ADUR & WORTHING COUNCILS

Joint Governance Committee
22 January 2019
Agenda Item 10

Joint Strategic Committee
31 January 2019
Agenda Item 7
Key Decision : No
Ward(s) Affected: All

JOINT TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2019/20 to 2021/22, ADUR DISTRICT COUNCIL AND WORTHING BOROUGH COUNCIL

REPORT BY THE DIRECTOR FOR DIGITAL AND RESOURCES

EXECUTIVE SUMMARY

1. PURPOSE

1.1 This report asks Members to approve and adopt the contents of the Treasury Management Strategy Statement and Annual Investment Strategy for 2019/20 to 2021/22 for Adur and Worthing Councils, as required by regulations issued under the Local Government Act 2003.

2. RECOMMENDATIONS

2.1 **Recommendation One**
The Joint Governance Committee is recommended to note the report (including the Prudential Indicators and Limits, and MRP Statements) for 2019/20 to 2021/22.

2.2 **Recommendation Two**
The Joint Governance Committee is recommended to refer any comments or suggestions to the next meeting of the Joint Strategic Committee on 31st January 2019.

2.3 **Recommendation Three**
The Joint Strategic Committee is recommended to approve and adopt the TMSS and AIS for 2019/20 to 2021/22, incorporating the Prudential Indicators and Limits, and MRP Statements.

2.4 **Recommendation Four**
The Joint Strategic Committee is recommended to forward the Prudential Indicators and Limits, and MRP Statements of the report for approval by Worthing Council at its meeting on 26 February 2019, and by Adur Council at its meeting on 28 February 2019.

3. INTRODUCTION

3.1 Background

The Councils are 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 high quality counterparties or instruments commensurate with the Councils' low risk appetite, providing adequate liquidity initially, before considering investment return. This is consistent with national guidance which promotes security and liquidity above yield.

The second main function of the treasury management service is the funding of the Councils' capital plans. These capital plans provide a guide to the borrowing need of the Councils, essentially the longer term cash flow planning, to ensure that the Councils can meet their 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 Councils' risk or cost objectives.

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.

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

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 has been reported separately.

For both Councils, commercial activity is confined to the Strategic Property Investment Fund, which is used to purchase commercial property to generate a long-term income stream for the Councils.

3.2 Reporting requirements

3.2.1 Capital Strategy

The CIPFA revised 2017 Prudential and Treasury Management Codes require, for 2019-20, all local authorities to prepare an additional report, a capital strategy report to 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

The aim of this capital strategy is to ensure that all elected Members on the full council fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite. The Capital Strategy for 2019/20 to 2021/22 and the Commercial Property Strategy were approved by Adur Council on the 19th July 2018 and by Worthing Council on the 17th July 2018.

This 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 strategy for commercial investments which is governed by different principles which are detailed in the Councils' Commercial Property Investment Strategy.

The capital strategy shows:

- 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.

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.

Where the Councils have borrowed to fund any non-treasury investment, there should also be an explanation of why borrowing was required and why the MHCLG Investment Guidance and CIPFA Prudential Code have not been adhered to.

If any non-treasury investment sustains a loss during the final accounts and audit process, the strategy and revenue implications will be reported as part of the outturn report and the annual review of the Corporate Property Investment Portfolio.

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

3.2.2 Treasury Management Reporting

The Councils are required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report), to be approved by the Joint Strategic Committee (JSC) and by the Councils - the first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and noting whether any policies require revision.

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

Scrutiny - The above reports are required to be scrutinised by the Joint Governance Committee (JGC) which may make recommendations to the JSC regarding any aspects of Treasury Management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations as may be made shall be incorporated within the above named reports and submitted to meetings of the JSC for consideration as soon after the meetings of the JGC as practically possible. The reports are approved by the JSC and recommended to the Councils for approval.

3.3 Treasury Management Strategy for 2019/20

The strategy for 2019/20 covers two main areas:

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 Councils;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- the policy on use of external service providers

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

3.4 **Training**

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 for Members was provided by Link Asset Services in June 2018 and further training will take place in 2019 as required.

The training needs of treasury management officers are periodically reviewed and officers attend courses provided by appropriate trainers such as Link and CIPFA.

3.5 **Treasury management consultants**

The Councils last undertook a joint re-tender for treasury management consultancy services in 2017. This culminated in the re-appointment of the Councils' incumbent consultants, Link Asset Services, on similar terms for 3 years from 1 April 2017.

