

TREASURY MANAGEMENT STRATEGY 2018-19



1.0 Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA's) *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) in February 2012 which requires the Council to approve a Treasury Management Strategy (TMS) before the start of each financial year. In addition to the CIPFA Code, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an Investment Strategy before the start of each financial year. This Strategy fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

The CIPFA Code and CIPFA's 2011 *Prudential Code for Capital Finance in Local Authorities* (amended 2012) requires the Council to set a number of **Treasury Management and Prudential Indicators** and this TMS 2018-19 revises some of the indicators for 2017-18, 2018-19, 2019-20 and 2020-21 and introduces new indicators for 2021-22 which are detailed in **Schedule A**. The indicators either summarise the expected activity or introduce limits upon the activity, and reflect the underlying capital programme.

Where a Council finances capital expenditure by debt, it must put aside revenue resources to repay that debt in later years and this amount charged to revenue is called the Minimum Revenue Provision (MRP). The *Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008* requires the Council to produce and approve an **Annual Minimum Revenue Provision (MRP) Statement** before the start of the financial year that details the methodology for the MRP charge and this is detailed in **Schedule B**. There is not a statutory minimum for the amount set aside. It needs to be considered a prudent provision to ensure that the debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits or in the case of borrowing supported by Welsh Government's Revenue Support Grant reasonably commensurate with the period implicit in the determination of that grant.

The Council has an integrated Treasury Management Strategy (TMS) where borrowing and investments are managed in accordance with best professional practice. The Council borrows money either to meet short term cash flow needs or to fund capital schemes approved within the capital programme. Therefore any actual loans taken are not associated with particular items of expenditure or assets. The Council is exposed to financial risks including the potential loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's TMS.

The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's strategy, Treasury Management Practices (TMP) and CIPFA's *Standard of Professional Practice on Treasury Management*. Council will receive reports on its treasury management activities, including as a minimum, an annual strategy in advance of the year, a mid-year review and an annual report after its financial year end. Quarterly reports will also be received by Cabinet. The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

CIPFA published new editions of *Treasury Management in the Public Services: Code of Practice* and the *Prudential Code for Capital Finance in Local Authorities* in late December 2017. This TMS 2018-19 has been produced using the 2011 Codes (as advised above) following advice from the Council's treasury adviser Arlingclose as there is still some information which has yet to be published but once the regulatory framework is clearer any revision required to the TMS for 2018-19 will be reported to Council for approval. Also, in accordance with the WG Guidance, the Council will be asked to approve a revised TMS should the assumptions on which this is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Council's capital programme or in the level of its investment balance.

Future Generations Well-being Act: In complying with the Well-being of Future Generations (Wales) Act 2015, the Council must ensure that decisions are sustainable, whereby "the needs of the present are met without compromising the ability of future generations to meet their own needs" and recognise "the importance of balancing short term needs with the need to safeguard the ability to meet long term needs". The implications of the Act have been taken into account when compiling this TMS. Within the Borrowing Strategy, the cautious approach ensures that no unnecessary long term borrowing is taken where the interest costs would need to be met from future revenue budgets. Instead, the recommendation is to use internal resources or borrowing for short periods. The Council actively examines its existing borrowing to review any potential opportunities to reschedule debt and generate future revenue savings. Also within the Investment Strategy, the importance of maintaining capital security is stressed with a strategy that does not solely rely on credit ratings before investments are placed. This will hopefully minimise any situation where future generations have to pay the costs associated of any impairment or loss of investments due to a financial crisis.

2.0 Economic Context and Forecasts for Interest Rates

Economic background: The major external influence on the Council's TMS for 2018-19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remains relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018-19. Consumer price inflation remained at 3.0% in December 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their

own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low.

Interest rate forecast: The Monetary Policy Committee increased the Bank Rate from 0.25% to 0.50% in November 2017 and Arlingclose's central case is for Bank Rate to remain at 0.50% during 2018-19. Stilted progress in the EU exit negotiations, softening consumer spending and a tightening of consumer credit are expected to stay the Committee's hands. Longer-term interest rates have risen in the past year, reflecting the possibility of increasing short-term rates. Arlingclose forecasts these to remain broadly constant during 2018-19, but with some volatility as interest rate expectations change with press reports on the progress of EU exit negotiations.

