TREASURY MANAGEMENT STRATEGY STATEMENT, MINIMUM REVENUE PROVISION POLICY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2019/20

SUMMARY

This appendix addresses the requirements of the prudential and treasury management codes and sets out the treasury management strategy, borrowing and investment strategies and a policy statement on the minimum revenue provision required for the repayment of debt.

1. INTRODUCTION

1.1 Background

1.1.1 The Council is required to operate a balanced budget which broadly means that income raised during the year will meet planned expenditure. Part of the treasury management operation is to ensure that the cashflow for this is adequately planned, with cash being available when it is needed. Where surplus monies are available these are invested in counterparties or instruments commensurate with the Council's low risk appetite, providing security and adequate liquidity initially before considering investment return.

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

1.1.3 The contribution the treasury management function makes to the authority is critical, as the balance of debt and investment operations ensure liquidity or the ability to meet spending commitments as they fall due, either on day-to-day revenue or for larger capital projects. The treasury operations will see a balance of the interest costs of debt and the investment income arising from cash deposits affecting the available budget. Since cash balances generally result from reserves and balances, it is paramount to ensure adequate security of the sums invested, as a loss of principal will in effect result in a loss to the General Fund Balance.

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

1.1.5 CIPFA defines treasury management as:

'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'

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

1.2 Reporting Requirements

Capital Strategy

1.2.1 In 2017 the Prudential Code and Treasury Management Code were revised to include a new requirement for local authorities to prepare a capital strategy report which will provide the following:

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

1.2.2 The aim of the capital strategy is to outline the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.3 The capital strategy is reported separately from the Treasury Management Strategy Statement; non-treasury investments will be reported through the former. This ensures the separation of the core treasury function under security, liquidity and yield principles, and the policy and commercialism investments usually driven by expenditure on an asset. The capital strategy will show:

- The corporate governance arrangements for these types of activities;
- Any service objectives relating to the investments;
- The expected income, costs and resulting contribution;
- The debt related to the activity and the associated interest costs;
- The payback period (MRP policy);
- For non-loan type investments, the cost against the current market value;
- The risks associated with each activity.

1.2.4 Where a physical asset is being bought, details of market research, advisers used, (and their monitoring), ongoing costs and investment requirements and any credit information will be disclosed, including the ability to sell the asset and realise the investment cash.

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

Treasury Management Reporting

1.2.6 The Council is required to receive and approve as a minimum, three reports each year, which incorporate a variety of policies, estimates and actuals. These reports are required to be adequately scrutinised by Members before being recommended to the Council. This role is undertaken by the Audit and Governance Committee, which then reports to Full Council. The three reports are:

(1) Treasury Management Strategy and Prudential and Treasury Indicators (this report) covering:

- Capital plans (including prudential indicators);
- Minimum Revenue Provision Policy Statement (how residual capital expenditure is charged to revenue over time);
- Treasury Management Strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- Investment Strategy (the parameters on how investments are to be managed).

(2) Mid Year Treasury Management Report –This report updates members on the progress of the capital and treasury management positions, amending prudential indicators as necessary and assesses whether the treasury strategy is meeting needs or whether any policies require revision. In addition the Audit Committee receives quarterly update reports.

(3) Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations after the year end compared to estimates within the strategy.

1.3 Treasury Management Strategy for 2019/20

1.3.1 The proposed strategy for 2019/20 covers the following:

Capital issues

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

Treasury management issues

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

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

1.4 Knowledge & Skills

1.4.1 The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training is provided for all new members overseeing treasury management and other sessions can be arranged as required.

1.4.2 Officers responsible for treasury management are suitably trained to ensure that the appropriate level of skills and knowledge are available to the Council. Officers and members are also supported through the skills and knowledge provided by the Council's external treasury management advisors, Link Asset Services, Treasury Solutions. However the Council also recognises that responsibility for treasury management decisions remains with itself and ensures that undue reliance is not placed upon its external service providers.

2. CAPITAL PRUDENTIAL INDICATORS FOR 2019/20 TO 2022/23

The prudential code requires the Council to have set a number of forward looking prudential indicators to both support and record local decision making with regard to capital expenditure and treasury management decisions. The full set of indicators is shown in Annex 1. Each is now discussed in turn.

