Cornwall Council 2019/20

Annual Treasury Management Strategy
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Prudential Indicators and
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1 INTRODUCTION

1.1 Background

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

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

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

"The management of the local authority's 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."

1.2 Reporting requirements and Scrutiny

In the context of treasury management, Cornwall Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

The report on the annual Treasury Management Strategy, covering the Prudential and Treasury indicators is the first report and covers:

- Capital plans, including prudential indicators;
- Minimum Revenue Provision (MRP) policy – 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 – how the parameters on investments are to be managed.

A mid-year treasury management review updates Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury management is meeting the strategy or whether any policies require revision.

An annual treasury outturn report provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the treasury strategy.

The Strategy is required to be adequately scrutinised before being recommended to the Council. This role will be undertaken by the Customer and Support Services Overview and Scrutiny Committee.

1.3 Treasury Management Strategy for 2019/20

The Strategy for 2019/20 will cover the following areas:

Capital Activity:

- Capital plans, in line with the approved budget
- Capital prudential indicators including the Capital Financing Requirement (CFR)
- Minimum Revenue Provision (MRP) policy

Treasury Management Activity:

- Current and forecast treasury position
- Treasury indicators which limit the treasury risk and activities of the Council
- Prospects for interest rates
- Borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- Annual Investment Strategy
- Creditworthiness policy
- Performance indicators
- Policy on the use of financial derivatives
- Housing Revenue Account (HRA) self-financing
- Member and officer training; and
- Policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code and Treasury Management Code, and Statutory Guidance issued by the Secretary of State (for Housing, Communities and Local Government) on Minimum Revenue Provision and Local Government Investments.

This Annual Treasury Management Strategy covers only those investments arising from the Council's cash flows and debt management activity. In accordance with the Code and recognised best practice guidelines, the security and liquidity of funds are placed ahead of investment return/yield. The power to invest is set out in the Local Government Act, Section 12.

The CIPFA Treasury Management Code recognises that organisations may make investments for policy reasons outside normal treasury management activity. Non-financial, or non-treasury investments tend to relate to expenditure powers under Section 1 of the Act and are subject to the guiding principles outlined separately in the Capital Strategy and are outside the scope of this Treasury Management Strategy.

2 THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

In setting a balanced budget, the Council must calculate its budget requirement for each financial year to include the revenue costs that flow from capital expenditure and financing decisions.

Under the Local Government Act 2003 and the Prudential Code for Capital Finance in Local Authorities, local authority capital expenditure – and borrowing to finance – is limited to what is affordable, prudent and sustainable.

The Council’s capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members in their overview and consideration of capital expenditure plans both in terms of affordability and prudence.

2.1 Capital expenditure

This prudential indicator is a summary of the Council’s capital expenditure plans, both those agreed previously, and those forming part of this budget cycle:

Capital expenditure £m	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
General Fund	178.4	216.7	168.1	178.3	96.6
HRA	15.9	20.9	25.3	33.9	38.2
Commercial activities / non financial investments	6.6	38.7	129.7	82.2	66.8
Total	**201.0**	**276.4**	**323.0**	**294.3**	**201.5**

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Capital expenditure £m	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
General Fund	178.4	216.7	168.1	178.3	96.6
HRA	15.9	20.9	25.3	33.9	38.2
Commercial activities / non financial investments	6.6	38.7	129.7	82.2	66.8
Total	**201.0**	**276.4**	**323.0**	**294.3**	**201.5**
Financed by:					
Capital receipts	13.9	16.9	21.5	17.0	8.0
Capital grants	100.4	97.9	41.9	102.8	99.1
Revenue/Reserves	39.9	60.1	54.6	21.0	20.3
Net borrowing need for the year	**46.7**	**101.5**	**205.0**	**153.5**	**74.0**
Total Financing	**201.0**	**276.4**	**323.0**	**294.3**	**201.5**

The net financing need for commercial activities / non-financial investments included in the above table against expenditure is shown below:

Commercial activities / non financial investments £m	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital expenditure	6.6	38.7	129.7	82.2	66.8
Financed by:					
Capital grants			2.8	21.9	22.7
Revenue/Reserves		1.0			
Prudential Borrowing	**6.6**	**37.7**	**126.8**	**60.3**	**44.0**
Total Financing	6.6	38.7	129.7	82.2	66.8
Percentage of total net financing need	*14%*	*37%*	*62%*	*39%*	*59%*

2.2 The Capital Financing Requirement

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The forecast CFR shows that, over the medium and long term, the underlying borrowing need will increase:

£m	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Financing Requirement					
CFR - General Fund	850.6	887.9	934.1	985.2	970.4
CFR - Housing	109.6	109.2	114.1	127.7	141.8
CFR - Commercial activities / non financial investments	6.6	44.2	170.1	227.0	266.4
Total CFR	**966.8**	**1041.3**	**1218.4**	**1339.9**	**1378.5**
Movement in CFR		74.5	177.1	121.5	38.7
Movement in CFR represented by:					
Net borrowing need for the year (above)		101.5	205.0	153.5	74.0
Less MRP/VRP and other financing movements		(27.0)	(28.0)	(32.0)	(35.4)
Movement in CFR		**74.5**	**177.1**	**121.5**	**38.7**

The CFR does not increase indefinitely, as the Minimum Revenue Provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with the estimated useful life of each asset.

The 'MRP/VRP (Voluntary Revenue Provision) and other financing' includes PFI / finance lease annual principal payments. The figure also includes other technical accounting adjustments for the treatment of long term debtors and amounts set aside for HRA attributable debt.