The Councils recognise that responsibility for treasury management decisions remains with the organisations at all times and will ensure that undue reliance is not placed upon our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.

They also recognise that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Councils 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.

The scope of investments within the Councils' operations includes both conventional treasury investments, (the placing of residual cash from the Councils' functions), and commercial type investments in property. The Councils use appropriate specialist advisers in relation to the commercial activity.

4. THE CAPITAL PRUDENTIAL INDICATORS 2019/20 – 2021/22

The Councils' capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist Members' overview and confirm capital expenditure plans.

4.1 Capital expenditure

This prudential indicator is a summary of the Councils' capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts.

The tables below summarise the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a financing or borrowing need.

ADUR DISTRICT COUNCIL

Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Non-HRA	5.785	16.041	3.304	1.841	1.432
HRA	2.936	5.305	8.420	8.437	6.790
Commercial activities	11.579	45.193	18.228	0.000	0.000
TOTAL	**20.300**	**66.539**	**29.952**	**10.278**	**8.222**
Financed by:					
Capital receipts	0.583	0.975	1.870	1.045	0.464
Capital grants and contributions	2.488	4.091	1.491	0.350	0.350
Revenue Reserves & contributions	2.926	4.577	4.482	4.391	4.082
Net financing need for the year	**14.303**	**56.896**	**22.109**	**4.492**	**3.326**

The net financing need for commercial property purchases included in the above table against expenditure is shown below:

Adur DC Commercial property	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Capital Expenditure	11.579	45.193	18.228	n/a	n/a
Financing costs	11.579	45.193	18.228		
Net financing need for the year	**14.303**	**56.896**	**22.109**		
Percentage of total net financing need	81%	79%	82%		

WORTHING BOROUGH COUNCIL

Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Non-HRA	29.550	14.941	7.749	4.399	4.147
Commercial activities	0.000	45.228	16.835	0.000	0.000
TOTAL	**29.550**	**60.169**	**24.584**	**4.399**	**4.147**
Financed by:					
Capital receipts	5.226	0.164	1.000	1.000	1.000
Capital grants and contributions	6.542	1.179	1.706	0.770	0.750
Revenue Reserves & contributions	0.207	0.452	0.210	0.129	0.379
Net financing need for the year	**17.575**	**58.374**	**21.668**	**2.500**	**2.018**

Worthing BC Commercial property	2017/18 Actual £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Capital Expenditure	0.000	45.228	16.835	n/a	n/a
Financing costs	n/a	45.228	16.835		
Net financing need for the year	**17.575**	**58.374**	**21.668**		
Percentage of total net financing need	n/a	77%	78%		

4.2 **The Councils' borrowing need (the Capital Financing Requirement)**

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

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 each asset's life. The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Councils' borrowing requirement, these types of scheme include a borrowing facility and so the Councils are not required to separately borrow for these schemes. The Councils currently do not have any such schemes within the CFR. The Councils are asked to approve the CFR projections below:

ADUR DISTRICT COUNCIL

Capital Financing Requirement (£m)	**2017/18 Actual**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
CFR – non-HRA	16.921	27.758	28.279	28.125	27.915
CFR Commercial	11.579	56.622	74.025	72.943	71.831
CFR – HRA	60.103	60.103	62.473	65.970	68.303
Total CFR	**88.603**	**144.483**	**164.777**	**167.038**	**168.049**
Movement in CFR	13.591	55.880	20.294	2.261	1.011
Movement in CFR represented by					
Net financing need for the year (above)	14.303	56.896	22.109	4.492	3.326
Less: MRP/VRP and other financing movements	(0.712)	(1.016)	(1.815)	(2.231)	(2.315)
Movement in CFR	**13.591**	**55.880**	**20.294**	**2.261**	**1.011**

Worthing Borough Council

Capital Financing Requirement (£m)	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
CFR – non-HRA CFR Commercial	39.150 0.000	51.185 45.228	54.916 61.478	56.197 60.657	56.946 59.811
Total CFR	**39.150**	**96.413**	**116.394**	**116.854**	**116.757**
Movement in CFR	**16.766**	**57.263**	**19.981**	**0.460**	**(0.097)**
Movement in CFR represented by					
Net financing need for the year (above)	17.575	58.374	21.668	2.500	2.018
Less: MRP/VRP and other financing movements	(0.809)	(1.111)	(1.687)	(2.040)	(2.115)
Movement in CFR	**16.766**	**57.263**	**19.981**	**0.460**	**(0.097)**

A key aspect of the regulatory and professional guidance is that elected Members are aware of the size and scope of any commercial activity in relation to the Councils' overall financial position. The capital expenditure figures shown above demonstrate the scope of this activity and, by approving these figures, Members consider the scale proportionate to the Councils' remaining activity.