Arlingclose (Council's TM Advisers) central interest rate forecast December 2017/January 2018

| | Bank Rate | 3 month LIBID rate | 1 Year LIBID rate | 5-year gilt yield | 10 year gilt yield | 20 year gilt yield | 50 year gilt yield |
|----------------|------------------|--------------------|-------------------|-------------------|--------------------|--------------------|--------------------|
| Mar 2018 | 0.50 | 0.50 | 0.70 | 0.75 | 1.25 | 1.85 | 1.70 |
| June 2018 | 0.50 | 0.50 | 0.70 | 0.80 | 1.25 | 1.85 | 1.70 |
| Sept 2018 | 0.50 | 0.50 | 0.70 | 0.80 | 1.25 | 1.85 | 1.70 |
| Dec 2018 | 0.50 | 0.50 | 0.80 | 0.80 | 1.25 | 1.85 | 1.70 |
| Mar 2019 | 0.50 | 0.50 | 0.80 | 0.85 | 1.30 | 1.90 | 1.75 |
| June 2019 | 0.50 | 0.50 | 0.80 | 0.90 | 1.30 | 1.90 | 1.80 |
| Sept 2019 | 0.50 | 0.50 | 0.80 | 0.90 | 1.35 | 1.95 | 1.85 |
| Dec 2019 | 0.50 | 0.50 | 0.80 | 0.95 | 1.40 | 1.95 | 1.90 |
| Mar 2020 | 0.50 | 0.50 | 0.80 | 0.95 | 1.45 | 2.00 | 1.95 |
| Jun 2020 | 0.50 | 0.50 | 0.80 | 1.00 | 1.50 | 2.05 | 1.95 |
| Sept 2020 | 0.50 | 0.50 | 0.80 | 1.05 | 1.55 | 2.05 | 1.95 |
| Dec 2020 | 0.50 | 0.50 | 0.80 | 1.10 | 1.55 | 2.05 | 1.95 |
| Mar 2021 | 0.50 | 0.50 | 0.80 | 1.15 | 1.60 | 2.10 | 2.00 |
| Average | 0.50 | 0.50 | 0.78 | 0.92 | 1.38 | 1.95 | 1.84 |

3.0 The Council's Current Treasury Management Position

The Council's external debt and investment position as at 31 December 2017 is shown in table 1 below and more detail is provided in section 4 the Borrowing Strategy and section 5 the Investment Strategy.

Table 1: Council's debt and investment position as at 31 December 2017

| | Principal as at 31-12-17 £m | Average Rate % |
|---|--------------------------------------|----------------------|
| External long term borrowing: | | |
| Public Works Loan Board (PWLB) | 77.62 | 4.70 |
| Lender's Option Borrower's Option (LOBO) | 19.25 | 4.65 |
| Total external long term borrowing | 96.87 | 4.69 |
| External short term borrowing: | | |
| Short term Local Authority loan | 2.00 | 0.35 |
| Total external borrowing | 98.87 | 4.60 |
| Other long term liabilities (LTL) | | |
| Private Finance Initiative (PFI) | 17.79 | |
| Llynfi Loan | 2.40 | |
| Other LTL | 0.98 | |
| Total other long term liabilities | 21.17 | |
| Total gross external debt | 120.04 | |
| Treasury investments: | | |
| Banks | 10.35 | 0.60 |
| Building Societies | 2.00 | 0.54 |
| Government (including Local Authorities) | 31.00 | 0.58 |
| Total treasury investments | 43.35 | 0.58 |
| Net Debt | 76.69 | |

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Forecast changes in these sums are included in the Prudential Indicators shown in **Schedule A** which shows that the Council expects to comply with this recommendation during 2017-18, 2018-19 and the following three years.

4.0 Borrowing Strategy

The major **objectives** to be followed in 2018-19 are:-

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to forecast average future interest rates and borrow accordingly

- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

The £19.25 million shown in table 1 above, relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The next trigger point is July 2018 and although the Council understands that the lender is unlikely to exercise this option in the current low interest rate environment, an element of refinancing risk remains and the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future. Following advice from Arlingclose, the Council approached the LOBO's lender for potential repayment options in 2017, however the premium was deemed too excessive to action.

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy. With short-term interest rates currently much lower than long term rates, it is likely to be more cost effective in the short term to either use internal resources or borrow short term. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates as shown in the Treasury Management Indicators in **Schedule A**.

The Section 151 Officer will take the most appropriate form of borrowing depending on the prevailing interest rates at the time however, with long term rates forecast to rise modestly in future years, any such short term savings will need to be balanced against the potential longer-term costs. The Council's Treasury Management advisers will assist the Council with this 'cost of carry' and breakeven analysis. The last time the Council took long term borrowing was £5m from the PWLB in March 2012 and it is not expected that there will be a requirement for any new long term borrowing for the remainder of 2017-18 or 2018-19. Alternatively, the Council may arrange forward starting loans during 2018-19 where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow short term loans (normally for up to one month) to cover unexpected cash flow shortages. The Council has previously raised the majority of its long-term borrowing from the PWLB, but will also investigate other sources of finance, such as Welsh Government and local authority loans and bank loans, that may be available at more favourable rates.