2.1 Capital expenditure

2.1.1 The Council's capital expenditure plans are the key driver of treasury management activity. The first prudential indicator is a summary of the Council's capital expenditure plans as detailed in the capital strategy shown in Appendix I to the budget report.

2.2 The Council's net financing need (Capital Financing Requirement)

2.2.1 The third prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is the total historic outstanding capital expenditure which has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and, hence, its underlying borrowing need. Any capital expenditure shown within the capital programme in Appendix I, which has not immediately been paid for through a revenue or capital resource, will increase the CFR.

2.2.2 The CFR does not increase indefinitely, as the minimum revenue provision is a statutory annual revenue charge which broadly reduces the indebtedness in line with each asset's life, and thereby charges the economic consumption of capital assets as they are used.

2.2.3 Current CFR projections are as follows:

Table 1

£'000	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Capital Financing Requirement (CFR)					
General Fund	143,667	150,287	145,457	141,008	135,544
HRA	178,677	188,796	208,583	214,327	218,879
Commercial Activities / Non Financial Investments	66,555	72,555	78,555	78,555	78,555
Total CFR	388,899	411,638	432,595	433,890	432,978
Movement in CFR	27,774	22,739	20,957	1,295	(912)
Movement in CFR represented by					
Net financing need for the year	31,281	26,345	24,790	5,144	2,936
Less Minimum Revenue Provision, Voluntary Revenue Provision and other financing movements	(3,508)	(3,606)	(3,833)	(3,849)	(3,848)
Movement in CFR	27,774	22,739	20,957	1,295	(912)

2.2.4 The tables above demonstrate the size and scope of commercial activity in relation to the Council's overall financial position.

2.3 Minimum Revenue Provision Policy Statement

2.3.1 Where capital expenditure has been funded through the use of borrowing, the Council is required to set aside an amount from revenue each year to provide for the eventual repayment of this debt. The Council is required to provide an annual policy statement on how the methodology has been implemented. This is set out in Annex 2.

2.3.2 There is no requirement for the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made. In the HRA business plan the Council will set aside funding in an investment reserve from 2019/20 for the repayment of the HRA self financing loan of £141m when it matures in 2042.

2.4 Core funds and expected investment balances

2.4.1 The application of resources either to finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Estimates of year-end balances, for each resource and anticipated year-end cash flow balances are taken into account to establish the likely level of resources available for investment.

3. BORROWING

3.1 Current portfolio position

3.1.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1.2 The Council's actual and projected treasury portfolio position is summarised below. The table shows the actual external debt, against the underlying capital borrowing need (the CFR), highlighting any over or under borrowing.

3.1.3 The Council will continue to provide loan finance to a number of council wholly owned companies, including Sutton Decentralised Energy Network (SDEN) and Sutton Living.

Table 2

£'000	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
External debt					
Debt at 1 April	267,471	295,881	302,128	329,359	352,891
Expected change in debt	22,050	(9,000)	3,605	0	(4,500)
Other long term liabilities at 1 April	5,202	6,360	15,247	23,626	23,532
Expected change in other long term liabilities	1.158	8,887	8,379	(94)	(94)
Actual gross debt at 31 March	295,881	302,128	329,359	352,891	371,829
Capital Financing Requirement	388,899	411,638	432,595	433,890	432,978
Under / (over) borrowing	93,018	109,510	103,236	80,999	61,149

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

£'000	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
Actual debt as at 31 March (£m)	54,825	75,298	95,771	95,771	95,771
Percentage of total external debt (%)	18.53	24.92	29.08	27.14	25.76

3.1.5 At the end of the third quarter 2018/19, the Council had external debt totalling £287.2m with an average annual borrowing rate of 3.4%. Of the total, £246.9m has been borrowed from the Public Works Loan Board (PWLB), £15.0m from other local authorities and £25.3m from individual banks.

