in excess of the loan and as such a disposal of those assets would provide sufficient funds to fully repaying the outstanding capital borrowing of the Council.

4.14 Charges for the provision to repay capital debt relating to share capital for group holdings will not be applied in circumstances where any proposed debt restructuring and re-gearing is expected to lead to the redemption of called up share capital over the short to medium term.

4.15 Where the Council has outstanding borrowing relating to individual and specific investment property assets, in exceptional circumstances where a substantial void period in lettings occur, the Council reserves the right to take a temporary "holiday" in MRP payments for that asset until the property is let or a strategy determined to change the asset use or dispose of the asset and thus generate a capital receipt. Any MRP holiday arising from such a situation will be reversed by correspondingly adjusting future MRP charges over the estimated remaining life of the asset or a capital receipt realised.

4.16 Individual assets being subject to an MRP charge will cease to be subject to MRP charges at the point they are identified as surplus and have a likely expectation of generating a capital receipt in the short to medium term.

4.17 The Housing Revenue Account (HRA) is not subject to the same statutory annual requirement to make an MRP charge as the General Fund. It is however required to make provision for the repayment of capital debt over the longer term (broadly over the thirty year life of the HRA Business Plan). In prior years, the HRA has set aside 2% per annum of its CFR to meet this obligation. This Policy proposes that this blanket 2% per annum policy is dis-continued and that the HRA is given greater flexibility to make provision for the repayment of debt over the life of its Business Plan. The HRA Business Plan provides for significant investment in modernising its existing holdings as well as new housing stock, the application of a more flexible and long term strategy for debt repayment will ease pressure on HRA balances and enable greater provision of decent homes whilst still allowing the overall level of debt to be repaid over the long term. The Council's s151 officer will continue to ensure that the HRA Business Plan provides for the prudent repayment of debt over the longer term.

4.18 Subject to affordability and the sustainability of the budget and Medium Term Financial Strategy, the Council's S151 Officer will continue to explore opportunities for the earlier reduction of outstanding debt for both the General Fund and HRA, and where appropriate and subject to available resources, reserve the power to make supplementary MRP contributions over and above the minimum previously determined as prudent, where longer term financial benefits may be derived.

Capital Receipts

4.19 Capital receipts may ordinarily be applied to fund capital expenditure or be set aside for the repayment of debt. An exemption currently applies which allows receipts to be used to fund revenue expenditure which generates future and ongoing savings and service transformation – referred to as the Flexible Use of Capital Receipts.

4.20 The Council's S151 Officer will apply General Fund capital receipts so as to optimise the benefit to the Revenue Account whilst being mindful of the long term need to prudently repay capital debt.

4.21 To the above end, all capital receipts (unless statutorily or contractually ring-fenced to specific purposes) will be applied to their most beneficial purpose. Where capital receipts are applied to repay debt, such repayments will be applied against the remaining borrowing identified on an asset by asset basis and the MRP liability adjusted accordingly.

MRP Overpayments

4.22 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 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. Up until the 31 March 2019 nil overpayments were made.

5 BORROWING

5.1 The capital expenditure plans set out in section 3 of this report summarise the Council's proposed service capital expenditure activity. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The Strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual Investment Strategy.

Current Treasury Management Portfolio Position

5.2 The overall treasury management portfolio as at 31 March 2019 and for the position as at 30 November 2019 are shown below for both borrowing and investments.

Table 5 – Treasury Portfolio

Treasury Portfolio	Actual 31.03.19 £m	Actual 31.03.19 %	Current 30.11.19 £m	Current 30.11.19 %
Treasury Investments				
Banks	1.250	2%	0.635	0.8%
Other (Reading Transport, Homes for Reading, Brighter Futures)	22.500	39%	36.200	47.2%
Money Market Funds	18.475	32%	24.900	32.4%
Property Fund	15.000	26%	15.000	19.5%
Total Managed In-House	57.225	100%	76.735	100.0%
Treasury External Borrowing				
Local Authorities	(43.000)	11%	(15.000)	4%
PWLB	(326.297)	82%	(354.126)	89%
LOBOs	(25.000)	6%	(25.000)	6%
Other Loans	(5.000)	1%	(5.000)	1%
Total External Borrowing	**(399.297)**	**100%**	**(399.126)**	**100%**
Net Treasury Investments / (Borrowing)	**(342.072)**		**(322.391)**	

5.3 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying need to borrow, (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