2.3 Minimum Revenue Provision (MRP) Statement

As part of the MRP regulations, the Council is required to approve a policy for calculating a prudent level of MRP on borrowing undertaken for the 2019/2020 capital programme and prudential borrowing undertaken in previous years. The Council is also allowed to undertake additional voluntary payments if required (voluntary revenue provision; VRP).

Minimum Revenue Provision is a charge to the Council's revenue account to make provision for the repayment of debt that will have been undertaken for financing long term capital investment. MRP will cause a reduction in the CFR annually.

The Council's strategy is to charge MRP based on a reasonable assessment of the period of benefit that associated capital investment will deliver. The amount of MRP charged shall not be less than zero in any financial year.

<u>MRP Policy 2019/20</u>

i. For capital expenditure financed by supported borrowing (borrowing funded by central Government through the revenue funding system), MRP will be made on a straight line basis over a period of 40 years (i.e. 2.5%) based on the Opening Adjusted Capital Financing Requirement as at 1st April 2016.

   This effectively means that, for capital expenditure financed by borrowing prior to April 2008, MRP is made based on a straight line (equal instalment) method over a 40 year period (2.5%).

ii. For borrowing under the prudential system, for which no Government support is given, MRP provision will be made over the estimated life of the asset for which the borrowing is undertaken. This will be done on a straight line basis in-line with the asset life determined for depreciation purposes and the MRP provision will commence in the financial year following the one in which the asset becomes operational.

   This effectively means that, for capital expenditure financed by borrowing after 1 April 2008, MRP is made on the basis of equal annual instalments over the life of relevant assets: the 'straight line' method.

The method shall be varied in the following circumstance:

a. MRP will not be made on the value of Long Term Debtors outstanding, as these will be repaid by third parties and therefore it is not deemed necessary to make an additional revenue charge in relation to these amounts. However, if the third party is not making annual repayments of principal, then MRP payments will be made over the life.
b. MRP will continue to be charged on the amount of capital expenditure incurred by the Tamar Bridge and Torpoint Ferry Joint Committee and this will be off-set by an equivalent receipt from the

Joint Committee to ensure that Cornwall Council remains revenue neutral.

c. For MRP in relation to the PFI schemes which have come back on balance sheet due to the changes in accounting regulations, the Council has adopted the following approach:
   - Assets and financing liabilities have been set up for each scheme
   - MRP had been provided for on a basis equivalent to the capital repayment for the outstanding financing liability
d. MRP on investments in share or loan capital will be made over 20 years. However, and where the capitalised expenditure can be linked (directly or indirectly) to an asset, then the estimated life of that asset may be used (up to a maximum of 50 years). This is in accordance with Government guidance.
e. For capital investment incurred mainly, or in part, for commercial purposes then MRP may, where appropriate, be calculated using the annuity method to better reflect the anticipated cash flows arising over the life of that capital investment.
f. Finance Leases; in accordance with legislation, the Council will make a MRP charge for finance leases equivalent to the principal payment contained within the lease terms.
g. There is no requirement on the HRA to make a minimum revenue provision but, following HRA reform, there is a requirement for a charge for depreciation to be made.

2.4 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans i.e. to provide an indication of the impact of capital investment plans on the Council's overall finances.

Under the CIPFA Prudential Code a local authority is responsible for deciding its own level of affordable borrowing.

<u>Ratio of financing costs to net revenue stream</u>

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
General Fund	7.3%	7.0%	8.3%	10.0%	10.7%
of which relates to Commercial activities / non financial investments	*0.0%*	*0.2%*	*1.0%*	*1.8%*	*2.3%*
HRA	8.1%	9.5%	9.1%	10.6%	11.5%

The estimates of financing costs include current commitments and the proposals for the capital financing budget in the relevant budget setting report.

Ratio of capital financing requirement to revenue

The following 'local' indicator, for both General Fund and HRA, is a gearing ratio showing the projected trend in the capital financing requirement (underlying debt requirement) against the annual revenue budget.

It also shows the amount of underlying debt per capita, based on the number of dwellings:

	2017/18 Actual	**2018/19 Forecast**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
General Fund ratios					
GF CFR (underlying debt) £m (including Commercial Activities / non financial investments)	857.2	932.1	1,104.2	1,212.1	1,236.7
Net Revenue Budget £m	518.8	550.0	561.2	533.8	545.2
Dwellings (per CTB1)	268,648	271,275	273,988	276,728	279,495
Ratio of debt : revenues	1.7	1.7	2.0	2.3	2.3
Debt per dwelling (£)	3,191	3,436	4,030	4,380	4,425
HRA ratios					
HRA CFR (underlying debt) £m	109.6	109.2	114.1	127.7	141.8
HRA revenues £m	39.6	39.8	40.1	40.6	41.8
Number of HRA dwellings	10,363	10,311	10,279	10,239	10,217
Ratio of debt : revenues	2.8	2.7	2.8	3.2	3.4
Debt per dwelling	10,576	10,591	11,101	12,476	13,878

3 TREASURY MANAGEMENT STRATEGY

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. 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.

Treasury Management Policy Statement

i. The Council defines its treasury management activities as:
   The management of the organisation's 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.

ii. This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

iii. This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

The Council will invest its monies prudently, considering security first, liquidity second, and yield last, carefully considering its investment counterparties. It will similarly borrow monies prudently and consistent with the Council's service objectives.