3.1.6 The borrowing from individual banks is through five Lender Option Borrower Option (LOBO) loans held with four counterparties with interest rates in the range 3.49% to 4.55%. These are simple structured loans with no complicated mechanisms, which are present in other LOBOS e.g. inverse floating rate structures. Under these arrangements, the lender has the option to increase rates but, should it do so, the Council can choose to redeem without penalty. The Council's treasury advisors, Link Asset Services, carried out a review of the Councils LOBOs in 2016, the outcome of which was reported orally to the 8 December 2016 Audit Committee. This review concluded that levels of risk with the Council's LOBO loans were low, with just a small risk that the lender may look to increase the interest rate in the future. However, if this happens the Council has access to the PWLB for refinancing with no penalty applied.

3.1.7 The Public Works Loan Board (PWLB) continues to be the main source of long term loans for the Council. However, the Council will continue to seek out alternative cheaper options where possible such as the use of LOBO loans or through the Municipal Bonds Agency. The Council continues to benefit from the 20 basis points (0.2%) reduction on the interest rates on loans from PWLB under the 'certainty rate' arrangements following the provision of information on the Council's plans for long-term borrowing and associated capital spending to Government.

3.1.8 A graph showing the maturity profile of the Council's long term debt as at the end of the third quarter 2018/19 is attached at Annex 3. The Council's loan portfolio will be kept under review to see if savings can be made by further debt restructuring. No restructuring has been undertaken during 2018/19 as market conditions have not been favourable. Any opportunities in the coming year will continue to be explored although this position is not expected to change in the short term.

3.1.9 The Council approved a temporary borrowing limit of £82.4m for 2018/19. Due to a reduction in underlying cash balances held by the Council it as been necessary to undertake temporary borrowing during the first nine months of 2018/19. The total amount of temporary borrowing undertaken during that time was £135.3m. The average loan was for £3.8m for a duration of 15 days. The temporary borrowing limit for 2019/20 will be set at £85.4m.

3.1.10 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes. The Strategic Director of Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

3.2.1 **The operational boundary.** This is the overall limit which external debt is not normally expected to exceed. This would usually be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Table 3

Operational boundary £'000	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Debt	322,344	339,083	354,040	355,335	354,423
Other long term liabilities	4,260	4,674	4,580	4,486	4,392
Commercial Activities / Non Financial Investments	68,654	83,127	97,601	97,601	97,601
Total	395,258	426,884	456,221	457,422	456,416

3.2.2 **The authorised limit for external debt.** A further key prudential indicator represents a control on the maximum level of borrowing. This is a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. The Council is recommended to approve the authorised limit as part of the approval of the Treasury Strategy and Prudential Indicators.

Table 4

Authorised limit £’000	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Debt	342,344	359,083	374,040	375,335	374,423
Other long term liabilities	4,260	4,674	4,580	4,486	4,392
Commercial Activities / Non Financial Investments	68,654	83,127	97,601	97,601	97,601
Total	415,258	446,884	476,221	477,422	476,416

3.2.3 To manage interest rate exposure, loans at fixed rates can be arranged up to the authorised limit at maximum, whilst those at variable rates are limited to 25% of this level. Exposure levels are monitored on a continuing basis.

3.2.4 Separately, the Council was also limited to a maximum HRA CFR through the HRA self-financing regime. This limit has now been abolished.

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

- Upper limit on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limit on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council’s exposure to large fixed sums falling due for refinancing.

The indicators that the Council is asked to approve are shown in Annex 1.

3.3 Prospects for interest rates

3.3.1 Interest rates are dependent on the outlook for inflation which in turn reflects the prospects for the economy. The Bank of England increased base rate to 0.75% in August 2018 when Consumer Prices Index (CPI) was above the 2% target at 2.7%. The Monetary Policy Committee (MPC) took the view that with a falling unemployment rate together with rising labour costs the economy was experiencing little slack. The MPC expect some excess demand by late 2019 which was forecast to increase over the next 2-3 years. Over the forecast period inflation was expected to remain above target until the third year and that was why the decision was made to increase base rate.