Table 6 – Borrowing Estimates

£m	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
External Debt					
Debt at 1 April	376.236	399.297	422.893	520.530	585.179
Expected Change in Debt	23.061	23.595	97.637	64.650	46.104
Actual Gross Debt at 31 March	399.297	422.893	520.530	585.179	631.283
Capital Financing Requirement	548.020	610.147	740.891	833.757	901.895
Under / (Over) Borrowing	**148.723**	**187.255**	**220.362**	**248.578**	**270.613**

5.4 Within the above figures the level of debt relating to commercial activities / non-financial investment is:

Table 7 – Analysis of Non Financial Investment Borrowing

	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
External Debt for Non-Financial Investments					
Actual Debt at 31 March (£m)	42.753	75.667	150.667	200.667	250.667
percentage of Total External Debt %	11%	18%	29%	34%	40%

5.5 Within the range of 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 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

5.6 The Executive Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this report.

Treasury Indicators: Limits to Borrowing Activity

5.7 **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 and the ability to fund under-borrowing by other cash resources.

5.8 **The authorised limit for external debt.** This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

5.9 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.

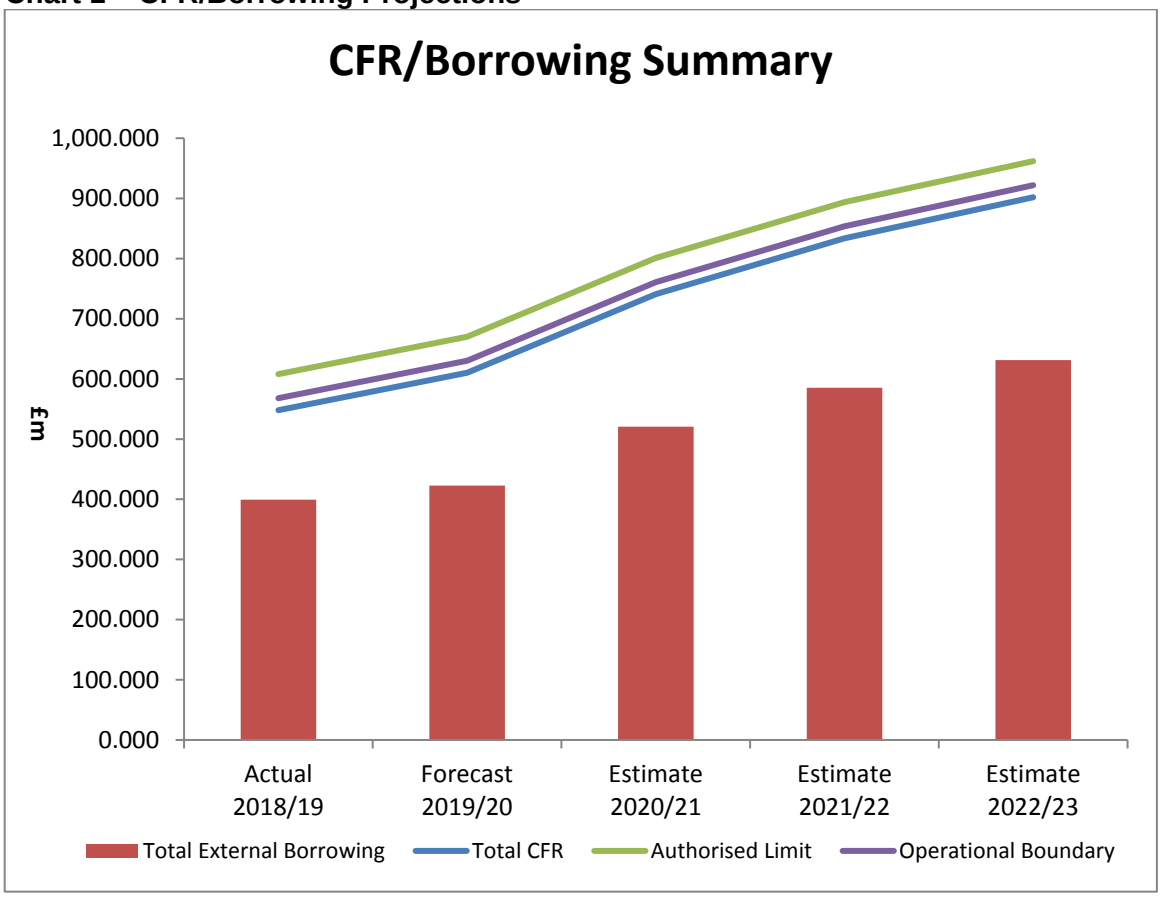
5.10 The Operational Boundary and Authorised Borrowing limits are set out below:

Table 8 – Borrowing Limits

Treasury Indicators (£m)	2018/19 Actual	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Authorised Limit for External Debt					
Borrowing and Other Long Term Liabilities	568.020	630.147	760.891	853.757	921.895
Headroom	40.000	40.000	40.000	40.000	40.000
Total	**608.020**	**670.147**	**800.891**	**893.757**	**961.895**
Operational Boundary for External Debt					
Borrowing	548.020	610.147	740.891	833.757	901.895
Other Long Term Liabilities	20.000	20.000	20.000	20.000	20.000
Total	**568.020**	**630.147**	**760.891**	**853.757**	**921.895**

5.11 The graph below provides a graphical representation of projections of CFR and borrowing position up to 2022//23.

Chart 1 – CFR/Borrowing Projections



Prospects for Interest Rates

5.12 The Council has appointed Link Asset Services as its treasury advisors and part of their remit is to assist the Council to formulate a view on interest rates. The following table gives the Council's treasury advisor's central view on prospects for interest rates.

Table 10 – Interest Rate Projections

Link Asset Services Interest Rate View	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23
Bank Rate View	0.75	0.75	0.75	0.75	0.75	1.00	1.00	1.00	1.00	1.00	1.25	1.25	1.25	1.25
3 Month LIBID	0.70	0.70	0.70	0.80	0.90	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.30	1.30
6 Month LIBID	0.80	0.80	0.80	0.90	1.00	1.10	1.10	1.20	1.30	1.40	1.50	1.50	1.50	1.50
12 Month LIBID	1.00	1.00	1.00	1.10	1.20	1.30	1.30	1.40	1.50	1.60	1.70	1.70	1.70	1.70
5yr PWLB Rate	2.30	2.40	2.40	2.50	2.50	2.60	2.70	2.80	2.90	2.90	3.00	3.10	3.20	3.20
10yr PWLB Rate	2.60	2.70	2.70	2.70	2.80	2.90	3.00	3.10	3.20	3.20	3.30	3.30	3.40	3.50
25yr PWLB Rate	3.20	3.30	3.40	3.40	3.50	3.60	3.70	3.70	3.80	3.90	4.00	4.00	4.10	4.10
50yr PWLB Rate	3.10	3.20	3.30	3.30	3.40	3.50	3.60	3.60	3.70	3.80	3.90	3.90	4.00	4.00

5.13 The above forecasts have been based on an assumption that there is an agreed deal on Brexit, including agreement on the terms of trade between the UK and EU. The result of the general election has removed much uncertainty around this major assumption. However, it does not remove uncertainty around whether agreement can be reached with the EU on a trade deal prior to December 2020, as the Prime Minister has pledged.

5.14 The Monetary Policy Committee (MPC) has left the Bank Rate unchanged at 0.75% so far in 2019. According to minutes of its meeting on 7 November, the MPC has become more dovish due to increased concerns over the outlook for the domestic economy and uncertainties around Brexit. If these uncertainties were to materialise, then the MPC would likely cut Bank Rate. However, if they were both to dissipate, then rates would need to rise at a "gradual pace and to a limited extent".

5.15 There is still some residual risk that the MPC could cut Bank Rate in the near future if the UK economic growth remains weak in 2020 due to continung uncertainty over whether there could effectively be a no deal Brexit in December 2020 if agreement on a trade deal is not reached with the EU. Until that major uncertainty is removed, or the period for agreeing a deal is extended, it is unlikely that the MPC would raise the Bank Rate.

5.16 During the first half of 2019-20, gilt yields plunged and caused a near halving of longer term PWLB rates to unprecedented historic low levels prior to Government raising rates on 9th October 2019. There is though, an expectation that financial markets have gone too far in their fears about the degree of the downturn in US and world growth. If, as now expected, the US only suffers a mild downturn in growth, bond markets in the US are likely to sell off and that would be expected to put upward pressure on bond yields, not only in the US, but also in the UK due to a correlation between US treasuries and UK gilts. However, forecasting the timing of this, and how strong the correlation is likely to be, is very difficult with any degree of confidence. Any changes in the UK Bank Rate will also impact on gilt yields.