4 BORROWING

4.1 Current and Forecast Portfolio position

The Council's treasury portfolio position, as at 31 December 2018, is summarised below. It shows the Council has borrowings totalling £812m and investments of £401m; a net debt of £411m:

	£m	
Total Borrowing	**812**	
Long Term		
Public Works Loan Board (PWLB)	**374**	**46%**
UK:	**251**	**31%**
Barclays (fixed term)	80	
Dexia*	158	
KBC*	13	
Germany: Bayerische Landesbank GIR*	**15**	**2%**
Ireland: DEPFA*	**49**	**6%**
Sub-Total	**689**	
Short Term		
Temporary Borrowing: Local Authorities	**123**	**15%**

* indicates LOBO (totalling £235m)

	£m	
Total Investments	**401**	
UK:	**322**	**80%**
Local Authorities	171	
Prime Rate	50	
RBS	40	
Goldman Sachs	31	
Metropolitan (Registered Provider)	10	
Aldermore Bank	10	
Sainsburys Bank	10	
Australia: Commonwealth Bank of Australia	**20**	**5%**
Netherlands: Rabobank	**10**	**2%**
Germany: Deutsche Bank	**49**	**12%**

	£m
Net Debt	**411**

The following table shows the actual and forecast external debt (the treasury management operations) against the underlying capital borrowing need (the Capital Financing Requirement - CFR) and highlights any over or under borrowing. The Council is currently under borrowed and this is expected to continue for the medium term:

£m	2017/18 Actual	2018/19 Forecast	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt					
Debt at 1 April	707.4	723.0	775.0	875.0	975.0
Expected change in debt	15.6	52.0	100.0	100.0	50.0
Gross debt at 31 March	**723.0**	**775.0**	**875.0**	**975.0**	**1025.0**
Capital Financing Requirement	966.8	1041.3	1218.4	1339.9	1378.5
- less technical adjustment for non-borrowing items (pfi, finance leases etc)	*(167.3)*	*(159.0)*	*(151.8)*	*(144.5)*	*(136.9)*
Underlying borrowing requirement	**799.5**	**882.3**	**1066.6**	**1195.3**	**1241.7**
Under / (Over) borrowing	**76.5**	**107.3**	**191.6**	**220.3**	**216.7**
as percentage of borrowing requirement	*10%*	*12%*	*18%*	*18%*	*17%*

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within 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 the current (i.e. 2019/20) and following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Section 151 Officer reports that the Council is forecast to comply with this prudential indicator in the current year 2018/19 and does not envisage difficulties for the future. This view takes into account existing plans and commitments, and the proposals in the approved MTFP.

4.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary; This is the limit beyond which external debt is not normally expected to exceed. It is calculated with regard to the Council's capital expenditure and financing plans allowing for the most likely, prudent, but not worst case scenario cash flow. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

£m Operational Boundary	2018/19 Strategy	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	900.0	1125.0	1125.0	1125.0

The Authorised Limit for External Debt; This is a key prudential indicator which sets a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. It includes more headroom to take account of eventualities e.g. forward borrowing to take advantage of attractive interest rates.

£m Authorised Limit	2018/19 Strategy	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Debt	950.0	1175.0	1175.0	1175.0

These external debt indicators are intended to ensure external borrowing levels are affordable, prudent and sustainable. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although to date this power has never been exercised.

4.3 Prospects for interest rates

Cornwall Council's treasury advisor, Link Asset Services, has provided the following interest rate forecast. The underlying trend shows forecast interest rates are set to gradually increase but, compared to historical levels, will remain extremely low for the next two years, with anticipated small rises in the second half of 2019/early 2020.

The PWLB rate forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012:

	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 year	25 year	50 year
Dec-2018	0.75	2.00	2.50	2.90	2.70
Mar-2019	0.75	2.10	2.50	2.90	2.70
Jun-2019	1.00	2.20	2.60	3.00	2.80
Sep-2019	1.00	2.20	2.60	3.10	2.90
Dec-2019	1.00	2.30	2.70	3.10	2.90
Mar-2020	1.25	2.30	2.80	3.20	3.00
Jun-2020	1.25	2.40	2.90	3.30	3.10
Sep-2020	1.25	2.50	2.90	3.30	3.10
Dec-2020	1.50	2.50	3.00	3.40	3.20
Mar-2021	1.50	2.60	3.00	3.40	3.20
Jun-2021	1.75	2.60	3.10	3.50	3.30
Sep-2021	1.75	2.70	3.10	3.50	3.30
Dec-2021	1.75	2.80	3.20	3.60	3.40
Mar-2022	2.00	2.80	3.20	3.60	3.40

The flow of generally positive economic statistics after the quarter ended 30 June meant that it came as no surprise that the MPC came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%.

Growth has been healthy since that meeting, but is expected to weaken somewhat during the last quarter of 2018. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures. However, it is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. The next increase in Bank Rate is therefore forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008.

Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment.

Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.00 – 2.25% in September 2018. It has also continued its policy of not fully reinvesting proceeds from bonds that it holds as a result of quantitative easing, when they mature. We have, therefore, seen US 10 year bond Treasury yields rise above 3.2% during October 2018 and also seen investors causing a sharp fall in equity prices as they sold out of holding riskier assets.

Rising bond yields in the US have also caused some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure has been dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The balance of risk to increases in Bank Rate and shorter PWLB rates is probably even and are dependent on how strong GDP turns out, how slowly inflation pressures subside and how quickly the Brexit negotiations move forward positively.

The cautious pace of even these limited increases is predicated on the assumption that an agreement is reached on Brexit between the UK and the EU. If no agreement is reached at all, then forecast increases in Bank rate and PWLB rates will be subject to greater change, most likely downwards. In this event, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly.