3.3.2 In the Bank of England’s November inflation report the economy was judged to be in balance with forecast GDP averaging 1.75% over the next 3 years. This is marginally higher than the forecast growth in supply capacity at 1.5% which creates the excess demand in the economy and will require further increases in base rate to bring inflation back to target. These increases in base rate will be gradual as base rate is expected to reach 1.4% in quarter 4 2021. The economic forecasts assume that the stock of UK government debt purchased by central bank reserves remains at £435 billion and also the stock of corporate bonds remains at £10 billion

3.3.3 The Bank of England's forecasts assume a smooth transition out of the European Union. The MPC has stated that depending on the nature of the UK's departure, monetary policy could go in either direction. A successful departure would increase business and consumer confidence with a corresponding impact on GDP and inflationary pressures. An unsuccessful departure would likely have the reverse impact except that inflation may increase if Sterling depreciates further.

3.3.4 In the light of these uncertainties Link Asset Services have provided some forecast rates as shown in Table 6 below. Their forecast for base rate is higher than that in the Bank of England's November report, ending the forecast period at 2.20%. PWLB rates are expected to increase by around 20 basis points per annum from 2020 to end the forecast period 90 basis points higher than January 2019.

Table 6. Link Asset Services Interest Rate View

Interest	Current	Forecast	Forecast	Forecast	Forecast
Rates	Jan 2019	Mar 2019	Mar 2020	Mar 2021	Mar 2022
Bank Rate	0.75%	0.75%	1.25%	1.50%	2.20%
PWLB 25 yr rate*	2.81%	2.90%	3.20%	3.40%	3.60%
PWLB 50yr rate*	2.66%	2.70%	3.00%	3.20%	3.40%

3.4 Borrowing strategy

General

3.4.1 Currently the Council's actual long term borrowing is well below its CFR limit. This difference represents the extent to which the Council has been financing capital investment from internal cash balances. This is a consequence of the Council's treasury management strategy which manages the Council's cash flows in an integrated way so that external borrowing arises as a consequence of all the financial transactions of the Council and not simply those arising from capital expenditure. This approach has ensured that debt levels, and the associated revenue costs of financing that debt, have been kept to a minimum. The Strategic Director of Resources will monitor interest rates in financial markets and consider necessary action if interest rates appear to be on an upward trend.

HRA Borrowing

3.4.2 A major influence on the Council's borrowing strategy in the future is the inclusion of significant HRA debt through the settlement payment made to Government under HRA Reform (self financing) in March 2012. The payment totalled £141.1m and significantly increased the level of debt that the Council holds. The Council was previously limited to a maximum level of HRA debt called the debt ceiling. This ceiling was set as part of the self financing regime. The ceiling was abolished as part of announcements in the Chancellor's Budget.

3.4.3 The Council is applying the two pool option to calculate interest due from the HRA and the General Fund in relation to external loans. This option splits the Council's borrowing into two pools, one for the General Fund and one for the HRA. Within this arrangement the underlying principles are:

- there is no detriment to the General Fund
- any solution is broadly equitable for both the HRA and General Fund
- the HRA is given a greater degree of independence, certainty and control over its borrowing charges, subject to the overriding corporate interests of the Council

General Fund Borrowing

3.4.4 Long term funding needs have traditionally been met from the PWLB. However, long term fixed market loans rates such as LOBOs can often be below the PWLB rates for the equivalent maturity periods, although it is important that an appropriate balance is maintained between PWLB and this type of market debt in the debt portfolio. This is because LOBO's are only fixed during the initial primary period of the loan (typically 3 to 5 years) and beyond that the lender has the option to change the interest rate and, should it do so, the Council has the option to repay the loan. This introduces a level of interest rate risk if the Council has a large proportion of its debt in the form of LOBOs. The current split between PWLB and market loans is 90/10.

3.4.5 The Local Government Association has been working with local authorities to set up a Municipal Bonds Agency. The Council has become a shareholder, having invested in the establishment of the Agency. The Agency is now in operation and is due to be offering loans to local authorities in the near future. It is envisaged that the borrowing rates will be lower than those offered by the PWLB. The Council will consider making use of this new option when it becomes necessary to take on additional external borrowing.

3.4.6 The Council will continue its policy of maintaining a planned and stable maturity pattern for its loans whilst borrowing as cheaply as possible using all available prudent market instruments.