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

5.18 In addition, PWLB rates are subject to ad hoc decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9th October 2019.

Investment and Borrowing Rates

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

5.20 Borrowing interest rates fell during the first half of 2019-20 but then jumped up by 100 bps on 9th October 2019. The policy of avoiding new borrowing by running down spare cash balances has served the Council well over the last few years. However, the unexpected increase of 100 bps in PWLB rates means the gap between longer term borrowing rates and investment rates has materially widened, and as in the long term the Bank Rate is not expected to rise above 2.5%, it is unlikely that the Council will

borrow in advance but will instead look to delay borrowing until funds are required or until the extra 100 bps margin is removed.

Borrowing Strategy

5.21 The Council is currently under-borrowed. 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 on a temporary basis. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

5.22 The most cost effective borrowing is internal borrowing which would mean running down cash balances and foregoing interest earned at historically low rates in lieu of taking out new borrowing at a higher rate. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential longer term costs if the opportunity is missed for taking loans at rates which will be higher in future years.

5.23 Against this background and the risks within the economic forecast, caution will be adopted with the 2020/21 treasury operations. The Executive Director Resources 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 borrowing rates, (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then borrowing will be postponed.
- if it was felt that there was a significant risk of a much sharper rise in borrowing rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the US 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 lower than they are projected to be in the next few years.

5.24 Any decisions will be reported subsequently to the Audit & Governance Committee.

Policy on Borrowing in Advance of Need

5.25 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.

5.26 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.

Debt Rescheduling

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

5.28 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, the Council will give consideration to sourcing funding at cheaper rates from the following:

- Local authorities (primarily shorter dated maturities)
- Financial institutions (including where available insurance companies, pension funds and some banks)
- Municipal Bonds Agency

5.29 The degree to which any of these options proves cheaper than the PWLB Certainty Rate is still evolving, but our advisors will keep us informed of new developments or funders that may be willing to lend to the Council.

5.30 The Authority holds £25m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. Although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Approved Sources of Long and Short term Borrowing

5.31 The list of approved lenders and types of funding that can be secured with each entity is set out below.

On Balance Sheet	Fixed	Variable
PWLB	●	●
Municipal bond agency	●	●
Local authorities	●	●
Banks	●	●
Pension funds	●	●
Insurance companies	●	●
Market (long-term)	●	●
Market (temporary)	●	●
Overdraft		●
Finance leases	●	●

6 ANNUAL INVESTMENT STRATEGY

Investment Policy – Management of Risk

6.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments. Non-financial investments, essentially the purchase of income yielding assets, are covered in the Council's Capital Strategy.

6.2 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

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

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

i. 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.

ii. Ratings will not be the sole determinant of the credit 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.

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

iv. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use as follows:

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

v. **Non-specified investments limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments to £20m of the total investment portfolio.

vi. **Lending limits**, (amounts and maturity), for each counterparty will be set through applying the matrix in Table 11.

vii. **Transaction limits** are set for each type of investment in Table 11.

viii. This authority will set a £20m limit for the amount of its investments which are invested for **longer than 365 days**.

ix. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating**.

x. All investments will be denominated in **sterling**.

xi. As a result of the change in accounting standards for 2019/20 under IFRS 9, when investing, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund.

xii. In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1st April 2018. As a result of this exemption, the Council will not need to adhere to IFRS 9 when reporting on its investment in the CCLA pooled property fund.

6.5 The key requirements of both the Code and the investment guidance are to set an annual Investment Strategy, as part of the annual Treasury Management Strategy for the following year, covering the identification and approval of the following:

- The 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 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.

6.6 **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:

i. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).

ii. Supranational bonds of less than one year's duration.

iii. A local authority, housing association, parish council or community council.

iv. 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 *AAA* by Standard and Poor's (S & P), Moody's and / or Fitch rating agencies.

v. 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 S & P, Moody's and / or Fitch rating agencies.

6.7 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 as set out in Table 11.

6.8 **Non-specified investments –** are any other type of investment (i.e. not defined as specified above).

6.9 The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non-specified investments would include any sterling investments that meet the above criteria.

6.10 **The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information including changes, rating watches and rating outlooks from Link Asset Services as and when ratings change, following which 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 Executive Director of Resources, and if required new counterparties which meet the criteria will be added to the list.

6.11 **Use of external fund managers** – The Council does not currently employ external fund managers for any part of its investment portfolio and does not plan to do so. If in future, officers determine that an external fund manager will add value to the Council's treasury management function, a report will be brought to the Audit and Governance Committee to first seek approval of a change in policy and subsequently the appointment of a preferred fund manager.