4.3 **Minimum revenue provision (MRP) policy statement**

The Councils are required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although they are also allowed to undertake additional voluntary payments (voluntary revenue provision - VRP). MHCLG regulations require the full Councils to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

For both Councils, the MRP relating to built assets under construction will be set aside once the asset is completed. The Councils are recommended to approve the following MRP Statements:

ADUR DISTRICT COUNCIL

For Adur District Council it was approved by Joint Strategic Committee on 2 June 2016 that for capital expenditure incurred before 1st April 2008, the MRP will be set aside in equal instalments over the life of the associated debt. No such policy was required by Worthing Borough Council which had no debt as at 1 April 2008.

4.3.1 General Fund

For non-HRA capital expenditure after 1st April 2008 the MRP will be calculated as the annual amount required to repay borrowing based on the annuity method: equal annual payments of principal and interest are calculated, with the interest element reducing and the principal element increasing as the principal is repaid. The interest is based on the rate available to the Council at the beginning of the year in which payments start and the MRP is calculated as the amount of principal, so that by the end of the asset's estimated life the principal is fully repaid. The option remains to use additional revenue contributions or capital receipts to repay debt earlier (the Asset Life Method).

An exception was agreed in the 2015/16 Treasury Management Strategy Statement: the Chief Financial Officer has discretion to defer MRP relating to debt arising from loans to Registered Social Landlords (RSLs) to match the profile of debt repayments from the RSL. RSLs normally prefer a maturity type loan as it matches the onset of income streams emanating from capital investment with the timing of the principal debt repayment. The deferral of MRP to the maturity date would therefore mean that MRP is matched at the same point as the debt is repaid, and is therefore cash (and revenue cost) neutral to the Council.

If concerns arise about the ability of the RSL to repay the loan, the Chief Financial Officer will use the approved discretion to make MRP as a "prudent provision" from the earliest point to ensure that sufficient funds are set aside from revenue to repay the debt at maturity if the RSL defaults.

It is proposed to use the same policy for 2019/20.

4.3.2 Housing Revenue Account

Unlike the General Fund, the HRA is not required to set aside funds to repay debt. The Council's MRP policy previously applied the financially prudent option of voluntary MRP for the repayment of HRA debt, to facilitate new borrowing in future for capital investment. However in order to provide additional capital funding to address the maintenance backlog identified by the condition survey, the payment of voluntary MRP was suspended for a period of 9 years from 2017/18 whilst the Council invests in its current housing stock and manages the impact of rent limitation.

WORTHING BOROUGH COUNCIL

4.3.3 Worthing applies the same MRP policy as Adur for unfunded capital expenditure from 1 April 2008. Worthing has the same discretion as Adur Council in the application of MRP in respect of loans to RSLs. It is proposed to retain this policy for 2019/20.

If any finance leases are entered into the repayments are applied as MRP.

MRP Overpayments – A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory MRP, voluntary revenue provision or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31st March 2019 Adur had not made any VRP overpayments, but Worthing had made a £300k VRP overpayment which will be reclaimed over the following 5 years.

5. BORROWING

The capital expenditure plans set out above provide details of the service activity of the Councils. The treasury management function ensures that the Councils' cash is organised in accordance with the the relevant professional codes, so that sufficient cash is available to meet this service activity and the Councils' 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.

5.1 Current portfolio position

The Councils' treasury portfolio positions at 31 March 2018 and for the position as at 31 December 2018 are shown below.