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

- Brexit – if it were to cause significant economic disruption and major downturn in the rate of growth.
- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than is currently anticipated.
- A resurgence of the Eurozone sovereign debt crisis, possibly in Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. This is likely to lead to friction with the EU when setting the target for the fiscal deficit in the national budget.

  The rating agencies have started on downgrading Italian debt to just one notch above junk level. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and so Italian bond yields have risen sharply – and at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Challenges developing from a strong and growing anti-immigration political movement impacting across Europe could put considerable pressure on the cohesion of the EU and could spill over into impacting the euro, EU financial policy and financial markets. This risk is worsened by the increasingly fragile political outlook created by vulnerable minority governments across the Eurozone including Germany, Spain, Portugal, Netherlands and Belgium.

- Weak capitalisation of some European banks.
- Rising interest rates in the US could spark a sudden flight of investment funds from more risky assets (e.g. shares) into bonds yielding a much improved yield. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to the risk of an investor flight to safe havens e.g. UK gilts.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates include:

- Brexit – if both the UK and the EU are able to agree a compromise that removed all threats of economic and political disruption.
- The Federal Reserve causes a sudden shock in financial markets by misjudging the pace and strength of increases in its Federal Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than is currently expected.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

4.4 Borrowing strategy

Cornwall Council is currently forecast to be under-borrowed at the end of the year and will seek to maintain that position through 2019/20. This means that the capital borrowing need i.e. the Capital Financing Requirement, has not been fully funded with long term loan debt as cash supporting the Council’s reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

However, against this background, and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Section 151 Officer will monitor interest rates in financial markets and adopt a pragmatic and flexible approach to changing circumstances.

If it was felt that there was a significant risk of a fall in long and short term rates, e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

If it was felt that there was a significant risk of a much sharper rise in long and short term rates than that currently forecast, perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates were still relatively cheap. This may include borrowing in advance of future year requirements.

It is expected that any long term borrowing will be undertaken through the PWLB; however the Council will continue to investigate other sources of finance that may be available at more favourable rates. Temporary borrowing will also continue to be undertaken during 2019/20 in order to smooth cash flows and actively manage the Council’s treasury position.

Any new borrowing taken out will be made with regard to the limits, indicators and the economic environment.

4.5 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

During periods when short term interest rates are lower than long term rates, the resulting differential creates a 'cost of carry' impacting on the Council's revenue budget when the proceeds of any long term borrowing are temporarily held in lower yielding investments.

As such in 2019/20 the Council will continue to follow a policy of utilising internal cash balances i.e. liquid investments to finance capital expenditure, thereby deferring the need to actually borrow externally. Forgoing investment income at historically low rates provides the cheapest option; and by minimising the time between borrowing and anticipated cash flow need, this keeps borrowing costs lower than they otherwise would be and reduces credit risk.

However, as detailed in the Borrowing strategy, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future, when the Council may not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt or called in debt.

Note: latest guidance issued by the Secretary of State makes clear that borrowing to finance the acquisition of non-financial investments (e.g. commercial property investment) made *purely* for profit shall be considered 'borrowing in advance of need'.

Such investment would most likely be considered capital and determined under the guiding principles outlined separately in the Capital Strategy and outside the scope of this Treasury Management Strategy.

However, and to be clear, the Council will not borrow for capital investment made solely for yield generating opportunities. Under the Prudential Code if, exceptionally, the Council chooses not to have regard that provision, then an explanation should be brought forward explaining the rationale for its decision.

4.6 Treasury Management limits on activity

There are three debt related treasury activity limits. The purpose of these are 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:

<u>Maturity structure of borrowing</u>

- Maturity structure of borrowing. These gross limits are set to protect against excessive exposure to large fixed rate sums falling due for refinancing in any one period, and are required for upper and lower limits[1].

Maturity structure of fixed interest rate borrowing 2019/20		
	Lower	**Upper**
Under 12 months	0%	40%
12 months to 10 years	0%	40%
10 years to 50 years	0%	100%

- Variable debt limit. A local indicator, this limits the maximum percentage of long-term variable debt to no more than 30% of total long term debt.

Long term variable debt exposure		
	Lower	**Upper**
Maximum variable long term debt as percentage of total long term debt	0%	30%

The preference for fixed interest rate borrowing reflects that it is possible to construct a prudent treasury strategy on the basis of using only fixed rate debt and investments, provided the maturity of these debts and investments are reasonably spread. The same does not apply to variable rates where a higher exposure could lead to significant year on year fluctuations in the cost of debt.

4.7 Lender Option Borrower Option (LOBO) Debt & Risk
The Council currently holds around 30% of its long term debt in LOBOs.

LOBOs are an alternative option to the Governments Public Works Loan Board (PWLB). In simple terms the instrument gets its name because the lender i.e. the bank has an option to set revised interest rates at predetermined call dates, at which point the borrower i.e. the Council has the option to either accept the revised rates or repay the debt in full without incurring any penalty fees.

Due to the current and forecast market environment, it is unlikely that any of the LOBOs will be called in the near future. However there is a risk that, as interest rates rise, the lender proposes an increase in rates that the Council has no option but to agree to the increase, thereby increasing the level of interest it has to pay on its debt.

The Council’s exposure to this risk is low as it has been significantly mitigated by spreading its LOBO portfolio over several individual deals

[1]*Note: the maturity structure guidance changed in the 2011 guidance notes; for LOBO loans, the maturity date is now deemed to be the next call date.*

with four different lenders, with the call dates being structured so that they are staggered, with the next call date on each LOBO falling at different frequencies, thereby not exposing the Council to a 'perfect storm' where all lenders want to call in their options all at the same time.