Creditworthiness Policy

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

6.13 The Executive Director of Resources 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.

6.14 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 list. Any rating changes, rating Watches, rating Outlooks are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

6.15 The criteria for providing a pool of high quality investment counterparties, (both specified and non-specified investments) is set out inTable 11 below.

6.16 **Time and monetary limits applying to investments.** The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

Table 11 – Investment Criteria

	Credit Rating	Cash Limit	Time Limit
Banks and organisations and securities whose lowest long term credit rating published by Fitch, Moody's or Standard & Poor is:	AAA	£20m each *	5 Years
	AA+		3 Years
	AA		
	AA-		2 Year
	A+		
	A		1 Year
	A-		
The Council's current account, Lloyds Bank Plc should circumstances arise when it does not meet above criteria	N/A	£1m	Next Day
UK Building Societies without credit rating	N/A	£10m	1 Year
UK Government (irrespective of credit rating)	N/A	Unlimited	50 Years
UK Local Authorities (irrespective of credit rating)	N/A	£20m each	50 Years
UK Registered Providers of Social Housing whose published long term credit rating is A- or higher	A-	£5m	2 Years
UK Registered Providers of Social Housing whose published long term credit rating is lower than A- or without a long term credit rating	N/A	£2m	1 Year
	Fund rating**	Cash Limit	Time
Money Market Funds	AAA	£20m	liquid
Pooled Funds	AAA	£20m	liquid

Other Limits

6.17 Due care will be taken to consider the exposure of the Council's total investment portfolio to non-specified investments, countries, groups and sectors.

a) **Non-specified investment limit.** The Council has determined that it will limit the maximum total exposure to non-specified investments at £20m maximum.

b) **Country limit.** The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of *AA-* from Fitch or equivalent. The list of countries that qualify using this credit criteria as at the date of this report are set out in Annexe 3 to this appendix. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

c) **Other limits.** In addition:

- no more than £20m will be placed with any non-UK country at any time;

- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

6.18 As an additional layer of security, a concentration of investments in too few counterparties or countries will be avoided with officers ensuring that the portfolio is diversified across counterparties/countries.

Investment Strategy

6.19 **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. Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

- If it is thought that the Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.
- Conversely, if it is thought that the Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

6.20 The Council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the Council's Corporate Plan and values. This would include institutions with material links to:

- human rights abuse (e.g. child labour, political oppression)
- environmentally harmful activities (e.g. pollution, destruction of habitat, fossil fuels)
- socially harmful activities (e.g. tobacco, gambling)

6.21 Table 12 below sets out the limits on investments that can be longer than 365 days.

Table 12 – Upper limit for principal sums invested for longer than 365 days

	2020/21	2021/22	2022/23
Principal sums invested for longer than 365 days	£20m	£20m	£20m
Current investments as at 31.03.20 in excess of 1 year maturing in each year	Nil	Nil	Nil

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

Investment Return Expectations

6.23 On the assumption that the UK and EU agree a Brexit deal in early 2020 or soon after, the Bank Rate is forecast to increase slowly over the next few years to reach 1.25% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are**:**

- Q1 2021 0.75%
- Q1 2022 1.00%
- Q1 2023 1.25%

6.24 The following factors impact on the outlook for interest on invested cash and have been taken into consideration in suggested investment returns:

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

6.25 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2020/21	0.75%
2021/22	0.75%
2022/23	0.75%

Policy on Apportioning Interest to the HRA

6.26 Reform of the Housing Revenue Account Subsidy system was completed at the end of 2011/12, the Council was required to pay MHCLG £147.8m. Prior to 2012/13 The Council would recharge interest expenditure and income attributable to the HRA in accordance with determinations issued by MHCLG. The Council has previously adopted a policy that it will continue to manage its debt as a single pool using a similar regime that applied prior to self-financing which will set out how interest charges attributable to the HRA will be determined, or an appropriate method that does not result in a material change to the average interest rate paid by the Council.

6.27 However, during 2016/17 and 2017/18 some technical details of the methodology have been adjusted to recognise that in essence the £147.8m of loans the Council borrowed at the time of self-financing were primarily taken for HRA debt, and therefore the operation of the single pool should not lead to the average interest rate being charged to the HRA being less than the average rate on the remaining part of those loans.

