

Treasury Management Strategy 2020/21

Bridgend County Borough Council

Cyngor Bwrdeistref Siro



1.0 INTRODUCTION

The Council carries out its treasury management activities in accordance with the Chartered Institute of Public Finance and Accountancy's (CIPFA) *Treasury Management in the Public Services: Code of Practice (2017) (the 'Code')*. These require the Council to set out the policies and objectives of its treasury management activities and to manage its treasury risks in accordance with the Code.

CIPFA has adopted the following as its definition of treasury management activities:

'The management of the organisation'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.'

The definition of 'Investments' above includes:

- Treasury Management investments (held for the prudent management of financial affairs), and
- Non-Treasury Investments, undertaken as part of a Capital Strategy either in the course of provision of services; or made for commercial reasons purely to make a financial gain. These are managed outside of normal treasury management activity

In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This Strategy fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the WG Guidance. In accordance with the WG Guidance Council would be asked to approve a revised Treasury Management Strategy (TMS) should the assumptions on which it is based change significantly. This might be for example a large unexpected change in interest rates, in the Council's Capital Programme, or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process, or a change in Accounting Standards.

Local authorities are required to separately approve a Capital Strategy for capital expenditure and financing, treasury management and non-treasury investments. The Council's Capital Strategy includes the Prudential Indicators along with details regarding the Council's non-treasury investments. The CIPFA Code requires the Council to set a number of Treasury Management Indicators which are forward looking parameters and enable the Council to measure and manage its exposure to treasury management risks which are integral to the TMS. The Capital Strategy and TMS should be read in conjunction with each other as borrowing and investments are directly impacted upon by capital plans.

The Council has an integrated TMS where borrowing and investments are managed in accordance with best professional practice, which is assessed either from internal expertise or consultation with our external advisers. 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 generally 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. Should these change significantly, a revised TMS will be presented to Council for approval. A half year review of treasury management performance will also be presented to Council for approval as will an annual report for the financial year

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*. Quarterly reports will be presented to Cabinet. The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies and regular reports will be presented to Audit Committee for their consideration.

2.0 ECONOMIC CONTEXT

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's TMS for 2020-21. The Bank of England maintained Bank Rates at 0.75% in December 2019 following a 7-2 vote by the Monetary Policy Committee. The Committee's latest projections for activity and inflation were set out in the November Monetary Policy Report and were based on the assumption of an orderly transition to a deep free trade agreement between the United Kingdom and the European Union. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even with a Brexit deal.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crises banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Council's treasury management advisor Arlingclose is forecasting that the Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be significantly weighted to the downside, particularly given the result of the general election, the need for greater clarity on Brexit and the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in

its November Monetary Policy Report and its Bank Rate decision to hold rates that the MPC now believe this is less likely even in the event of a deal.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

3.0 EXTERNAL DEBT AND INVESTMENT POSITION

On 31 December 2019, the Council held £96.87 million of borrowing and £38.95 million of investments. The external debt and investment position is shown in table 1 below and more detail is provided in sections 4.0 Borrowing Strategy and 5.0 Investment Strategy. Forecast changes in these sums are shown in the balance sheet analysis in table 2 below.

Where a Council finances capital expenditure by borrowing it must put aside revenue resources to repay that debt in later years, known as 'Minimum Revenue Provision' or 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 charge as detailed in the Council's Capital Strategy. 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. This strategy is prudent as investment returns are low and counterparty risk is relatively high. The Council is forecasting an increased CFR due to the prudential borrowing in the capital programme and the impact of the new MRP policy approved by Council in September 2018. Changes in the accounting treatment for leases under International Financial Reporting Standard – IFRS16 - will also have an impact and, once this impact is known, an updated TMS will be presented to Council for approval. As the implementation of the new Standard is for 2020-21, further work is needed before the changes are applied. This requires the Council to 'bring on' to the balance sheet a 'Right of Use Asset' and an equivalent liability, for any assets it leases or is presumed to lease through service contract arrangements

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. Table 3 below shows that the Council complied with this in 2018-19 and expects to comply with this recommendation during 2019-20, 2020-21 and the following two years. More detail is provided in the Capital Strategy.