The Council will further mitigate this risk by holding significant level (between the range of £50m-£75m) of investments which are held in liquid deposits i.e. short term, and therefore can be called upon to provide funding to repay a LOBO if a call was exercised. If a LOBO call option is exercised the Council will consider terminating that agreement as a potential option.

In addition the Council can also call on PWLB to take out new borrowing to refinance the repayment of the LOBO over shorter periods where the rates are forecast to be cheaper, but would also improve the Council's current debt maturity profile.

4.8 Debt rescheduling and Premature Repayment Opportunities

The relationship between the interest rates on existing loans, discount rates and new borrowing rates may provide opportunity for debt restructuring and the realisation of various gains:

- the generation of cash savings
- helping to fulfil the treasury strategy
- to enhance the balance of the portfolio (by amending the maturity profile and/or the balance of volatility).

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

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

The Section 151 Officer, with reference to the advice of the Council's external treasury advisors, will monitor prevailing interest rates for any opportunities during the year.

5 ANNUAL INVESTMENT STRATEGY

The Council holds invested funds, representing income received in advance of expenditure, plus balances and reserves held.

The Secretary of State recommends that each local authority produce and publish an Annual Investment Strategy, approved by the Council and revised in year as required.

The following investment strategy sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments. It outlines which instruments the Council may use for investment purposes, making a distinction between specified and non-specified investments. This strategy also determines limits in respect of their overall levels.

The Council has regard to the Ministry of Housing, Communities and Local Government (HMCLG) guidance on Local Government Investments as cited under section 15(1) (a) of the Local Government Act 2003 and the CIPFA Code of Practice on Treasury Management in Public Services.

All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

5.1 Investment Policy

The prime objective of the Council's investment strategy is to ensure prudent investment of surplus funds. The Council's investment priorities are as follows, in order of priority:

- Security of capital,
- Liquidity of investments,
- Secure optimum performance (yield)

Furthermore, under the Council's Ethical Investment Policy, the Council will not knowingly invest in financial institutions that do not match the Council's core values and principles. This is a secondary consideration and will be applied to the counterparty list only after taking into account security and liquidity issues.

<u>Ethical Investment; Statement of Policy</u>
The Council will not knowingly invest directly in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the Council. This would include, inter alia, avoiding direct investment in institutions with material links to:

- Human Rights abuse (e.g. child labour, political oppression)
- Environmentally harmful activities (e.g. pollution, mass destruction of habitat, fossil fuels)

The following investment instruments may be used by the Council in 2019/20 – defined as either 'specified' or 'non specified' investments:

Specified investments
The Council will make use of specified investments (as defined within the terms of the Government guidance). These are investments that satisfy the following conditions, designed to offer high security and high liquidity:

- The investment is denominated in Sterling and all payments or repayments are payable only in Sterling
- The investment is not a long term investment i.e. due to be repaid within 12 months of the date in which it was made or one which the Council may require to be repaid within that period
- The investment is made with a body which has been awarded a high credit rating, or is made with one of the following:
    a. The United Kingdom Government;
    b. A Local Authority in England and Wales, or a similar body in Scotland or Northern Ireland;
    c. A Town / Parish or Community Council.
- The making of the investment is not defined as capital expenditure[2] by legislation

Non-specified investments
Non-specified investments are defined as those not meeting the criteria detailed above; they are, by implication, considered higher risk than specified investments. The following categories of investments may be used under the definition of specified investments:

Investment Instrument	Specified	Non Specified (with maturities in excess of 1 year)
Term deposits* (pound sterling) in the following: - UK Local Authorities - Institutions considered 'high credit' rating	✓	✓
Call Accounts	✓	
Money Market Funds (MMF)	✓	
Enhanced Money Market Funds (EMMF)	✓	
Certificates of Deposit	✓	✓
Gilts (UK Government Bonds)	✓	✓
UK Government Treasury Bills	✓	
Debt Management Account Deposit Facility	✓	
Multilateral Development Bank bonds	✓	✓
UK Local Authority Bonds	✓	✓
Corporate Bonds	✓	✓

** includes Forward Deals (provided the investment is made within 12 months, and subject to the counterparty investment limits outlined below)*

[2] Regulation 25(1) (d) of The Local Authorities (Capital Finance and Accounting) Regulations 2003 [SI 3146 as amended] states that some categories of investment are defined as Capital Expenditure. This relates to the acquisition of share or loan capital in any body corporate.
The impact of investing in instruments of this nature are such that, unlike other investment instruments, either capital or revenue resources would have to be applied to this expenditure, and once the investment was sold or matured, the income would be a capital receipt.
Any such expenditure incurred by the Council is subject to the guiding principles outlined in the Capital Strategy and is outside the scope of this Treasury Management Strategy.

The Council will also provide a short term (i.e. less than 1 year) cash flow facility to the Council's wider group of companies to cover temporary cash flow fluctuations and ensure that they are able to meet known obligations and continue to operate. Where this is required, a formal agreement will be put in place outlining the full terms and conditions of the advance and will be formally agreed and signed by the Council's Section 151 officer.