6.28 The HRA also has a notional cash balance which may be positive or negative. This balance is measured each month and interest transferred between the General Fund and HRA at the net average rate earned by the Council on its portfolios of treasury investments (excluding the CCLA Property Fund) and short-term borrowing

End of year investment report

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

6.30 **APPENDICES**

Annexe 1 – Prudential and treasury indicators and MRP statement

Annexe 2 – Treasury management scheme of delegation

Annexe 3 – List of Approved Countries for Investment

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2020/21 – 2022/23 AND MRP STATEMENT

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

Prudential Indicators	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Capital Expenditure (£m)					
General Fund	62.761	110.902	163.832	100.877	92.883
HRA	15.481	18.977	31.777	24.822	11.503
Total	**78.242**	**129.879**	**195.609**	**125.699**	**104.386**
Ratio of Financing Cost to Net Revenue Stream (%)					
General Fund	12.5%	11.6%	13.3%	16.9%	20.5%
HRA	22.1%	20.3%	18.7%	19.4%	19.6%
Gross Debt and Capital Financing Requirement (£m)					
Gross Debt	399.297	422.893	520.530	585.179	631.283
Capital Financing Requirement	548.020	610.147	740.891	833.757	901.895
Under / (Over) Borrowed	**148.723**	**187.255**	**220.362**	**248.578**	**270.613**
In Year Capital Financing Requirement (£m)					
General Fund	21.958	54.226	114.647	81.297	64.699
HRA	1.103	7.901	16.097	11.569	3.439
Total	**23.061**	**62.127**	**130.744**	**92.866**	**68.138**
Capital Financing Requirement as at 31 March 2019 (£m)					
General Fund	361.220	415.446	530.093	611.390	676.089
HRA	186.800	194.701	210.798	222.367	225.806
Total	**548.020**	**610.147**	**740.891**	**833.757**	**901.895**
Incremental Impact of Financing Cost (£)					
Increase in Council Tax (Band) per annum	0	1.00	5.13	4.82	3.10
Increase in average housing rent per week	0	0.05	0.39	0.57	1.02

3. The Council is asked to approve the following treasury management indicators.

Treasury Indicators	**2018/19**	**2019/20**	**2020/21**	**2021/22**	**2022/23**
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Authorised Limit for External Debt (£m)					
Borrowing and Other Long Term Liabilities	568.020	630.147	760.891	853.757	921.895
Headroom	40.000	40.000	40.000	40.000	40.000
Total	**608.020**	**670.147**	**800.891**	**893.757**	**961.895**
Operational Boundary for External Debt (£m)					
Borrowing	548.020	610.147	740.891	833.757	901.895
Other Long Term Liabilities	20.000	20.000	20.000	20.000	20.000
Total	**568.020**	**630.147**	**760.891**	**853.757**	**921.895**
Upper Limit for Fixed Interest Rate Exposure (%)					
Net Principal for Fixed Interest Rate Borrowing/Investment	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure (%)					
Net Principal for Variable Interest Rate Borrowing/Investment	100%	100%	100%	100%	100%
Upper Limit for Total Principal Sum Invested over 364 Days	£20m	£20m	£20m	£20m	£20m

Maturity structure of borrowing

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.

Maturity structure of fixed interest rate borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	20%
2 years to 5 years	0%	20%
5 years to 10 years	0%	30%
10 years to 20 years	0%	40%
20 years to 30 years	0%	50%
30 years to 40 years	0%	60%
40 years to 50 years	0%	60%
Maturity structure of variable interest rate borrowing 2020/21		
	Lower	**Upper**
Under 12 months	0%	100%
12 months to 2 years	0%	100%
2 years to 5 years	0%	100%
5 years to 10 years	0%	100%
10 years to 20 years	0%	100%
20 years to 30 years	0%	100%
30 years to 40 years	0%	100%
40 years to 50 years	0%	100%

TREASURY MANAGEMENT SCHEME OF DELEGATION

i) Full Council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of/amendments to the council's adopted clauses, treasury management policy statement and treasury management practices;
- approval of annual Strategy.

ii) Audit & Governance Committee

- Receive and recommend to Full Council amendments to the council'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.

iii) Section 151 Officer

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

Annexe 3 – Approved Countries for Investment

The below list of approved countries for investment is based on lowest available rating from all ratings agencies.

AAA

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

AA+

- Finland
- U.S.A.

AA

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

AA-

- Belgium
- Qatar