Table 1: Council's external debt and investment position as at 31 December 2019

	Principal as at 31-12-19 £m	Average Rate %
External Long Term Borrowing:		
Public Works Loan Board	77.62	4.70
Lender's Option Borrower's Option	19.25	4.65
Total External Long Term Borrowing	96.87	4.69
Other Long Term Liabilities:		
Private Finance Initiative*	16.83	
Llynfi Loan**	2.25	
Other LTL	1.22	
Total Other Long Term Liabilities	20.30	
Total Gross External Debt	117.17	
Treasury Investments:		
Banks	4.90	0.91
Building Societies	2.00	0.78
Local Authorities	22.50	0.91
Money Market Funds ***	9.55	0.74
Total Treasury Investments	38.95	0.86
Net Debt	78.22	

* (PFI) arrangement for the provision of a Secondary School in Maesteg 14.25 years remaining term

** Loan from the Welsh Government Central Capital Retained Fund for regeneration works within the Llynfi Valley which has not yet commenced

***the funds provide instant access

Table 2 below has been produced using estimates of capital spend and forecasts on useable reserves for the current financial year and the next three years. The Capital Plans highlight that the Loans CFR, which is the Council's need to borrow to fund capital expenditure, is increasing year on year due to additional prudential borrowing.

Table 2: Balance sheet summary and forecast

	31.3.19 Actual £m *	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m	31.3.23 Estimate £m
CFR	171	171	172	177	180
Less: Other debt liabilities	(17)	(16)	(15)	(14)	(13)
Loans CFR	154	155	157	163	167
Less: External borrowing	(97)	(97)	(100)	(107)	(109)
Internal borrowing	57	58	57	56	58
Less: Usable reserves	(76)	(68)	(64)	(61)	(59)
Less: Working capital	(2)	-	-	-	-
Investments	21	10	10	10	10
New Borrowing - cumulative	-	-	3	5	9

*The accounting practice followed by the Council requires financial instruments in the accounts (debt and investments) to be measured in a method compliant with International Financial Reporting Standards (IFRS) so these figures will differ from other figures in the TMS which are based on the actual amounts borrowed and invested

Liability benchmark: To compare the Council's actual borrowing against an alternative strategy, a liability benchmark has been calculated showing the lowest risk level of borrowing. This forecasts the minimum amount of debt the Council could hold if its internal resources are used in lieu of external borrowing. This assumes the same forecasts as table 2 above, but that cash and investment balances are kept to a minimum level of £10 million at each year-end to maintain sufficient liquidity but minimise credit risk.

Table 3: Liability benchmark

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m	31.3.23 Estimate £m
Loans CFR	154	155	157	163	167
Less: Usable reserves	(76)	(68)	(64)	(61)	(59)
Less: Working capital	(2)	-	-	-	-
Plus: Minimum investments	21	10	10	10	10
Liability Benchmark	97	97	103	112	118

4.0 BORROWING STRATEGY

The Council currently holds £96.87 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 2 above shows that the Council will have to borrow £9 million over the next three years as detailed below:-

Table 4: New Borrowing

	31.3.19 Actual £m	31.3.20 Estimate £m	31.3.21 Estimate £m	31.3.22 Estimate £m	31.3.23 Estimate £m
New Borrowing	-	-	3	2	4

The Section 151 Officer will monitor and update the liability benchmark assumptions on an on-going basis and report any significant changes within the treasury management monitoring reports to Cabinet, Audit Committee and Council as appropriate. This could be as a result of changes in the level of useable reserves at year end, slippage within the Capital Programme or changes within the working capital assumptions.