3.4.7 There is one natural maturity of an existing PWLB loan due in the next three years. The value of the loan is £95k and it has an existing interest rate of 5.125%. It is unlikely that this will be replaced, however any refinancing would result in a small revenue saving to the Council and this has been built into the budget plans.

3.5 Policy on borrowing in advance of need

3.5.1 The Council will not generally borrow more than or in advance of its needs purely in order to seek to profit from the investment of the extra sums borrowed. A proportion of the increase in the CFR will be linked to the commercial activity that the authority is carrying out. Borrowing will take place for this on the basis that the commercial activity will involve acquiring assets with a value to the authority, generate an income to support service provision and be self financing.

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

3.6 Debt rescheduling

3.6.1 The Council will continue to look for opportunities to reduce the cost of outstanding debt such as looking at options involving switching from long term to short term debt or refinancing using other sources of loan finance such as LOBOs. Any such exercises will be undertaken in line with the Council's treasury management strategy and the reasons for any rescheduling will be either to generate cash savings and/ or discounted cash flow savings, helping to fulfil the borrowing strategy for 2019/20 or to enhance the balance of the overall debt portfolio.

4. ANNUAL INVESTMENT STRATEGY

4.1 Current portfolio position

4.1.1 During the first six months of 2018/19 the Council has had surplus funds available for investment. Available balances totalled £21.9m at the beginning of the year and had risen to £36.4m at the end of December. During the year these funds were available to lend on a temporary basis, with the in year fluctuation largely dependent on the timing of payments, receipt of Council Tax and grants and progress of the capital programme. Interest earned during the period totalled £0.1m and represented a weighted average interest rate earned by the Council of 0.68%. This compares favourably with the average of the 7 day and 3 month LIBID (London Interbank Bid Rate) figure of 0.57%.

4.1.2 In 2019/20 the Council has continued to make use of Money Market Funds (MMFs) to manage liquidity risk. A 95 day notice account with Santander has also continued to be used. At the start of the year the rate on this account was 0.60%, this was increased to 0.85% from 1 September.

4.2 Investment policy

4.2.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with financial investments. Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy (Appendix I to the Budget Report).

4.2.2 The Council's investment policy has regard to the following: -

- MHCLG's Guidance on Local Government Investments ("the Guidance")
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the Code")
- CIPFA Treasury Management Guidance Notes 2018

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

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

4.2.5 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “credit default swaps” and overlay that information on top of the credit ratings.

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

4.2.7 This authority has defined the list of types of investment instruments that the treasury management team are authorised to use. This list is shown in Annex 4. This includes the categories of ‘specified’ and ‘non-specified’ investments.

- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
- **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use.

4.3 Creditworthiness policy

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

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

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

Yellow (AAA rated Government debt or its equivalent) up to 5 years (unlimited monetary amount);
Purple £20m, up to 2 years;
Blue £20m, up to 1 year (only applies to nationalised or semi nationalised UK banks);
Orange £17.5m, up to 1 year;
Red £15m, up to 6 months;
Green £12.5m up to 100 days;
No colour - not to be used.

4.3.3 All counterparties and their credit ratings are monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services’ creditworthiness service. if a downgrade results in the counterparty / investment scheme no longer meeting the Council’s minimum criteria, its further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council’s lending list.

4.4 UK banks – Ring Fencing

4.4.1 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), were required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as "ring-fencing". Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

4.4.2 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and "riskier" activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

4.4.3 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the newly-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.5 Approved countries for investments

4.5.1 Other than the UK the Council will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

4.6 Investment Strategy

4.6.1 Over the last few years the Council has used internal resources where possible to fund capital expenditure through internal borrowing instead of undertaking external borrowing. This has ensured the most efficient use of resources since currently the cost of external borrowing significantly exceeds the level of interest that can be earned on cash investments. However the Council is now reaching a point whereby internal resources are at the minimum level required to cover fluctuations in the monthly cash flow requirements. In the future any new capital expenditure is likely to be funded by external borrowing.

4.6.2 Investments are made with reference to core balances and cash flow requirements and the outlook for short term interest rates (i.e. rates for investments up to 12 months).