The **approved sources** of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- UK Local Authorities
- any institution approved for investments (see Investment Strategy below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Council's Pension Fund)
- capital market bond investors
- special purpose companies created to enable local authority bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Council is currently maintaining an under-borrowed position. This means that the underlying need to borrow for capital purposes (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 is known as Internal Borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Debt Rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some higher rate loans with new loans at lower interest rates, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

City Deal: The City Deal will have significant capital expenditure and treasury management implications. Under the current financial model, it is envisaged that project capital expenditure will be incurred at a faster rate than Her Majesty's Treasury (HMT) grant funding, thus requiring Local Authorities to meet the shortfall in the interim. For this Council, an earmarked reserve is being built up to meet the capital expenditure requirements of City Deal.

5.0 Investment Strategy

Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Investment Balances: The Council holds surplus funds representing income received in advance of expenditure plus balances and reserves and as shown in table 1 above in section 3, the balance at 31 December 2017 was £43.35 million. Investments are estimated to drop to between £29 and £32 million by the 31 March 2018. As in previous years this is due partly to the reduction in income collected from Council Tax and National Non-Domestic Rates in February and March 2018 and increased expenditure expected to be incurred for the capital programme.

Based on its cash flow forecasts, the Council anticipates its investment balances in 2018-19 to range between £25 million to £55 million with an average investment rate of between 0.50% to 0.60% depending on the bank rate and investment types used but this will be reviewed at half year and reported to Council. The actual balance varies because of the cash flow during the month and year as to when income is received (such as specific grant income, housing benefits subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments).

The major **objectives** to be followed in 2018-19 are:

- to maintain capital **security**
- to maintain **liquidity** so funds are available when expenditure is needed
- to achieve the **yield** on investments commensurate with the proper levels of security and liquidity

The Council's investments have historically been placed in mainly short term bank and building society unsecured deposits and local and central government, however, investments may be made with any public or private sector organisations that meet the credit criteria detailed below. Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to further diversify into more secure and/or higher yielding asset classes during 2018-19 with consultation with the Council's treasury management advisers.

With short term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long term borrowing if appropriate options become available as referred to in section 4 the Borrowing Strategy.

Credit Rating: Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's to ensure that this lies within our agreed minimum credit rating and **Schedule C** shows the equivalence table for credit ratings for Fitch, Moody's and Standard & Poor's and explains the different investment grades. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Approved Counterparties: The Council may invest with any of the counterparty types shown in table 2 below, subject to the cash limits and the time limits shown. **These cash/time limits are per counterparty and relate to principal only and exclude any accrued interest.**

Table 2: Approved Investment Counterparties and Limits

These limits must be read in conjunction with the notes immediately below the table and the combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments:

| Credit Rating | Banks (including building societies) Unsecured | Banks (including building societies) Secured | Government | Corporates | Registered Providers |
|------------------------|--|--|-------------|------------|----------------------|
| UK Central Government | N/A | N/A | £ Unlimited | N/A | N/A |
| | | | 50 Years | | |
| UK Local Authorities * | N/A | N/A | £12,000,000 | N/A | N/A |
| | | | 10 Years | | |
| AAA | £3,000,000 | £6,000,000 | £6,000,000 | £3,000,000 | £3,000,000 |
| | 5 Years | 20 Years | 50 Years | 20 Years | 20 Years |
| AA+ | £3,000,000 | £6,000,000 | £6,000,000 | £3,000,000 | £3,000,000 |
| | 5 Years | 10 Years | 25 Years | 10 Years | 10 Years |
| AA | £3,000,000 | £6,000,000 | £6,000,000 | £3,000,000 | £3,000,000 |
| | 4 Years | 5 Years | 15 Years | 5 Years | 10 Years |
| AA- | £3,000,000 | £6,000,000 | £6,000,000 | £3,000,000 | £3,000,000 |
| | 3 Years | 4 Years | 10 Years | 4 Years | 10 Years |
| A+ | £3,000,000 | £6,000,000 | £3,000,000 | £3,000,000 | £3,000,000 |
| | 2 Years | 3 Years | 5 Years | 3 Years | 5 Years |
| A | £3,000,000 | £6,000,000 | £3,000,000 | £3,000,000 | £3,000,000 |
| | 13 Months | 2 Years | 5 Years | 2 Years | 5 Years |
| A- | £3,000,000 | £6,000,000 | £3,000,000 | £3,000,000 | £3,000,000 |
| | 6 Months | 13 Months | 5 Years | 13 Months | 5 Years |
| None | £1,000,000 | N/A | N/A | N/A | £3,000,000 |
| | 6 Months | | | | 5 Years |
| Pooled Funds | £6,000,000 | | | | |
| | Per Fund | | | | |

* excluding parish and community councils

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Where additional amounts received into our accounts with our own bankers are received too late in the day to

make an investment the same day, the limit in the above table will not apply as this does not count as an investment.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment and consultation with the Council's treasury management advisers.