The Council's **chief objective** when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Therefore the major **objectives** to be followed in 2020-21 are:

- to minimise the revenue costs of debt

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- 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 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

Given the significant cuts to public expenditure in recent years 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 instead.

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 £5 million from the Public Works Loan Board (PWLB) in March 2012. As detailed above, it is anticipated that there will be a requirement for new long term borrowing in 2020-21, 2021-22 and 2022-23. It is anticipated that this would be from PWLB and for estimate purposes it has been assumed that this will be over 30 years.

Alternatively, the Council may arrange forward starting loans during 2020-21 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 (normally for up to one month) to cover unexpected cash flow shortages.

Sources of borrowing: The approved sources of long term and short term borrowing are:

- PWLB and any successor body
- any institution approved for investments (see Investment Strategy below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- 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

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

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Council has previously raised the majority of its long-term borrowing from the PWLB, but the government increased PWLB rates by 1% in October 2019 making it now a more expensive option. The Council will look to borrow any long-term loans from other sources such as Welsh Government and local authority loans and bank loans, that may be available at more favourable rates. Alternatively the Council may arrange forward starting loans, 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.

LOBOs: 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. There are two trigger points in 2020-21 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.

Short term and variable rate loans: These loans expose the Council to the risk of short term interest rate rises should interest rates change.

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.

Maturity structure of borrowing indicator: This indicator is set for the forthcoming financial year to control the Council's exposure to refinancing risk with respect to the maturity of the Council's external borrowing 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. It is the amount of projected borrowing maturing in each period as a percentage of total projected borrowing. The upper and lower limits on the maturity structure of borrowing will be:

Table 5: Treasury Management Indicator Maturity Structure of Borrowing 2020-21

Refinancing rate risk indicator Maturity structure of borrowing 2020-21	Upper limit	lower limit
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	40%	0%
10 years and within 20 years	50%	0%
20 years and above	60%	25%

5.0 INVESTMENT STRATEGY

The preparation each year of an Investment Strategy is central to the Welsh Government guidance on Local Authority Investments. It encourages the formulation of policies for the prudent investment of the surplus funds that authorities hold on behalf of their communities. In addition, the need for the Strategy to be approved by full Council ensures that these policies are subject to the scrutiny of elected Members: this is particularly important as since 2004 central Government no longer closely regulates local government investment.

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 2019 was £38.95 million. Investments are estimated to drop to between £10 and £20 million by 31 March 2020. As in previous years this is due partly to increased expenditure expected to be incurred in respect of the capital programme and the reduction in income collected from Council Tax in February and March 2020. Based on its cash flow forecasts, the Council anticipates its investment balances in 2020-21 to range between £10 million to £55 million with an average investment rate of between 0.75% to 1.00% depending on the Bank Rate and investment types, which will be reviewed at half year and reported to Council. The actual balance varies because of the cash flow during the 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 Council may also hold investment properties with a view to securing a rental income. The Council will consider such investment opportunities should they arise, in line with CIPFA TM Code of Practice. As at 31 December 2019, the Council held £4.635 million of investment properties with an expected return of £0.478 million (10.3%) in 2020-21.

Both the CIPFA Code and the Welsh Government Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments while 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, minimising the risk of incurring losses from defaults and the risk of 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 to or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

The major **objectives** are:

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

Negative interest rates: If the UK enters into a recession in 2020-21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in some other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: 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 will consider further diversifying into more secure and/or higher yielding asset classes during 2020-21 as appropriate in consultation with the Council's treasury management advisers. The majority of the Council's surplus cash is currently invested in Money Market Funds (MMF) and with other local authorities but the Council will continue to look at investment options in line with the limits detailed below.

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 4.0 Borrowing Strategy.