Adur District Council

	Principal at 31.03.18 £m	Actual 31.03.2018 %	Principal at 31.12.18 £m	Actual 31.12.2018 %
External Borrowing				
PWLB	(67.198)	79%	(83.513)	82%
Other Borrowing	(17.940)	21%	(18.212)	18%
Finance lease	(0.000)		(0.000)	
TOTAL BORROWING	**(85.138)**	100%	**(101.725)**	
Treasury Investments:				
Local Authority Property Fund	0.968	9%	0.968	8%
In-house:				
Banks	5.000	46%	7.010	63%
Building societies	2.000	18%	0.000	0%
Bonds	0.080	1%	0.055	1%
Local authorities	2.000	18%	0.000	0%
Money market funds	0.800	8%	3.155	28%
TOTAL INVESTMENTS	**10.848**	100%	**11.188**	100%
NET DEBT	**(74.290)**		**(90.537)**	

Worthing Borough Council

	Principal at 31.03.18 £m	Actual 31.03.2018 %	Principal at 31.12.18 £m	Actual 31.12.2018 %
External Borrowing				
PWLB	(31.536)	76%	(45.263)	87%
Other Borrowing	(10.028)	24%	(7.000)	13%
Finance lease	(0.000)		0.000	
TOTAL BORROWING	**(41.564)**	100%	**(52.263)**	100%
Treasury Investments:				
Local Authority Property Fund	0.484	4%	0.484	3%
In-house:				
Banks	7.000	60%	13.000	78%
Building societies	1.000	9%	0.000	0%
Bonds	0.075	1%	0.075	0%
Local authorities	0.000	0%	0.000	0%
Money market funds	3.000	26%	3.225	19%
TOTAL INVESTMENTS	**11.559**	100%	**16.784**	100%
NET INVESTMENTS	**(30.005)**		**(35.479)**	

Worthing Borough Council has also made a £10m loan to Worthing Homes, which is categorised as capital, rather than a treasury investment.

The Councils' forward projections for borrowing are summarised below. The tables show the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

ADUR DISTRICT COUNCIL

Adur District Council External Debt	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Debt at 1 April	(74.552)	(85.138)	(138.622)	(158.735)	(161.030)
Expected change in Debt	(10.586)	(53.484)	(20.113)	(2.295)	(1.026)
Other long-term liabilities (OLTL)	0.000	0.000	0.000	0.000	0.000
Actual gross debt at 31 March	(85.138)	(138.622)	(158.735)	(161.030)	(162.056)
The Capital Financing Requirement	88.603	144.483	164.777	167.038	168.049
Under/(over) borrowing	3.465	5.861	6.042	6.008	5.993

Within the above figures the level of debt relating to commercial property is:
Adur District Council

Adur District Council	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt for commercial activities / non-financial investments					
Actual debt at 31 March £m	(11.179)	(55.103)	(72.506)	(71.424)	(70.312)
Percentage of total external debt %	13%	40%	46%	44%	43%

Worthing Borough Council

Worthing BC External Debt	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Debt at 1 April	(22.309)	(41.564)	(93.297)	(113.280)	(113.695)
Expected change in Debt	(19.255)	(51.733)	(19.983)	(0.415)	(0.018)
Other long-term liabilities (OLTL)	0.000	0.000	0.000	0.000	0.000
Actual gross debt at 31 March	(41.564)	(93.297)	(113.280)	(113.695)	(113.713)
The Capital Financing Requirement	39.150	96.413	116.394	116.854	116.757
Under/(over) borrowing	(2.414)	3.116	3.114	3.159	3.044

Within the above figures the level of debt relating to commercial property is:

Worthing B C	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
External Debt for commercial activities / non-financial investments					
Actual debt at 31 March £m	0.00	45.228	61.478	60.657	59.811
Percentage of total external debt %	n/a	48%	54%	53%	53%

Within the prudential indicators there are a number of key indicators to ensure that the Councils operate their activities within well-defined limits. One of these is that the Councils need to ensure that their 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 Chief Financial Officer reports that the Councils 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.

5.2 **Treasury Indicators: limits to borrowing activity**

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

ADUR DISTRICT COUNCIL

Operational boundary	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m
Debt	143.0	166.0	166.0	166.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**144.0**	**167.0**	**167.0**	**167.0**

WORTHING BOROUGH COUNCIL

Operational boundary	2018/19 Approved	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m
Debt re Worthing Homes	10.0	10.0	10.0	10.0
Other Debt	90.0	110.0	110.0	110.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**101.0**	**121.0**	**121.0**	**121.0**

The authorised limit for external debt - A further key prudential indicator represents 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 Councils. 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.

1. 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.

2. The Councils are asked to approve the following authorised limits:

ADUR DISTRICT COUNCIL

Authorised limit	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m
Debt	147.0	170.0	170.0	170.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**148.0**	**171.0**	**171.0**	**171.0**

WORTHING BOROUGH COUNCIL

Authorised limit	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m
Debt re Worthing Homes	10.0	10.0	10.0	10.0
Other Debt	95.0	115.0	115.0	115.0
Other long term liabilities	1.0	1.0	1.0	1.0
Total	**106.0**	**126.0**	**126.0**	**126.0**

The Councils have agreed a maximum spend of £75m each in respect of commercial property purchases.