Registered Providers: Loans and bonds issued by, guaranteed by, or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Welsh Government and, as providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility can be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period can be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. As these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Operational bank accounts: The Council may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a minimum. The Bank of England has stated that in the event of failure, banks with assets greater

than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes as they occur.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made
- any existing investments that can be recalled or sold at no cost will be
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments: This is an investment which offers high security and high liquidity. It is a low risk investment where the possibility of loss of principal or

investment income is negligible and satisfies the conditions below as defined by *WG Investment Guidance*:-

- denominated in pound sterling
- contractually committed to be paid within 12 months of arrangement (364 days)
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government
 - a UK local authority
 - a UK parish or community council or
 - body or investment scheme of “high credit quality”

The Council defines “**high credit quality**” organisations and securities as those having a credit rating of A- or higher. For those domiciled outside of the UK, investments would only be made with a country having a sovereign rating of AA+ or higher.

Non-specified Investments: Any investment that does not fall into the criteria detailed above under the Specified definition. The Council does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to:

- long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement
- those that are defined as capital expenditure by legislation, such as shares in money market funds and other pooled funds
- investments with bodies and schemes not meeting the definition on high credit quality

All investments longer than 364 days will be made with a cautious approach to cash flow requirements and advice from the Council’s treasury management advisers will be sought as necessary.

The WG Guidance requires the Council’s Investment Strategy to set an overall limit for non-specified investments which is currently set at £25 million. Table 3 below shows the non-specified categories and the relevant limits – the total of the individual limits exceed £25 million, however at any one point in time a maximum of **£25 million** of investments could be in one of the following non-specified categories with the following category limits:

Table 3: Non-Specified Investment Limits

| | Category Cash limit |
|---|----------------------------|
| Total long-term investments | £15m |
| Total invested in Money Market Fund (pooled funds)* | £20m |
| Total invested in other pooled funds* | £10m |
| Total investments without credit ratings (except the UK Government and Local Authorities) or rated below the Council’s definition of “high credit quality” (A-) | £10m |
| Total investments (except pooled funds)with institutions domiciled in foreign countries with a sovereign rating below AA+ | £3m |
| Total Non-Specified Investments Outstanding ** | £25m |

* Consultation on proposed amendments to the Local Authorities (Capital Finance & Accounting) (Wales) Regulations 2003 which if approved will mean that some investments in pooled funds will not need to be classed as Non-specified investments so this limit will not then apply

**The total of the category cash limits for individual non-specified categories can exceed the overall total non-specified limit but non-specified investments outstanding at any one time cannot exceed the overall limit of £25m

Investment Limits:

The combined values of specified and non-specified investments with any one organisation are subject to the investment limits detailed below in table 4, the approved counterparties and limits shown in table 2 above and also the non-specified limits in table 3 above. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investments Limits

| | Category Cash limit |
|---|----------------------------|
| Any single organisation, except the UK Central and Local Government | £6m |
| UK Central Government | unlimited |
| UK Local Authorities (per Authority) | £12m |
| Any group of organisations under the same ownership | £6m per group |
| Any group of pooled funds under the same management | £6m per manager |
| Negotiable instruments held in a broker's nominee account | £10m per broker |
| Foreign countries | £6m per country |
| Registered Providers | £5m in total |
| Unsecured investments with Building Societies | £6m in total |

Liquidity Management: The Council forecasts on a prudent basis the maximum period for which funds may be committed therefore minimising the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. A limit of £15 million (table 3 above) has been set for 2018-19 for long term investments and this has been set with reference to the Medium Term Financial Strategy and cash flow forecast. This represents just under 30% of the maximum amount of investments that the Council anticipates to have at any one point in time during 2018-19.

Non-Treasury Investments: Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Council may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, or as equity investments and loans to the Council's subsidiaries.

Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and need not comply with this Treasury Management Strategy.

The Council's existing non-treasury investments relate to investment properties and the balance outstanding at 31 March 2017 was £5.06 million.

6.0 Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators as opposed to the treasury management and prudential indicators which are predominantly forward looking. One debt performance indicator is where the average portfolio rate of interest is compared to an appropriate average available such as the average PWLB Debt for Welsh and UK Local Authorities. The rate of return on investments can be monitored against the benchmark of the average one month London Inter Bank Bid (LIBID) rate, the average Bank Rate and the average rate of return on investments at each quarter end as compared to the average rate of Arlingclose's Welsh Local Authority Clients.