Business Models: Under the new IFRS 9 Standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Council may invest its surplus funds with any of the counterparty types shown in table 6 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 6: Approved investment counterparties and limits

These limits must be read in conjunction with the notes immediately below the table. 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	see above central government and local authority limit	n/a	£3,000,000
	6 Months				
Pooled Funds	£6,000,000 per fund				

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies to ensure that this lies within our agreed minimum credit rating. 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. **Schedule A** shows the equivalence table for credit ratings for three of the main rating agencies Fitch, Moody's and Standard & Poor's and explains the different investment grades.

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 generally a lower risk of insolvency, although they are not zero risk. 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 and registered social landlords, 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 or units in diversified investment vehicles consisting of 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 will 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 the Council of 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 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, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations as happened in 2008 and 2011, it 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: The *Welsh Government Statutory Guidance on Local Government Investments* defines specified investments as those:

- denominated in pound sterling
- due to be repaid within 12 months of arrangement
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government
 - a UK local authority
 - a town 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 that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

Non-specified investments: Any investment that does not fall into the criteria detailed above under the Specified investments definition. The Council does not intend to make any investments denominated in foreign currencies nor any defined as capital expenditure. 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
- investments with bodies and schemes not meeting the definition on high credit quality

The *Welsh Government Statutory Guidance on Local Government Investments* requires the Council's Investment Strategy to set an overall limit for non-specified investments which is currently set at £20 million. Table 8 below shows the non-specified categories and the relevant limits and although the total of the individual limits exceed £20 million, at any one point in time a **maximum of £20 million** could be invested in these non-specified investments.

Principal sums invested for periods longer than a year: All investments longer than 365 days (non-specified) 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.

Where the Council invests, or plans to invest, for periods longer than a year, an upper limit is set for each forward financial year period for the maturing of such investments. The purpose of this indicator is to control the Council's exposure to the risk of incurring

losses by seeking early repayment of long term investments. The limits on the long term principal sum invested to final maturities beyond the period end will be as shown in table 7 below.

Table 7: Treasury Management Indicator Principal sums invested for periods longer than a year

Price risk indicator	2020-21 £m	2021-22 £m	2022-23 £m
Limit on principal invested beyond financial year end	15	10	8

Investment Limits: The combined values of specified and non-specified investments with any one organisation are subject to the approved counterparties and limits shown in table 7 above and also the non-specified limits in table 8 and the investment limits detailed in table 9 below.

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.

The combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments.

Table 8: Non-specified investment limits

	Category Cash limit
Total long-term investments	£15m
Total investments without credit ratings or rated below the Council's definition of "high credit quality" (A-) (except the UK Government and UK local authorities)	£10m
Total investments (except pooled funds) with institutions domiciled in foreign countries with a sovereign rating below AA+	£3m
Total Non-Specified Investments Outstanding	£20m

Table 9: 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 and registered social landlords	£5m in total
Unsecured investments with Building Societies	£6m in total
Money market funds (MMF)	£20m 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 8 above) has been set for 2020-21 for long term investments and this has been set with reference to the Medium Term Financial Strategy and cash flow forecast as shown in the principal sums invested for periods longer than a year indicator in table 7 above. This represents just under 30% of the maximum amount of investments that the Council anticipates to have at any one point in time in 2020-21.

6.0 INTEREST RATE EXPOSURES BORROWING AND INVESTMENTS

The Council is exposed to interest rate movements on its borrowings and investments. Movements in interest rates have a complex impact on the Council, depending on how variable and fixed interest rates move across differing financial instrument periods. For instance, a rise in variable and fixed interest rates would have the following effects:

- borrowings at variable rates – the interest charged to revenue within the Comprehensive Income and Expenditure Statement will rise;
- borrowings at fixed rates – the fixed rate protects the Council from increased interest charges as an equivalent loan would now cost more. The fair value of the borrowing (liability) will fall;
- investments at variable rates – the interest income credited to the Comprehensive Income and Expenditure Statement will rise;
- investments at fixed rates – the fixed rate prevents the Council from receiving higher investment income from the same principal invested. The fair value of the investment (asset) will fall.