In respect of non-specified investments, the following instruments may also be used by the Council. An overall limit on the level of these investments will be set at **75%** of the total investment portfolio and the following limits will apply to each category of non-specified investments:

The following Non-Specified Investments may also be used:	Upper Limit
Principal Sums Invested for more than 1 year (see above)	60%
Pooled Investment Funds**: - Property Funds - Equity Funds - Bond funds including i) Ultra Short Dates Bond Funds (USDBF) ii) Short Dated Bond Funds (SDBF) - Multi Asset Income Funds	25%
Deposits with non-rated institutions: - Non rated Building Societies - Challenger Banks	15%

*** the use of some pooled investment funds may be deemed capital expenditure and as such would require an application of capital resources. The Council will seek guidance on the status and suitability of any fund it considers using.*

In the normal course of the Council's cash flow operations, it is expected that both specified and non-specified investment will be utilised for the control of liquidity as both categories allow for short term investments.

However, for certain types of investments, the accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue implications, the accounting implications of new transactions will be thoroughly reviewed before they are undertaken.

Lending to third parties

The Council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments, rather they are policy investments e.g. to support local business, for regeneration and economic development. Loans of this nature will be approved in line with the Council's Financial Regulations and only after relevant due diligence has been undertaken.

The primary aims of the Investment Strategy are the security and liquidity of its capital resources and, with that in mind, to obtain a reasonable level of return. These aims are equally relevant in determining whether to proceed with a potential loan.

5.2 Investment Counterparty Selection Criteria

The main principle governing the Council's investment criteria is the security and liquidity of its investments, although yield on the investment is also a key consideration.

In order to minimise the risk to investments, the Section 151 Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and bring forward to Council for approval as necessary. Any counterparty failing to meet the criteria will be omitted from the counterparty list.

These criteria are separate to those which determine the types of investment instrument accessible (as outlined above) as it provides an overall pool of counterparties considered high quality that the Council may use. Together, this enables a more diverse investment portfolio that avoids concentration of risk.

The Council will have regard to all three rating agencies and considers a high credit rating for investment counterparties to be as follows (limits apply to both specified and non-specified investments):

High Credit Rating Criteria and Counterparty Limits			
Organisation	Minimum Criteria (or equivalent)	Maximum Amount	Maximum Period
UK Government Debt Management Account Deposit Facility Gilts Treasury Bills	n/a	Unlimited	6 months 50 years 1 year
UK Local Authorities - Term Deposits - Bonds	n/a n/a	£50m £50m	5 years 30 years
Registered Providers	A+ and F1 A- and F1	£25m £15m	3 years 1 year
Banks and Building Societies	AA- and F1 A and F1 A- and F1	£50m £40m £25m	5 years 3 years 1 year
Nationalised and Part Nationalised Banks	n/a	£50m	1 year
Multilateral Development Bank Bonds	AAA	£25m	50 years
Money Market Funds (MMF)	AAA	£50m	Liquidity
Enhanced Money Market Funds (EMMF)	AAA	£25m	Liquidity
Corporate Bonds	A+ and F1	£15m	3 years
The following conditions and limits will also apply for Non Specified Investments:			
Pooled Investment Funds	By assessment	£25m	n/a
Non rated building societies	Assets greater than £5bn Assets greater than £1bn	£10m £5m	1 year 6 months
Challenger banks	By assessment	£10m	1 year

[notes: i) where a bank has a group structure, limits will relate to the group in its entirety rather than separately to the individual institutions within it.
ii) investments with the UK Government are considered the lowest level of risk and therefore have no upper limit.
iii) under revised EU legislation, investments in banks and building societies are now exposed to bail-in risk
iv) for the purposes of this Strategy 'Local Authorities' includes Town and Parish Councils, Police and Fire Authorities]

Fitch defines these ratings as follows:

- F1: Highest (short-term) credit quality; Indicates the strong capacity for timely payment of financial commitments (may have an added '+' to denote any exceptionally strong credit feature)

- A: High credit quality (long-term); 'A' ratings denote expectations of low default risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to change in circumstances or economic conditions than is the case for higher ratings.

Obligations rated 'A-' and above are considered upper-medium grade and are subjected to low credit risk. Further details on the definitions used by each of the ratings agencies are available at section 5.3 below.

On occasion ratings may be downgraded when an investment has already been made; the criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. A severe downgrade however, and in consideration of any potential penalties this might incur, may prompt the Section 151 Officer to instruct treasury management officers to take steps to withdraw any investments considered at risk.

Caution will be exercised in determining the creditworthiness of investment counterparties, even if they meet the minimum criteria above. In the event that any institutions are at the minimum criteria and are on negative rating watch, monies will not be placed with that organisation until such time that the negative outlook is revised.

It is recognised that ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector and the economic and political environments in which institutions operate. The assessment will also take into account market intelligence and to this end the Council will engage with its advisors to monitor market pricing such as, for example, credit default swaps[3] that contribute to forming a view of counterparty creditworthiness.

Geographical limits and diversification will be considered to ensure an appropriate spread of risk. Sovereign ratings will be taken account of when placing funds with institutions outside of the UK and no investments will be made with institutions where the Sovereign rating is less than AA-.

The time and monetary limits for institutions is also stated in the above table. The Secretary of State recommends that the Investment Strategy sets out the maximum period over which investments will be made. As a result of the nature of some of the existing investments, the current portfolio contains instruments with maturity dates up to 20 years.

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[3] Credit default swap: this is a financial instrument that effectively provides the holder 'insurance' against a loan defaulting. The CDS spread is the difference between the price at which providers are willing to sell the swap and the price at which buyers are willing to buy. A relatively high spread may suggest that the loan is more likely to default and may reflect the relative risk of dealing with a particular counterparty.

The Council considers that, provided investments made in excess of 5 years are made in instruments capable of being sold if necessary, then it would be appropriate to continue to make longer term investments in line with approved treasury management practices.