Abolition of HRA debt cap - in October 2018, Prime Minister Theresa May announced a policy change of abolition of the HRA debt cap. The Chancellor announced in the Budget that the applicable date was 29.10.18.

5.3 **Prospects for interest rates**

The Councils have appointed Link Asset Services as their treasury advisor and part of their service is to assist the Councils to formulate a view on interest rates. The following table gives their central view.

Link Asset Services Interest Rate View	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22
Bank Rate View	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%	1.75%	2.00%
3 Month LIBID	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%	1.50%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%
6 Month LIBID	1.00%	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%
12 Month LIBID	1.20%	1.30%	1.40%	1.50%	1.60%	1.70%	1.80%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%
5yr PWLB Rate	2.10%	2.20%	2.20%	2.30%	2.30%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%	2.80%
10yr PWLB Rate	2.50%	2.60%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%
25yr PWLB Rate	2.90%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.70%	2.80%	2.90%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	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. 2016 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 Sept 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.

Investment and borrowing rates

● Investment returns are likely to remain low during 2019/20 but to be on a gently rising trend over the next few years.

● Borrowing interest rates have been volatile so far in 2018-19 and have increased modestly since the summer. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt.

● There will remain a cost of carry, (the difference between higher borrowing costs and lower investment returns), to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost.

5.4 **Borrowing Strategy**

The Councils are both currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt, as cash supporting the Councils' reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are currently low and counterparty risk is still an issue that needs to be considered.
Against this background and the risks within the economic forecast, caution will be adopted with the 2019/20 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in 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 an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Fixed rate funding probably will be drawn whilst interest rates are still lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

5.5 Both Councils will refer in the first instance to the Public Works Loan Board (PWLB) for sourcing their borrowing needs, given that they are eligible to access the PWLB "Certainty" rate of interest, being 20 basis points below the normal prevailing PWLB rates. However, borrowing from other sources, including other Local Authorities and the Local Government Association Municipal Bonds Agency, may from time to time offer options to borrow more cheaply than from the PWLB, and therefore will be considered.

Given the expected under borrowing position of the Councils, the borrowing strategy will give consideration to new borrowing in the following order of priority:-

i) Internal borrowing, by running down cash balances and foregoing interest earned at historically low rates, as this is the cheapest form of borrowing;

ii) Weighing the short term advantage of internal borrowing against potential long term borrowing costs, in view of the overall forecast for long term borrowing rates to increase over the next few years;

iii) PWLB fixed rate loans for up to 20 years;

iv) Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB, market debt and loans from other councils in the debt portfolio;

v) PWLB borrowing for periods under 5 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt.

vi) Short term loans from other Councils where appropriate;

vii) Longer term PWLB loans

5.6 Preference will be given to PWLB borrowing by annuity and EIP loans instead of maturity loans, as this may result in lower interest payments over the life of the loans.

5.7 **Policy on borrowing in advance of need**

The Councils will not borrow more than or in advance of their 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 Councils can ensure the security of such funds.

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.

5.8 **Debt rescheduling**

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 size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and/or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhancement of the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identifying 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.

Adur's debt portfolio includes a large proportion of long term loans with a duration of over 10 years left to run, and at rates above prevailing market rates for equivalent loans. The cost to redeem these loans early would incur a large debt premium, making this an unaffordable option.

By contrast, Worthing's existing fixed rate debt portfolio is at or below current interest rates, so options for early settlement do not really apply.

All rescheduling will be reported to the Councils at the earliest meeting following its action.

5.9 **Municipal Bond Agency**

The Municipal Bond Agency intends to offer loans to local authorities in the future. It is hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). These Authorities intends to make use of this new source of borrowing as and when appropriate.

6. ANNUAL INVESTMENT POLICY AND STRATEGY

6.1 Investment Policy – Management of risk

6.1.1 The MHCLG and CIPFA have extended the meaning of 'investments' to include both financial and non-financial investments. This report deals solely with the management of financial investments, (as managed by the treasury management team). The strategy and approach to managing risk for investing in non-financial investments, essentially the purchase of commercial property, is dealt with by the Commercial Property Investment Strategy which forms part of the Capital Strategy.