4.6.3 The bank base rate is forecast to increase steadily but slowly over the next few years to reach 2.2% by quarter 1 2022. Bank rate forecasts for financial year ends (march) are as follows:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.5%
- 2021/22 2.2%

4.6.4 Given the low investment rate environment and the low level of internal resources available for longer term investment the Council will continue to use Money Market Funds that are AAA rated with at least one of the three credit ratings agencies. The Council may also use enhanced money market funds with a minimum AAA fS1 rating or equivalent. It will also use call accounts and notice accounts with approved counterparties for deposits placed directly with institutions to minimise risk.

4.7 Implementation of IFRS 9

4.7.1 As a result of the change in accounting standards for 2018/19 under IFRS 9, the council will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant changes at the end of the year to the General Fund.

4.8 Investment returns benchmarking

4.8.1 The Council will use the 7 day and 3 month LIBID as investment benchmarks to assess the performance of its investment portfolio.

4.9 Heritable Bank investment

4.9.1 On 7 October 2008, Heritable Bank, a UK subsidiary of Landsbanki was put into administration by the High Court in London. This followed the nationalisation of Landsbanki by the Icelandic Government during the global banking crisis of Autumn 2008. The Council had a £5.5m on deposit with Heritable Bank when it was put into administration and these funds were frozen.

4.9.2 Ernst and Young were appointed as the administrators for Heritable Bank and are required to administer the affairs of the bank and secure the best possible outcome for the creditors of the bank including the Council. The total funds recovered to date are just over £5.4m, representing around 98p in the pound. The administrators have retained a reserve to provide for legal costs and expenses until the conclusion of the administration. They do not intend to make further distributions to unsecured creditors until all outcomes are fully known.

4.9.3 The Council has initiated a claim against Landisbanki, the parent company of Heritable Bank. The claim is dependent on the conclusion of the administration of Heritable, after which no further dividend payments will be made to creditors. If the Council receives any further amounts from Heritable, these will be offset against the subsequent claim against Landisbanki.

Annex 1 -Summary Prudential Indicators

	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
STATUTORY PRUDENTIAL INDICATORS (to support the Council's capital financing requirement)	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Capital expenditure:					
General Fund	76,596	47,502	13,740	6,473	6,271
HRA	27,531	22,055	37,576	15,370	14,375
Total	104,127	69,557	51,316	21,843	20,646
Proportion of financing costs to net revenue stream:					
General Fund	2.52	2.54	2.71	2.74	2.76
Capital Financing Requirement as at 31 March:					
General Fund	143,667	150,287	145,457	141,008	135,544
Commercial Activities / Non Financial Investments	66,555	72,555	78,555	78,555	78,555
HRA	178,677	188,796	208,583	214,327	218,879
Total	388,899	411,638	432,595	433,890	432,978
Annual change in Capital Financing Requirement					
Brought forward 1 April	361,125	388,899	411,638	432,595	433,890
Carried forward 31 March	388,899	411,638	432,595	433,890	432,978
	27,774	22,739	20,957	1,295	(912)

	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
STATUTORY TREASURY MANAGEMENT INDICATORS	**£'000**	**£'000**	**£'000**	**£'000**	**£'000**
Authorised limit for external debt:					
Borrowing	342,344	359,083	374,040	375,335	374,423
Other long term liabilities	4,260	4,674	4,580	4,486	4,392
Commercial / Non Financial Investments	68,654	83,127	97,601	97,601	97,601
Total	415,258	446,884	476,221	477,422	476,416
Operational boundary for external debt:					
Borrowing	322,344	339,083	354,040	355,335	354,423
Other long term liabilities	4,260	4,674	4,580	4,486	4,392
Commercial / Non Financial Investments	68,654	83,127	97,601	97,601	97,601
Total	395,258	426,884	456,221	457,422	456,416
Annual borrowing requirement based on operational boundary					
Total					
Upper Limit on investments in excess of 365 days					
Maturity Structure of fixed rate borrowing					
	Upper Limit	Lower Limit			
Under 12 months	15%	0%			
12 months and within 24 months	15%	0%			
24 months and within 5 years	45%	0%			
5 years and within 10 years	75%	0%			
10 years and above	100%	0%			
Temporary Borrowing Limit					
20% of the operational boundary	79,052	85,377	91,244	91,484	91,283