<u>Banking arrangements</u>
The Council's own banker is currently NatWest (part of RBS Group). As a part nationalised bank at the current time it does meet the minimum credit criteria.

For transactional purposes, and in the event that the bank falls below the criteria, then Nat West will continue to be used for short term liquidity requirements and business continuity arrangements. However balances will be restricted to no more than £10m on an overnight basis only (including weekends). Otherwise, the investment criteria as defined above will apply.

Note: the criteria for choosing counterparties set out above provides a sound approach to investment in 'normal' market circumstances. However, under exceptional market conditions the S151 Officer may temporarily restrict further investment activity to those institutions considered of higher credit quality than the minimum criteria set out. Similarly, time periods for investments and investment limits may also be restricted. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient institutions of high credit quality are available to invest the Council's cash balances, then the surplus funds will be deposited with the UK Government, via the Debt Management Office, or with other local authorities. This may cause a reduction in the level of investment return, but will protect the principal sum invested.

5.3 Credit Rating Definitions

Link Asset Services, the Council's treasury advisors, provide the Council with real-time updates on counterparty credit ratings from the three main credit rating agencies Moody's, Fitch and Standard & Poor's.

The following gives a brief definition of the types of ratings that the Council uses to assess its counterparties. While the definitions and scales of ratings vary between rating agencies, they are broadly comparable.

The Council uses the 'Lowest Common Denominator' (LCD) approach, meaning that it uses the lowest rating of those published:

Moodys Long Term	Moodys Short term	S&P Long Term	S&P Short term	Fitch Long Term	Fitch Short term	Rating description
Aaa	P-1	AAA	A-1+	AAA	F1+	Prime (EXTREMELY STRONG capacity to meet its financial commitments
Aa1		AA+		AA+		High grade (VERY STRONG capacity to meet its financial commitments)
Aa2		AA		AA		
Aa3		AA-		AA-		
A1		A+	A-1	A+	F1	Upper medium grade (STRONG capacity to meet its financial commitments)
A2		A		A		
A3		A-		A-		
Baa1	P-2	BBB+	A-2	BBB+	F2	Lower medium grade (ADEQUATE capacity to meet its financial commitments)
Baa2	P-3	BBB	A-3	BBB	F3	
Baa3		BBB-		BBB-		
Ba1	Not Prime	BB+	B	BB+	B	Speculative (VULNERABLE - faces major uncertainty and exposure to adverse business, financial, or economic conditions)
Ba2		BB		BB		
Ba3		BB-		BB-		
B1		B+		B+		
B2		B		B		
B3		B-		B-		
Caa1		CCC+	C	CCC	C	Substantial risks (HIGHLY VULNERABLE - is dependent on favourable business, financial, or economic conditions)
Caa2		CCC				
Caa3		CCC-				
Ca		CC				
		C				
C		D	-	DDD	-	In default (has FAILED to pay one or more of its financial obligations when it became due)
-				DD		
				D		

- Short term ratings – short term ratings provide a view as to the likelihood of a counterparty defaulting on its obligations within one year.
- Long term ratings – provide a view on the probability of default over a longer term horizon.

6 OTHER TREASURY ISSUES

6.1 Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historical indicators, as opposed to the prudential indicators that are predominantly forward looking.

The following indicators will be monitored throughout the year and reported as part of the wider Council Performance Report:

- Debt – Borrowing – Average rate of borrowing for the year
- Investments – Average rate of return for the year compared to the average 7 day LIBID lending rate

6.2 Policy on the Use of Financial Derivatives

A financial derivative is a contract whose value is based on, or 'derived' from, an underlying financial instrument such as a loan. Local Authorities have previously been able to make use of financial derivatives embedded into loans and investments, both to reduce interest rate risk (e.g. forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The CIPFA Code requires local authorities to clearly detail their policy in the use of derivatives in the annual strategy.

The Council does not intend to use standalone financial derivatives (such as swaps, forwards, futures and options). No change in strategy will be made without Full Council approval.

6.3 Housing Revenue Account (HRA) Self-Financing

Following the introduction of the HRA Self-Financing regime in April 2012 local authorities are required to recharge the interest on balances between the HRA and General Fund. This is due to differences between the HRA borrowing and the HRA CFR (underlying borrowing need).

6.4 Member and Officer Training

The CIPFA Code requires the Section 151 officer to ensure that members with responsibility for treasury management receive adequate training relative to their needs and understand fully their roles and responsibilities.

The Council will provide Members with training and an overview of the treasury management function through the following:

- As part of the Member induction training following local elections.
- Member seminars through Link Asset Services, our external advisors.
- Further ad-hoc training as required.

The Council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills.

The training needs of the treasury management officers are periodically reviewed as part of the performance development system. The Council is a member of the CIPFA treasury and pension group and receives regular updates on the latest market news, regulation changes and has the opportunity to attend training events.

6.5 External Treasury Management Service Providers

<u>Treasury Management Advisors</u>
The Council uses Link Asset Services as its external treasury management advisors. The company provides a range of services which include:

- Credit and Investment advice
- Debt services including advice on the timing of borrowing and rescheduling opportunities
- Technical support on treasury matters and capital finance
- Economic and interest rate forecasts
- Workshops and training events for officers and members

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our advisors.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council maintains the quality of the service with its advisors through regular meetings and will tender periodically for the provision of treasury management advice.