6.1.2 The Councils' 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

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

6.1.3 The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements, and Prudential Indicators. As conditions in the financial markets remain uncertain, the proposed maximum limits for Specified and Unspecified Investments for 2019/20 are the same as for 2018/19, with the exception of an increase in the investment limit for each Council with the Local Authorities' Property Fund to £3m.

6.1.4 Investment instruments identified for use in the financial year are listed in Appendix B under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Councils' treasury management practices.

6.1.5 The guidance from the MHCLG and CIPFA places a high priority on the management of risk. This Councils have adopted a prudent approach to managing risk and define risk appetite by the following means: -

a) Minimum acceptable **credit criteria** are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.

b) **Other information**: 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 Councils will engage with the advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

c) **Other information sources** used will include the financial press, share price 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.

d) The Councils have defined the list of types of investment instruments that the treasury management team is authorised to use. There are two lists in Appendix B under 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.

e) Lending limits, (amounts and maturity), for each counterparty will be set through applying the matrix table in Appendix B.

f) Transaction limits are set for each type of investment in Appendix B.

g) The Councils will set a limit for the amount of its investments which are invested for longer than 365 days, (see paragraph 6.10).

h) Investments will only be placed with counterparties from countries with a specified minimum sovereign rating (see paragraph 6.5). The UK is excluded from this limit because it will be necessary to invest in UK banks and other institutions even if the sovereign rating is cut.

i) The Councils have engaged external consultants, (see paragraph 3.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of the Councils in the context of the expected level of cash balances and need for liquidity throughout the year.

j) All investments will be denominated in sterling.

k) As a result of the change in accounting standards for 2018/19 under IFRS 9, the Councils will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18. Consequently any fluctuations in the value of the Councils' investments in the Local Authorities' Property Fund will not be taken through the general fund for the period of the override).

6.1.6 However, the Councils will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance, (see paragraph 6.16). Regular monitoring of investment performance will be carried out during the year.

6.1.7 **Changes in investment limits from last year**

The investment limit for each Council for the Local Authorities' Property Fund has been increased to £3m.

6.2 Creditworthiness Policy

6.2.1 The primary principle governing the Councils' joint treasury management service investment criteria is the security of investments, although the yield or return on the investment is also a key consideration. After this main principle, the service will ensure that:

- They maintain a policy covering the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

- They have sufficient liquidity in investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Councils' prudential indicators covering the maximum principal sums invested.

6.2.2 The Chief Financial Officer will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Councils for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the service may use, rather than defining what types of investment instruments are to be used.

6.2.3 Credit rating information is supplied by Link Asset Services, our treasury advisors, on all active counterparties that comply with our criteria. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of the longer term bias outside the central rating view) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to a counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

6.2.4 The service uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

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

6.2.5 The result is a series of colour coded bands for counterparties indicating the relative creditworthiness of each as they are categorised by durational bands. These bands are used by the Councils to form a view of the duration for investments by each counterparty. The Councils are satisfied that this service gives a robust level of analysis for determining the security of its investments. It is also a service which the Councils would not be able to replicate using its own in-house resources.

6.2.6 Using Link's ratings service, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. The effect of a change in ratings may prompt the following responses:

- If a downgrade results in the counterparty/investment scheme no longer meeting the Councils' minimum criteria, its further use as a new investment will be withdrawn immediately.

- In addition to the use of Credit Ratings the Councils will be advised by Link of movements in Credit Default Swaps and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils' lending lists.

6.2.7 The Councils' officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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, the government support for banks, and the credit ratings of that government support.

6.2.8 Accordingly, the Councils may exercise discretion to deviate from Link's suggested durational bands for counterparties where sudden changes in financial markets, the banking sector, or other circumstances warrant a more flexible approach being taken.

The Councils' Minimum Investment Creditworthiness Criteria

6.3 The minimum credit ratings criteria used by the Councils generally will be a short term rating (Fitch or equivalents) of F1, and long term rating A-. There may be occasions when the counterparty ratings from one or more of the three Ratings Agencies are marginally lower than the minimum requirements of F1 Short term, A- Long term (or equivalent). Where this arises, the counterparties to which the ratings apply may still be used with discretion, but in these instances consideration will be given to the whole range of topical market information available, not just ratings.

The Councils include the top five **building society** names in the specified investments. It is recognised that they may carry a lower credit rating than the Councils' other counterparties, therefore the lending limits for the building societies shall be £2m each, excepting that for Nationwide (the top building society) the lending limit shall be £4m.