7.0 Other Items

The Council is required by CIPFA or WG to include the following additional items:

Policy on Use of Financial Derivatives: The Localism Act 2011 includes a general power competence that removes the uncertain legal position over English local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). These instruments are used by organisations to manage exposure to interest rate or exchange rate fluctuations. Although this change does not apply to Wales, the latest CIPFA Code requires authorities to clearly state their policy on the use of derivatives in the annual strategy. In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives transactions such as swaps, forwards, futures and options. Derivatives embedded into loans and investments including pooled funds and forward starting transactions may be used and the risks they present will be managed in line with the overall treasury risk management strategy.

Investment Advisers: The Council appointed Arlingclose Limited as treasury management advisers following a tender exercise in August 2016. They were awarded a four year contract, to provide advice and information relating to its borrowing and investment activities and the contract will be reviewed annually and either party may at any time terminate this agreement on 3 months prior written notice. The quality of this service is controlled by having regular meetings with the advisers and regularly reviewing the service provided.

Investment of Money Borrowed in Advance of Need: The Welsh Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity, however, the Council could potentially borrow in advance of need where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The Council has an integrated Treasury Management Strategy and borrowing is not linked to the financing of specific items of expenditure. The Council's Capital Financing Requirement (CFR) as at 1 January 2018 was in excess of the actual debt of the Council (as detailed in the Prudential Indicators in **Schedule A**) indicating there was no borrowing in advance of need.

Investment Training: The Treasury Management Team receives training from the Council's treasury management advisers. The Council also supports personal development so individuals enhance their own knowledge through reading CIPFA guidance, publications and research on the internet.

Schedule A

TREASURY MANAGEMENT INDICATORS

The following indicators (which are forward looking parameters) form part of the CIPFA Code of Practice on Treasury Management. They enable the Council to measure and manage its exposure to treasury management risks using the following indicators.

The Council needs to set the upper limits to its **Interest Rate Exposure** for the effects of changes in interest rates. There are two treasury management indicators that relate to both fixed interest rates and variable interest rates. These limits have been calculated with reference to the net outstanding principal sums and are set to control the Council's exposure to interest rate risk.

| No. | Interest Rate Exposure | 2017-18 £m | 2018-19 £m | 2019-20 £m | 2020-21 £m | 2021-22 £m |
|-----|--|---------------|---------------|---------------|---------------|---------------|
| | Total Projected Principal Outstanding on Borrowing 31 March | 96.87 | 96.87 | 96.87 | 96.87 | 96.87 |
| | Total Projected Principal Outstanding on Investments 31 March | 30.00 | 20.00 | 17.00 | 12.00 | 5.00 |
| | Net Principal Outstanding | 66.87 | 76.87 | 79.87 | 84.87 | 91.87 |
| 1. | Upper Limit on fixed interest rates (net principal) exposure | 130.00 | 130.00 | 130.00 | 130.00 | 130.00 |
| 2. | Upper Limit on variable interest rates (net principal) exposure | 50.00 | 50.00 | 50.00 | 50.00 | 50.00 |

The Section 151 Officer will manage interest rate exposures between these limits.

A further indicator for Treasury Management measures the **Maturity Structure of Borrowing** and is the amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing. This indicator is set to control the Council's exposure to refinancing risk and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk.

| No | Maturity structure of fixed rate borrowing during 2018-19 | Upper limit | lower limit |
|----|---|-------------|-------------|
| 3. | Under 12 months | 50% | 0% |
| | 12 months and within 24 months | 25% | 0% |
| | 24 months and within 5 years | 25% | 0% |
| | 5 years and within 10 years | 50% | 0% |
| | 10 years and within 20 years | 60% | 0% |
| | 20 years and above | 100% | 40% |

The Upper Limit for **Total Principal Sums Invested over 364 days** indicator controls the amount of longer term investments which mature beyond the period end. This is set to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

| No. | | 2018-19 £m | 2019-20 £m | 2020-21 £m | 2021-22 £m |
|-----|--|---------------|---------------|---------------|---------------|
| 4. | Upper Limit - Total Principal Sum Invested more than 364 day days | 15 | 10 | 8 | 6 |

2.0 PRUDENTIAL INDICATORS

The Prudential Indicators are required to be set and approved by Council in accordance with CIPFA's *Prudential Code for Capital Finance in Local Authorities*.

Council is required to formally adopt CIPFA's Treasury Management Code and the revised version of the 2011 code was adopted by Council on 22 February 2012.