7.0 PERFORMANCE INDICATORS

Performance indicators are set 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 average rate of return on investments against the Bank Rate and the average rate of return on investments as compared to the average rate of Arlingclose's Welsh local authority clients at each relevant quarter/year-end.

8.0 OTHER ITEMS

In line with the CIPFA Code and Welsh Government guidance the following also forms part of the Council's TMS.

Financial Derivatives: In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives 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.

Markets in Financial Instruments Directive II (MIFID II): From January 2018, MIFID II changed the classification of local authority investors. It reclassified local and public authorities as retail investors. The Council has opted up to professional client status with its providers of financial services, including treasury management advisers, banks, building societies and brokers, allowing it access to a greater range of services but without the greater regulatory protection afforded to individuals and small companies. Given the size and range of the Council's treasury management activities, the Section 151 Officer believed this to be the most appropriate status.

Investment training: The needs of the Council's treasury management staff for training in investment management are assessed every six months as part of the staff appraisal process and also if the responsibilities of individual members of staff change.

Training is received from the Council's treasury management advisers, CIPFA and other bodies in the form of training courses and seminars. The Council also supports personal development so individuals enhance their own knowledge through reading CIPFA guidance, publications and research on the internet.

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 capital finance issues. 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. As the contract is due to end in September 2020 a re-tendering exercise will be undertaken during the spring and early summer 2020.

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 the 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.

As the Council has an integrated TMS, borrowing is not linked to the financing of specific items of expenditure. The Council's Capital Financing Requirement (CFR) as at 1 January 2020 was in excess of the actual debt of the Council as shown in table 2 above indicating there was no borrowing in advance of need. More detail is provided in the Prudential Indicators in the Council's Capital Strategy.

Schedule A

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	
	Adequate	A-	F2	A3	P-3	A-	A-2
		BBB+		Baa1		BBB+	
		BBB		Baa2		BBB	
SPECULATIVE GRADE	Speculative	BBB-	F3	Baa3	Not Prime (NP)	BBB-	A-3
		BB+		Ba1		BB+	
		BB		Ba2		BB	
	Very speculative	BB-	B	Ba3		BB-	B
		B+		B1		B+	
	Vulnerable	B	C	B2		B	
		B-		B3		B-	
		CCC+		Caa1		CCC+	
		CCC		Caa2		CCC	
		CCC-		Caa3		CCC-	
Defaulting	CC	D	Ca	CC			
	C		C	C			
	D		C	D	D		

GLOSSARY

Annuity	A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion of interest reduces and the proportion of principal repayment increases over time. Repayment mortgages and personal loans tend to be repaid by the annuity method.
Asset Management	The stewardship of capital assets, including decisions around on-going maintenance and eventual disposal
Authorised limit	The maximum amount of debt that a local authority may legally hold, set annually in advance by the Council itself. One of the <i>Prudential Indicators</i> .
BACS	Bankers' automated payment system. UK bulk payments system allowing transfers between bank accounts with two days' notice, for a small charge.
Bail-in	A method of rescuing a failing <i>financial institution</i> by cancelling some of its <i>deposits</i> and <i>bonds</i> . Investors may suffer a reduction in their investment, but may be given shares in the bank as part compensation.
Bail-out	A method of rescuing a failing <i>financial institution</i> by the injection of public money. This protects investors at the expense of taxpayers.
Bank	Regulated firm that provides financial services to customers.
Bank of England	The <i>central bank</i> of the UK, based in London, sometimes just called 'the bank'.
Bank Rate	The official interest rate set by the <i>Monetary Policy Committee</i> , and the rate of interest paid by the <i>Bank of England</i> on commercial bank deposits. Colloquially termed the 'base rate'.
Bond	A certificate of <i>long-term</i> debt issued by a company, government, or other institution, which is tradable on financial markets
Borrowing	Usually refers to the stock of outstanding loans owned and <i>bonds</i> issued.
Broker	Regulated firm that matches either borrowers and lenders (a money broker) or buyers and sellers of <i>securities</i> (a stockbroker) with each other in order to facilitate transactions
Brokerage	Fee charged by a <i>broker</i> , normally paid by the borrower
Building Society	A mutual organisation that performs similar functions to a <i>retail bank</i> but is owned by its customers
Capital	(1) Long-term, as in <i>capital expenditure</i> and <i>capital receipts</i> (2) <i>Principal</i> , as in <i>capital gain</i> and <i>capital value</i> (3) <i>Investments in financial institutions that will absorb losses before senior unsecured creditors</i>