6.4 **UK banks – ring fencing**

The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are 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.

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.

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

6.5 **Country Limits and Proposed Monitoring Arrangements**

Due care will be taken to consider the country, group and sector exposure of the Councils' investments.

The Councils have determined that they will only use approved counterparties from countries (other than the UK) with a minimum sovereign credit rating of *AA-* from Fitch Ratings (or equivalent from other agencies if Fitch does not provide one). The list of countries that qualify using these credit criteria as at the date of this report is reflected in the counterparty approved lending list shown at Appendix B. This list will be added to, or deducted from, by officers should ratings change, in accordance with this policy. No more than 25% of investments shall be placed in non-UK financial institutions for more than 7 days.

6.6 Although the Councils can control the foreign exposure for fixed term deposits via the choice of counterparties, the ability to do this for instant access Money Market Funds (MMFs) is more difficult, as the assets which comprise the funds generally consist of loans to other financial institutions (UK and worldwide).

6.7 Recognising the present financial climate, and that any investment is only as good as the underlying assets, the Councils shall use a Money Market Fund Portal for placing and redeeming transactions. This will allow access to information on the underlying composition of the MMFs, including the geographic spread of the underlying assets.

Investment Strategy

6.8 **In-house funds**

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed. For cash flow balances, the Councils will seek to use notice accounts, money market funds and short-dated deposits to benefit from the compounding of interest.

- If it is thought that Bank Rate is likely to rise significantly within the time horizon being considered, then consideration will be given to keeping most investments as being short term or variable.

- Conversely, if it is thought that Bank Rate is likely to fall within that time period, consideration will be given to locking in higher rates currently obtainable, for longer periods.

The Chief Financial Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the meetings of the JGC and JSC in accordance with the reporting arrangements contained in the Treasury Management Practices Statement.

6.9 **Investment returns expectations**

Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 in 2022. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

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

	Now
2018/19	0.75%
2019/20	1.00%
2020/21	1.50%
2021/22	1.75%
2022/23	1.75%
2023/24	2.00%
Later years	2.50%

The overall balance of risks to economic growth in the UK is probably neutral.

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

6.10 **Investment treasury indicator and limit** - total principal funds invested for greater than 365 days. These limits are set with regard to the Councils' liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Councils are asked to approve the following treasury indicators and limits:

ADUR DISTRICT COUNCIL

MAXIMUM PROPORTION OF PRINCIPAL SUMS INVESTED > 365 DAYS			
	2019/20	**2020/21**	**2021/22**
Principal sums invested > 365 days	50%	50%	50%

WORTHING BOROUGH COUNCIL

MAXIMUM PROPORTION OF PRINCIPAL SUMS INVESTED > 365 DAYS			
	2019/20	**2020/21**	**2021/22**
Principal sums invested > 365 days	50%	50%	50%

Both Councils are currently holding only the Local Authorities' Property Fund and other small bonds (£50k each Council) which are expected to be invested for more than 365 days.

6.11 In any sustained period of significant stress in the financial markets, the default position is for investments to be placed with The Debt Management Account Deposit Facility of the Debt Management Office (DMO) of the UK central government. The rates of interest are below equivalent money market rates, however, the returns are an acceptable trade-off for the guarantee that the Councils' capital is secure.

6.12 The Councils' proposed investment activity for placing cash deposits in 2019/20 will be to use:

- AAA-rated Money Market Funds with a Constant Net Asset Value (CNAV) or a Low Volatility Net Asset Value (LVNAV) under the new money market fund regulations
- other local authorities, parish councils etc.
- business reserve accounts and term deposits. These are primarily restricted to UK institutions that are rated at least A- long term.
- the top five building societies by asset size

Other Options for Longer Term Investments

6.13 To provide the Councils with options to enhance returns above those available for short term durations, it is proposed to retain the option to use the following for longer term investments, as an alternative to cash deposits:

a) **Supranational bonds greater than 1 year to maturity**

b) **Gilt edged securities** with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.

c) **Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use the top five building societies by asset size up to £2m, (£4m Nationwide).

d) Any **bank or building society** that has a minimum long term credit rating of A- for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).

e) Any **non-rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a guarantee from the parent company, and exposure up to the limit applicable to the parent.