APPENDIX J

ANNEX 2

MINIMUM REVENUE PROVISION POLICY STATEMENT 2019/20

The Council will continue to implement the Minimum Revenue Provision (MRP) guidance and assess its MRP in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The guidance includes specific Options Local Authorities could use for calculating MRP:

- Option 1 – Regulatory Method – For expenditure incurred before 1 April 2008 and expenditure incurred on or after that date which is supported expenditure. MRP is equal to an amount determined in accordance to the former regulations, which broadly equates to 4%
- Option 2 – Capital Financing Requirement (CFR) Method - For expenditure incurred before 1 April 2008 and expenditure incurred on or after that date which is Supported expenditure. MRP is equal to 4% of the non-housing capital finance requirement
- Option 3 – Asset Life Method – For capital expenditure financed by unsupported borrowing on or after 1 April 2008. MRP is based on the life of the asset either using the Equal Instalment method or Annuity method.
- Option 4 – Depreciation Method - For capital expenditure financed by unsupported borrowing on or after 1 April 2008. MRP is calculated in accordance with the standard rules for depreciation.

Capital expenditure incurred before 1 April 2008 and future Supported Capital Expenditure will be charged at the rate of 4% or over the remaining useful life of the assets, whichever is most appropriate. Capital expenditure incurred on or after 1 April 2008 which is funded from prudential borrowing will be subject to MRP under Option 3 Asset Life Method, which will be charged over a period which is based on the estimated useful life of the assets. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

This MRP policy is reviewed annually with reference to the level of borrowing that the Council is undertaking but also the expenditure that the borrowing is supporting.

Where a past overprovision has been identified the Council will spread any resulting reduction in MRP across multiple years.

There are a number of circumstances whereby the Council will not be making a MRP for the repayment of debt.

- The Authority has established two wholly owned companies which will be provided with loans from the Authority on a commercial basis. Under these arrangements, the cash advances will be used by the companies to fund capital expenditure and should therefore be treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the loans advanced and under the terms of the contractual loan agreements are due to be returned in full with interest paid. Once funds are returned to the Authority, the returned funds are classed as a capital receipt, offset against the CFR, which will reduce accordingly. As this is a temporary arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The outstanding loan will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence.

- The Authority is purchasing commercial property to be held as part of its Investment Property Portfolio. The properties are held for investment purposes and are managed on a fully commercial basis. The purchase of these properties will be treated as capital expenditure and will increase the CFR. The Council is holding these properties solely for investment purposes and they are leased to tenants on a fully repairing basis. As the Council has the ability to sell these properties to repay any outstanding debt liabilities related to their purchase, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The market value of the assets will be reviewed on a regular basis and if the asset value significantly decreases, a prudent MRP policy will commence.

- In addition the Council is planning to acquire a number of ex local authority and market stock properties to be used as temporary accommodation. Initially these purchases will be funded by revenue from the HRA, however a number of purchases will be financed through prudential borrowing on an invest to save basis. In this case the purchase of these properties will be treated as capital expenditure and will increase the CFR. The units funded by prudential borrowing will be held outside of the HRA and the Council has the ability to sell these properties to repay any outstanding debt liabilities related to their purchase, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application on these purchases. The market value of the assets will be reviewed on a regular basis and if the asset value significantly decreases, a prudent MRP policy will commence.