The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

<u>Use of Brokers</u>
The Council uses five brokers on a regular basis, as well as dealing directly with leading institutions. Wherever possible the Council will spread its business amongst them on a regular basis, though this may not always be possible. Brokers currently being used are:

- ICAP
- RP Martins
- Tradition
- Tullet Prebon
- BGC

The limited function performed by brokers is acknowledged; however the Council would expect to be informed if a broker had any doubts about an organisation that we were dealing with.

7 GLOSSARY OF TERMS

- **Annuity** – method of repaying a loan where the payment amount remains uniform throughout the life of loan, therefore the split varies such that the proportion of the payment relating to the principal increases as the amount of interest decreases.

- **Bail-In** – previously, in response to the banking crisis, some governments used taxpayer funds to support banks in danger of failing. The European Union's Banking Recovery and Resolution Directive (BRRD) requires that, in future, 'bail in' will be applied in such a scenario; this means that after shareholders' equity, depositors' funds comprising balances over c£85k will be used to support the bank at risk. The £85k threshold is not available to local authorities and therefore all unsecured deposits with banks and building societies will be at risk of 'bail in'.

- **Base Rate** – minimum lending rate of a bank or financial institution in the UK

- **Bond** – a government or public company's document undertaking to repay borrowed money usually with a fixed rate of interest.

- **Capital Expenditure** – spend on major items e.g. land and buildings, which adds to and not merely maintains the value of existing fixed assets

- **Capital Grants** – specific targeted grants to cover capital spend

- **Capital Receipts** – the proceeds from the disposal of land or other assets. Capital receipts can be used to fund capital expenditure but cannot be used to finance revenue.

- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations, also the standard setting organisation for Local Government Finance.

- **Counterparty** – an institution (e.g. a bank) with whom a borrowing or investment transaction is made.

- **Credit Rating** – an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. It is based on any information available regarding the institution: published results, Shareholders' reports, reports from trading partners, and also an analysis of the environment in which the institution operates (e.g. its home economy, and its market sector). The main rating agencies are Fitch, Standard and Poor's and Moody's. They analyse credit worthiness under four headings:

  - **Short Term Rating** – the perceived ability of the organisation to meet its obligations in the short term, this will be based on measures of liquidity.
  - **Long Term Rating** – the ability of the organisation to repay its debts in the long term, based on opinions regarding future stability, e.g. its exposure to 'risky' markets.
  - **Individual/Financial Strength Rating** – a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank or national government.
  - **Legal Support Rating** - a view of the likelihood, in the case of a financial institution failing, that its obligations would be met, in whole or part, by its shareholders, central bank, or national government.

  The rating agencies constantly monitor information received regarding financial institutions, and will amend the credit ratings assigned as necessary.

- **DMADF and the DMO** – The DMADF is the 'Debt Management Account Deposit Facility'; this is highly secure fixed term deposit account with the Debt Management Office (DMO), part of Her Majesty's Treasury.

- **EIP** – Equal Instalments of Principal, a type of loan where each payment includes an equal amount in respect of loan principal is eroded, and so the total amount reduces with each instalment.

- **Gilts –** the name given to bonds issued by the UK Government (i.e. the loan instrument by which the Government borrows). Gilts are issued bearing interest at a specified rate, however they are then traded on the markets like shares and their value rises or falls accordingly. The Yield on a gilt is the interest paid divided by the Market Value of that gilt, e.g. a 30 year gilt is issued in 1994 at £1, bearing interest of 8%. In 1999 the market value of the gilt is £1.45.

  The yield on that gilt is calculated as 8%/1.45 = 5.5%.

- **Lender Option Borrower Option (LOBO)** - LOBOs are a long term borrowing instrument commonly used by banks. It is an alternative lender option to the Government's Public Works Loan Board. In simple terms the instrument gets its name because the lender has an option to set revised interest rates at predetermined dates, and at which point the borrower has the option to accept the revised rates or pay the debt in full without penalty.

- **LIBID** – The London Interbank Bid Rate, the rate which banks would have to bid to borrow funds from other banks for a given period. The official rate is published by the Bank of England at 11am each day based on trades up to that time. The average 7 day rate is the benchmark the Council uses for its own investment performance.

- **Liquidity** – Relates to the amount of readily available, or short term, investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.

- **Market –** The private sector institutions e.g. banks, building societies

- **Maturity** - Type of loan where only payments of interest are made during the life of the loan, with the total amount of principal falling due at the end of the loan period.

- **Minimum Revenue Provision (MRP) –** A statutory amount charged to the Council's revenue account for the provision to repay the loan principal on debt undertaken to finance the Capital Programme. For the Council this is done on a straight line basis in-line with the asset life and commences the financial year after the asset is operational.

- **Monetary Policy Committee (MPC)** – group that sets the bank base rate for the Bank of England.

- **Money Market Fund (MMF)** – A highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.

- **Multilateral Development Banks (MDB)** – these are supranational institutions set up by sovereign states, which are their shareholders (e.g. European Investment Bank). Their remits reflect the development aid and cooperation policies established by these states.

- **Policy and Strategy Documents** – Documents required by the CIPFA Code of Practice on Treasury Management in Local Authorities. These set out the framework for treasury management operations during the year.

- **Public Works Loans Board (PWLB)** – a central government agency providing long and short term loans to Local Authorities. Rates are set daily at a margin over the Gilt yield (see Gilts above). Loans may be taken at fixed or variable rates and as an Annuity, Maturity, or EIP loans (see separate definitions) over periods of up to fifty years. Financing is also available from the money markets, however because of its nature the PWLB is generally able to offer better terms.
- **Yield** – The amount in cash (in percentage terms) that returns to the owners of an investment e.g. interest earned from a deposit.