Prudential Indicators for Prudence

The following Prudential Indicators are based on the Council's capital programme which is subject to change.

The Council's capital expenditure plans are summarised below and this forms the first prudential indicator for Prudence. The total capital expenditure is funded from capital grants and contributions, capital receipts and revenue with the remainder being the **Net Financing Need for the Financial Year** to be met from borrowing.

| No. | Prudential indicators For Prudence | 2017-18 | 2018-19 | 2019-20 | 2020-21 | 2021-22 |
|-----|--|--------------|--------------|--------------|--------------|--------------|
| | | £m Proj. | £m Est. | £m Est. | £m Est. | £m Est. |
| 1 | Total Capital Expenditure (Non HRA) | 45.41 | 33.69 | 14.76 | 17.30 | 25.26 |
| | Financed by :- | | | | | |
| | Capital Grants and Contributions | 15.14 | 6.84 | 4.48 | 6.79 | 14.75 |
| | Capital Receipts | 10.90 | 9.18 | 0.89 | 1.50 | 0.00 |
| | Revenue Contribution to Capital | 9.61 | 7.49 | 2.35 | 2.90 | 0.69 |
| | Net Financing Need for Year | 9.76 | 10.18 | 7.04 | 6.11 | 9.82 |

The second Prudential Indicator is the **Capital Financing Requirement (CFR)** for the Council. This shows the total outstanding capital expenditure that has not been funded from either revenue or other capital resources. It is derived from the actual Balance Sheet of the Council. It is essentially a measure of the underlying need to finance capital expenditure and forms the basis of the charge to the Council Fund in line with the Prudential Code.

The process for charging the financing of capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP). The actual MRP charge needs to be prudent – as detailed in the Council's MRP policy in **Schedule B**. Directorates who receive Council approval for capital schemes via Unsupported Borrowing make annual contributions to the capital costs of their schemes known as Voluntary Revenue Provisions (VRP) or additional MRP. This type of borrowing is only approved when Directorates have the necessary revenue resources to make VRP to fund the capital costs though this will be deferred in some cases until the asset becomes operational in accordance with the Council's MRP Policy. The MRP requirement for the Maesteg School PFI Scheme and the Innovation Centre will be equivalent to the write down of the liability for the year and is met from existing budgets

| No. | Prudential indicators For Prudence | 2017-18 £m Proj. | 2018-19 £m Est. | 2019-20 £m Est. | 2020-21 £m Est. | 2021-22 £m Est. |
|----------|--|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| 2 | Capital Financing Requirement (CFR) | | | | | |
| | Opening CFR (1 April) adjusted excluding PFI & other liabilities | 149.20 | 152.56 | 156.18 | 156.33 | 155.58 |
| | Opening PFI CFR | 18.24 | 17.64 | 17.00 | 16.31 | 15.57 |
| | Opening Innovation Centre | 0.66 | 0.60 | 0.54 | 0.45 | 0.35 |
| | Opening Coychurch Crematorium | 0.08 | 0 | 0 | 0 | 0 |
| | Total Opening CFR | 168.18 | 170.80 | 173.72 | 173.09 | 171.50 |
| | Movement in CFR excl. PFI & other liabilities | 3.36 | 3.62 | 0.15 | (0.75) | 2.51 |
| | Movement in PFI CFR | (0.60) | (0.64) | (0.69) | (0.74) | (0.80) |
| | Movement in Innovation Centre CFR | (0.06) | (0.06) | (0.09) | (0.10) | (0.11) |
| | Movement in Crem CFR | (0.08) | 0 | 0 | 0 | 0 |
| | Total Movement in CFR | 2.62 | 2.92 | (0.63) | (1.59) | 1.60 |
| | Closing CFR (31 March) | 170.80 | 173.72 | 173.09 | 171.50 | 173.10 |
| | Movement in CFR represented by :- | | | | | |
| | Net Financing Need for Year (above) | 9.76 | 10.18 | 7.04 | 6.11 | 9.82 |
| | Minimum and Voluntary Revenue Provisions* | (7.14) | (7.26) | (7.67) | (7.70) | (8.22) |
| | Total Movement | 2.62 | 2.92 | (0.63) | (1.59) | 1.60 |

*Minimum Revenue Provision (MRP) and Voluntary Revenue Provision (VRP) represent the revenue charge for the repayment of debt and includes MRP for the Private Finance Initiative (PFI) and the Innovation Centre

Limits to Borrowing Activity

The Council's long term borrowing at the 31 December 2017 was £96.87 million as detailed in section 3 of the Strategy. External borrowing can arise as a result of both capital and revenue expenditure and timing of cash flows. As the Council has an integrated Treasury Management Strategy there is no association between individual loans and particular types of expenditure. Therefore, the Capital Financing Requirement and actual external borrowing can be very different especially when a Council is using Internal Borrowing as highlighted in section 4 in the Borrowing Strategy.