Capital Expenditure	Expenditure on the acquisition, creation or enhancement of fixed asset that are expected to provide value for longer than one year, such as property and equipment, plus expenditure defined as capital in legislation such as the purchase of certain investments
Capital Finance	Arranging and managing the cash required to finance <i>capital expenditure</i> , and the associated accounting.
Capital Financing Requirement (CFR)	A local authority's underlying need to hold debt for capital purposes, representing the cumulative capital expenditure that has been incurred but not yet financed. The CFR increases with <i>capital expenditure</i> and decreases with <i>capital finance</i> and <i>MRP</i> .
Capital Receipt	Cash obtained from the sale of an item whose purchase would be <i>capital expenditure</i> . The law only allows local authorities to spend capital receipts on certain items, such as new capital expenditure. They are therefore held in a capital receipts reserve until spent.
Capital strategy	An annual policy document required by the <i>Prudential Code</i> that sets out a local authorities' high-level plans for capital expenditure, debt and investments and its <i>Prudential Indicators</i> for the forthcoming financial year.
CIPFA	The Chartered Institute of Public Finance and Accountancy – the professional body for accountants working in the public sector. CIPFA also sets various standards for local government – eg Treasury Management Code and Prudential Code
Cost of Carry	When a loan is borrowed in advance of need, the difference between the interest payable on the loan and the income earned from investing the cash in the interim
Counterparty	The other party to a loan, investment or other contract
Counterparty limit	The maximum amount an investor is willing to lend to a <i>counterparty</i> , in order to manage <i>credit risk</i> .
Credit rating	Formal opinion by a <i>credit rating agency</i> of a <i>counterparty's</i> future ability to meet its financial obligations. As it is only an opinion, there is no guarantee that a highly rated organisation will not default.
Credit rating agency	An organisation that publishes <i>credit ratings</i> . The three largest agencies are Fitch, Moody's and Standard & Poor's but there are many smaller ones.
Credit risk	The risk that a <i>counterparty</i> will <i>default</i> on its financial obligations.
Debt	(1) A contract where one party owes money to another party, such as a <i>loan</i> , <i>deposit</i> , or <i>bond</i> . (2) In the Prudential Code, the total outstanding borrowing plus other long-term liabilities

Default	Failure to meet an obligation under a debt contract, including the repayment of cash, usually as a result of being in financial difficulty
Deposit	A regulated placing of cash with a <i>financial institution</i> . Deposits are not tradable on financial markets.
DMO	Debt Management Office – an executive agency of HM Treasury that deals with central government’s debt and investments.
Fair value	<i>IFRS</i> term for the price that would be obtained by selling an investment, or paid to transfer debt, in a market transaction.
FCA	Financial Conduct Authority – UK agency responsible for regulating financial markets and the conduct of <i>financial institutions, brokers, custodians, fund managers</i> and <i>treasury management advisors</i> .
Financial institution	A <i>bank, building society or credit union</i> . Sometimes the term also includes insurance companies.
Financial instrument	<i>IFRS</i> term for investments, borrowing and other cash payable and receivable.
Financing costs	In the <i>Prudential Code</i> , interest payable on <i>debt</i> less investment income plus <i>premiums</i> less <i>discounts</i> plus <i>MRP</i> .
Forward deal	An arrangement where a loan or deposit is arranged in advance of the cash being transferred, with the advance period being longer than the standard period (if any) for such a transaction.
GDP	Gross domestic product – the value of the national aggregate production of goods and services in the economy. Increasing GDP is known as economic growth.
General Fund	A local authority reserve that holds the accumulated surplus or deficit on revenue income and expenditure, except on council housing.
Gilt	Bond issued by the UK Government, taking its name from the gilt-edged paper they were originally printed on.
IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010.
Impairment	A reduction in the value of an investment caused by the counterparty being in financial difficulty.
Inflation risk	The risk that unexpected changes in inflation rates cause an unplanned loss, for example by costs rising faster than income.
Interest	Compensation for the use of cash paid by borrowers to lenders on debt instruments.
Interest rate risk	The risk that unexpected changes in interest rates cause an unplanned loss, for example by increased payments on borrowing or lower income on investments.