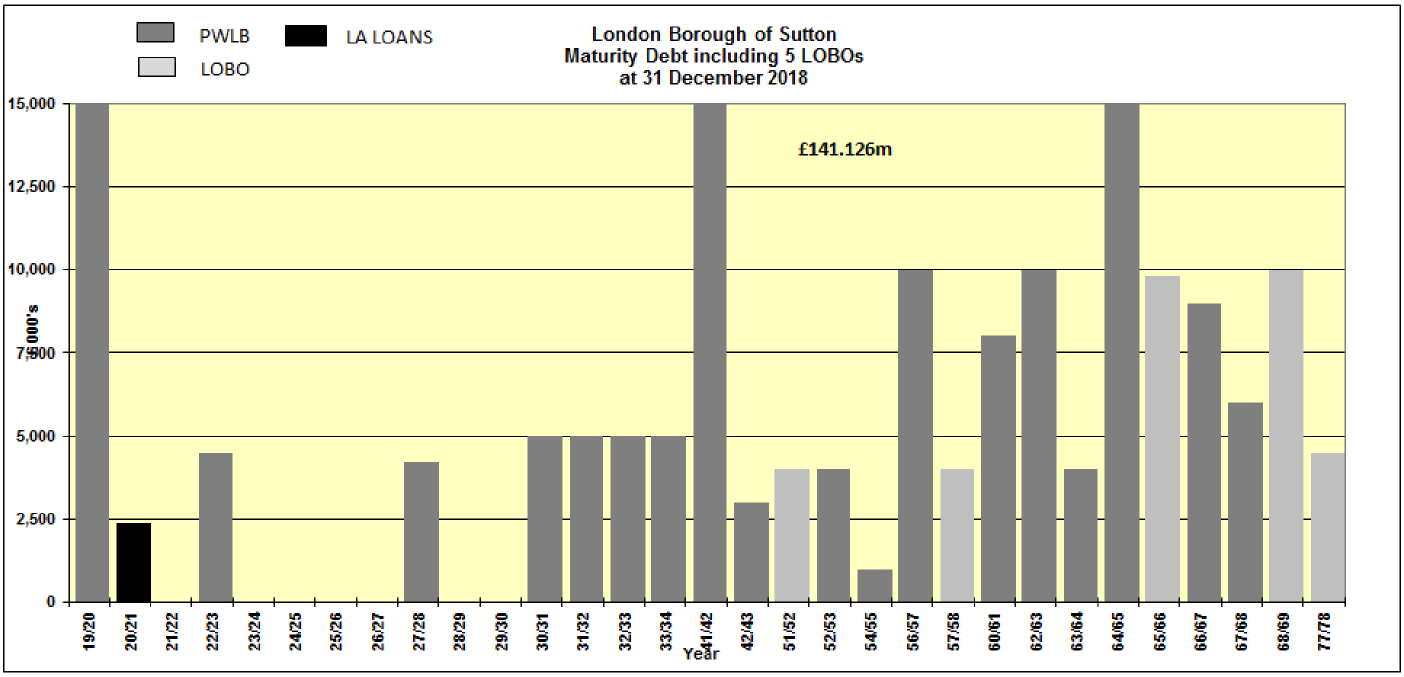
- The Council has purchased land as part of land assembly for the development of a London Cancer Hub. The land involved is a short term holding and the CFR liability arising from the purchase will be reduced by setting aside any capital receipt later received through the sale of the site to a developer. As such there will be no set aside to repay debt through MRP. These plans will be reviewed annually in light of this treatment of MRP.

Under the new Self-financing regime for the HRA, the Council will not initially be making a MRP for the repayment of HRA debt.

The application of MRP as outlined above remains sufficiently prudent in light of the magnitude and maturity of the Council’s debt.

APPENDIX J

ANNEX 3 -Debt Maturity



Annex 4 -Schedule of Approved Instruments

	Colour (and long term rating where applicable)	Money and/or % Limit	Time Limit
Banks & Building Societies	yellow	Unlimited	5yrs
Banks & Building Societies	purple	£20m	2 yrs
Banks -Building Societies	orange	£17.5m	1 yr
Banks (part nationalised)	blue	£20m	1 yr
Banks & Building Societies	red	£15m	6 mths
Banks & Building Societies	green	£12.5m	100 days
Banks & Building Societies	No colour	Not to be used	Not to be used
Limit 3 category – Council's banker (where "No Colour")	No Colour	£10m	1 day
DMADF	UK sovereign rating	unlimited	6 months
Local authorities	n/a	£10m per entity	5yrs
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money Market Funds LVNAV	AAA	£10m per fund	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.25	Dark pink / AAA	£10m per fund	liquid
Ultra-Short Dated Bond Funds with a credit score of 1.50	Light pink / AAA	£10m per fund	liquid

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