The **Gross Debt** position (Borrowing and Long Term Liabilities) is shown below:

| No. | Prudential indicators For Prudence Gross Debt 31 March | 2017-18 £m Proj. | 2018-19 £m Est. | 2019-20 £m Est. | 2020-21 £m Est. | 2021-22 £m Est. |
|----------|---|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| 3 | External Borrowing | 96.87 | 96.87 | 96.87 | 96.87 | 96.87 |
| | Long Term Liabilities (including PFI) | 20.99 | 20.24 | 17.84 | 16.95 | 15.68 |
| | Total Gross Debt | 117.86 | 117.11 | 114.71 | 113.82 | 112.55 |

Within the Prudential Indicators, there are a number of key indicators to ensure the Council operates its activities within well-defined limits. One key control is to ensure that over the medium term, debt will only be for a capital purpose. The Council needs to ensure that external debt does not, except in the short term, exceed the Capital Financing Requirement for 2017-18 (i.e. the preceding year) plus the estimates of any additional capital financing requirement for the current and next three financial

years, however 2021-22 has also been included to be consistent with the Medium Term Financial Strategy.

| No. | Prudential indicators For Prudence | 2017-18 £m Proj. | 2018-19 £m Est. | 2019-20 £m Est. | 2020-21 £m Est. | 2021-22 £m Est. |
|-----|------------------------------------|------------------------|-----------------------|-----------------------|-----------------------|-----------------------|
| 4 | Gross Debt & the CFR | | | | | |
| | Total Gross Debt | 117.86 | 117.11 | 114.71 | 113.82 | 112.55 |
| | Closing CFR (31 March) | 170.80 | 173.72 | 173.09 | 171.50 | 173.10 |

As can be seen from the above table, the Council does not have any difficulty meeting this requirement in 2017-18 and does not envisage any difficulties in the current and future years. This view takes into account current commitments, existing plans and the proposals for next year's budget.

A further two Prudential Indicators control the Council's overall level of debt to support Capital Expenditure. These are detailed below:-

- The **Authorised Limit** for External Debt – this represents the limit beyond which borrowing is prohibited. It reflects a level of borrowing that could not be sustained even though it would be affordable in the short term. It needs to be set and approved by Members.
- The **Operational Boundary** for External Debt – this is not an actual limit and actual borrowing could vary around this boundary during the year. It is based on the probable external debt during the course of the year.

| No. | Prudential indicators For Prudence | 2017-18 £m | 2018-19 £m | 2019-20 £m | 2020-21 £m | 2021-22 £m |
|-----|---|---------------|---------------|---------------|---------------|---------------|
| 5 | Authorised limit for external debt | | | | | |
| | Borrowing | 140 | 140 | 140 | 140 | 140 |
| | Other long term liabilities | 30 | 30 | 30 | 30 | 30 |
| | Total | 170 | 170 | 170 | 170 | 170 |
| 6 | Operational Boundary | | | | | |
| | Borrowing | 105 | 105 | 105 | 105 | 105 |
| | Other long term liabilities | 25 | 25 | 20 | 20 | 20 |
| | Total | 130 | 130 | 125 | 125 | 125 |

Prudential Indicators for Affordability

The Prudential Code Indicators Numbered 1 to 6 above cover the overall controls on borrowing and financing of capital expenditure within the Council. The second suite of indicators detailed below assesses the affordability of capital investment plans and the impact of capital decisions on the Council's overall finances.

The **Ratio of Financing Costs to Net Revenue Stream** indicator demonstrates the trend in the cost of capital against the total revenue amount to be met from local taxpayers and the amount provided by the WG in the form of Revenue Support Grant. The estimates of capital financing costs include interest payable and receivable on Treasury Management activities and the MRP charged to the Comprehensive Income and Expenditure Statement. The revenue stream is the amount to be met from government grants and local taxpayers.

| No. | Prudential Indicators for Affordability | 2017-18 Proj. % | 2018-19 Est. % | 2019-20 Est. % | 2020-21 Est. % | 2021-22 Est. % |
|-----|---|-----------------------|----------------------|----------------------|----------------------|----------------------|
| 7. | Estimate - Ratio of Financing Costs to Net Revenue Stream | 4.79 | 4.55 | 4.70 | 4.67 | 4.80 |