Internal borrowing	A local government term for when actual “external” debt is below the capital financing requirement, indicating that difference has been borrowed from internal resources instead; in reality this is not a form of borrowing.
Investment property	Land and buildings that are held purely for rental income and/or capital growth. Investment properties are not owner-occupied and provide no direct service benefit.
Investment strategy	A document required by investment guidance that sets out a local authority’s investment plans and parameters for the coming year. Sometimes forms part of the authority’s treasury management strategy.
Lease	A contract where one party permits another to make use of an asset in return for a series of payments. It is economically similar to buying the asset and borrowing a loan, and therefore leases are often counted as a type of debt.
Lessee	Party to a lease contract that uses an asset owned by the lessor.
Lessor	Party to a lease contract that own an asset but permits another (the lessee) to use it.
Liability benchmark	Term in CIPFA’s Risk Management Toolkit which refers to the minimum amount of borrowing required to keep investments at a minimum liquidity level. Used to compare against the actual and forecast level of borrowing.
LIBOR	London interbank offer rate - the benchmark interest rate at which banks offer to lend cash to other banks. Published every London working day at 11am for various currencies and terms. Due to be phased out by 2022.
Liquidity risk	The risk that cash will not be available to meet financial obligations, for example when investments cannot be recalled and new loans cannot be borrowed.
Loan	Contract where the lender provides a sum of money (the principal) to a borrower, who agrees to repay it in the future together with interest. Loans are not normally tradable on financial markets. There are specific definitions in government investment guidance.
Loans CFR	The capital financing requirement less the amount met by other long-term liabilities; i.e. the amount to be met by borrowing.
LOBO	Lender’s option borrower’s option – a long-term loan where the lender has the option to propose an increase in the interest rate on pre-determined dates. The borrower then has the option to either accept the new rate or repay the loan without penalty. LOBOs increase the borrower’s interest rate risk and the loan should therefore attract a lower rate of interest initially.
Long-term	Usually means longer than one year.

Market risk	The risk that movements in market variables will have an unexpected impact. Usually split into interest rate risk, price risk and foreign exchange risk.
Maturity	(1) The date when an investment or borrowing is scheduled to be repaid. (2) A type of loan where the principal is only repaid on the maturity date.
MiFID II	The second Markets in Financial Instruments Directive - a legislative framework instituted by the European Union to regulate financial markets in the bloc and improve protections for investors.
Monetary policy	Measures taken by central banks to boost or slow the economy, usually via changes in interest rates. Monetary easing refers to cuts in interest rates, making it cheaper for households and businesses to borrow and hence spend more, boosting the economy, while monetary tightening refers to the opposite. See also fiscal policy and quantitative easing.
Monetary Policy Committee (MPC)	Committee of the Bank of England responsible for implementing monetary policy in the UK by changing Bank Rate and quantitative easing with the aim of keeping CPI inflation at around 2%.
Money market fund (MMF)	A collective investment scheme which invests in a range of short-term assets providing high credit quality and high liquidity. Usually refers to CNAV and LVNAV funds with a WAM under 60 days which offer instant access, but the European Union definition extends to include cash plus funds.
Money markets	The markets for short-term finance, including deposits and T-bills. See also capital markets.
MRP	Minimum revenue provision - an annual amount that local authorities are required to set aside and charge to revenue for the repayment of debt associated with capital expenditure. Local authorities are required by law to have regard to government guidance on MRP.
Net borrowing	Borrowing minus treasury investments.
Net revenue stream	In the Prudential Code, income from general government grants, Council Tax and rates.
Non-specified investments	Government term for investments not meeting the definition of a specified investment or a loan upon which limits must be set. Since 2018, the term does not apply to treasury investments in England. Not applicable in Scotland.
Other long-term liabilities	Prudential Code term for credit arrangements.

Operational boundary	A prudential indicator showing the most likely, prudent, estimated level of external debt, but not the worst-case scenario. Regular breaches of the operational boundary should prompt management action.
Operational risk	The risk that fraud, error or system failure leads to an unexpected loss.
Pension Fund	Ringfenced account for the income, expenditure and investments of the local government pension scheme. Pension fund investments are not considered to be part of treasury management.
Private Finance Initiative (PFI)	A government scheme where a private company designs, builds, finances and operates assets on behalf of the public sector, in exchange for a series of payments, typically over 30 years. Counts as a credit arrangement and debt.
Property fund	A collective investment scheme that mainly invests in property. Due to the costs of buying and selling property, including stamp duty land tax, there is usually a significant fee charged on initial investment, or a significant difference between the bid and offer price.
Prudential borrowing	Another term for unsupported borrowing.
Prudential Code	Developed by CIPFA and introduced in April 2004 as a professional code of practice to support local authority capital investment planning within a clear, affordable, prudent and sustainable framework and in accordance with good professional practice. Local authorities are required by law to have regard to the Prudential Code.
Prudential indicators	Indicators required by the Prudential Code and determined by the local authority to define its capital expenditure and asset management framework. They are designed to support and record local decision making in a manner that is publicly accountable.
PWLB	Public Works Loans Board - a statutory body operating within the DMO that lends money from the National Loans Fund to local authorities and other prescribed bodies and collects the repayments.
Refinancing risk	The risk that maturing loans cannot, be refinanced, or only at higher than expected interest rates leading to an unplanned loss. Managed by maintaining a smooth maturity profile.
Supported borrowing	Borrowing for which the repayment costs are supported by government grant.
T-bill	Treasury bill - a bill issued by a government.
TMS	(1) Treasury management strategy. (2) Treasury management system.
Treasury bill	See T-bill.

Treasury investments	Investments made for treasury management purposes, as opposed to commercial investments and service investments.
Treasury management	The management of an organisation's cash flows, investment and borrowing, with a particular focus on the identification, control and management of risk. Specifically excludes the management of pension fund investments.
Treasury management advisor	Regulated firm providing advice on treasury management, capital finance and related issues.
Treasury Management Code (TM Code)	CIPFA's Code of Practice for Treasury Management in the Public Services and Cross-Sectoral Guidance Notes, to which local authorities are required by law to have regard.
Treasury management indicators	Indicators required by the Treasury Management Code to assist in the management of credit risk, interest rate risk, refinancing risk and price risk.
Treasury management policy statement	Document required by the Treasury Management Code setting out a local authority's definition of and objectives for treasury management.
Treasury management practices (TMPs)	Document required by the Treasury Management Code setting out a local authority's detailed processes and procedures for treasury management.
Treasury management strategy	Annual report required by the Treasury Management Code covering the local authority's treasury management plans for the forthcoming year.
Unsupported borrowing	Borrowing where the cost is self-financed by the local authority. Sometimes called prudential borrowing since it was not permitted until the introduction of the Prudential Code in 2004. See also supported borrowing.
Working capital	The cash surplus or deficit arising from the timing differences between income/expenditure in accounting terms and receipts/payments in cash terms.