The indicator of the **Incremental Impact of Capital Investment Decisions on Council Tax** identifies the estimate of the incremental impact to the Council Tax from the capital expenditure proposals, particularly changes in borrowing requirements that have occurred since the Capital Programme was approved for the year. This is a purely notional calculation designed to show the effect of changes in capital investment decisions.

| No. | Incremental Impact of Capital Investment Decisions on Council Tax | 2018-19 Est. % | 2019-20 Est. % | 2020-21 Est. % | 2021-22 Est. % |
|-----|--|----------------------|----------------------|----------------------|----------------------|
| 8. | Estimate - Increase in Band D Council Tax as per Capital Programme | 0 | 0 | 0 | 0 |

Schedule B

ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2018-19

The Annual Minimum Revenue Provision Statement needs to be approved by Council before the start of each financial year. The MRP charges for 2018-19 will be on the following bases:-

- i. Capital expenditure incurred before 1 April 2008 and any capital expenditure after 1 April 2008 that is government supported expenditure and does not result in a significant asset will be based on the Capital Financing Requirement after accounting adjustments at 4% of the opening balance. This charge was supplemented by voluntary MRP (based on the useful asset life) in respect of those assets which were financed by unsupported borrowing before 1 April 2008
- ii. Supported capital expenditure that results in a significant asset (based on an internal assessment) incurred on or after 1 April 2008 and all unsupported capital expenditure, exercised under the Prudential Code, the MRP charge will be based on the Asset Life Method. The minimum revenue provision will be at equal annual instalments over the life of the asset. The first charge can be delayed until the year after the asset is operational but this will be at the discretion of the Section 151 Officer
- iii. for assets reclassified as finance leases under International Financial Reporting Standards (IFRS) or resulting from a Private Finance Initiative, the MRP charge will be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability for the year
- iv. Where loans are made to other bodies for their capital expenditure with an obligation for the bodies to repay, no MRP will be charged. The capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead
- v. MRP may be waived on expenditure recoverable within a prudent period of time through capital receipts (e.g. land purchases) or deferred to when the benefits from investment are scheduled to begin or when confirmed external grant payments towards that expenditure are expected.

The MRP Charge 2018-19 based on the estimated capital financing requirement is detailed below:-

| | Options | Estimated Capital Financing Requirement 31-03-18 £m | 2018-19 Estimated MRP £m |
|---|---------|--|-----------------------------|
| Capital expenditure before 01-04-2008 and any after 01-04-2008 that does not result in a significant asset (Supported) | (i) | 122.19 | 4.88 |
| Capital Expenditure before 01-04-2008 (Unsupported) | | - | - |
| Supported capital expenditure that results in a significant asset, incurred on or after 1 April 2008 (Supported) | (ii) | 3.42 | 0.13 |
| Unsupported capital expenditure, exercised under the Prudential Code (Unsupported) | | 26.95 | 1.55 |
| PFI, Finance Leases and other arrangements PFI School Innovation Centre | (iii) | 17.64 0.60 | 0.64 0.06 |
| TOTAL | | 170.80 | 7.26 |

Schedule C

Credit Rating Equivalence Table

| | Description | Fitch | | Moody's | | Standard & Poor's | | |
|-------------------|------------------|-------|-------|---------|----------------|-------------------|-------|---|
| | | Long | Short | Long | Short | Long | Short | |
| INVESTMENT GRADE | Extremely strong | AAA | | Aaa | | AAA | | |
| | Very strong | AA+ | F1+ | Aa1 | P-1 | AA+ | A-1+ | |
| | | AA | | Aa2 | | AA | | |
| | | AA- | | Aa3 | | AA- | | |
| | Strong | A+ | F1 | A1 | P-2 | A+ | A-1 | |
| | | A | | A2 | | A | | |
| | | A- | | A3 | | A- | | |
| | Adequate | BBB+ | F2 | Baa1 | P-3 | BBB+ | A-2 | |
| | | BBB | | Baa2 | | BBB | | |
| BBB- | | Baa3 | | BBB- | | | | |
| SPECULATIVE GRADE | Speculative | BB+ | B | Ba1 | Not Prime (NP) | BB+ | B | |
| | | BB | | Ba2 | | BB | | |
| | | BB- | | Ba3 | | BB- | | |
| | Very speculative | B+ | C | B1 | | C | B+ | C |
| | | B | | B2 | | | B | |
| | | B- | | B3 | | | B- | |
| | Vulnerable | CCC+ | C | Caa1 | | C | CCC+ | C |
| | | CCC | | Caa2 | | | CCC | |
| | | CCC- | | Caa3 | | | CCC- | |
| CC | | Ca | | CC | | | | |
| | C | | | | C | | | |
| Defaulting | D | D | C | | D | D | | |