f) **Registered Social Landlords** (Housing Associations) - subject to confirming the Councils have appropriate powers, consideration will be given to lending to Registered Social Landlords. Such lending may either be as an investment for treasury management purposes, or for the provision of “social policy or service investment”, that would not normally feature within the Treasury Management Strategy.

g) **Property Investment Funds** for example the Local Authorities’ Property Fund. The Councils will consult the Treasury Management Advisors and undertake appropriate due diligence before investment of this type is undertaken. Some of these funds are deemed capital expenditure – the Councils will seek guidance on the status of any fund considered for investment.

h) **Other local authorities**, parish councils etc.

i) **Loan capital** in a body corporate.

j) **Share capital** *in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. Revenue resources will not be* *invested in corporate bodies.*

(Note: For (i) and (j) above the Councils will seek further advice on the appropriateness and associated risks with investments in these categories as and when an opportunity presents itself).

6.14 **The accounting treatment** may differ from the underlying cash transactions arising from investment decisions made by the Councils. To ensure that the Councils are protected from any adverse revenue impact, which may arise from these differences, the accounting implications of new transactions will be reviewed before they are undertaken.

6.15 The Councils will not transact in any investment that may be deemed to constitute capital expenditure (e.g. Share Capital, or pooled investment funds other than Money Market Funds), without the resource implications being approved as part of the consideration of the Capital Programme or other appropriate Committee report.

6.16 **Investment risk benchmarking** – the Councils will subscribe to Link's Investment Benchmarking Club to review the investment performance and risk of the portfolios.

6.17 At the end of the financial year the Councils will report on investment activity as part of the Annual Treasury Report.

7. OTHER MATTERS

7.1 **Balanced budget requirement** - the Councils comply with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

7.2 **Worthing Leisure Trust** - the arrangements for establishing The Worthing Leisure Trust include provision for Worthing Council to provide the Trust with temporary cash flow advances (if required) up to a maximum of £500k to assist it in the early start-up years. Such advances as may be made shall be repayable as soon as practical and attract a rate of interest for the loan term of Bank Base Rate plus 5%.

8. ENGAGEMENT AND COMMUNICATION

8.1 The Adur and Worthing Councils' treasury management team provides treasury services to Mid Sussex District Council through a shared services arrangement (SSA). The SSA is provided under a Service Level Agreement that was renewed from 18th October 2016, and which defines the respective roles of the client and provider authorities for a period of three years.

8.2 Information and advice is supplied throughout the year by Link Asset Services Ltd, the professional consultants for the Councils' shared treasury management service.

9. FINANCIAL IMPLICATIONS

9.1 This report has no quantifiable additional financial implications to those outlined above. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget.

10. LEGAL IMPLICATIONS

10.1 The approval and adoption of the Treasury Management Strategy Statement, Annual Investment Strategy, Minimum Revenue Provision Policy and Prudential Indicators is required by regulations issued under the Local Government Act 2003.

Background Papers

Joint Treasury Management Strategy Statement and Annual Investment Strategy Report 2018/19 to 20/21 – Joint Strategic Committee 2 February 2017, and Joint Governance Committee, 30 January 2018

Annual Joint In-House Treasury Management Operations Report 1 April 2017 – 31 March 2018 for Adur District Council and Worthing Borough Council – Joint Governance Committee, 31 July 2018 and Joint Strategic Committee, 11 September 2018

Overall Budget Estimates 2019/20 and Setting of 2019/20 Council Tax Report

Link Asset Services Ltd TMSS Template 2019/20

Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA, December 2017)

The Prudential Code for Capital Finance in Local Authorities (CIPFA, December 2017)

CLG Investment Guidance

Funding and Management Agreement with South Downs Leisure Trust

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SUSTAINABILITY & RISK ASSESSMENT

1. ECONOMIC

The treasury management function ensures that the Councils have sufficient liquidity to finance their day to day operations. Borrowing is arranged as required to fund the capital programmes. Available funds are invested according to the specified criteria to ensure security of the funds, liquidity and, after these considerations, to maximise the rate of return.

2. SOCIAL

2.1 Social Value

Matter considered and no issues identified.

2.2 Equality Issues

Matter considered and no issues identified.

2.3 Community Safety Issues (Section 17)

Matter considered and no issues identified.

2.4 Human Rights Issues

Matter considered and no issues identified.

3. ENVIRONMENTAL

Matter considered and no issues identified.

4. GOVERNANCE

4.1 The Councils' Treasury Management Strategy and Annual Investment Strategy place the security of investments as foremost in considering all treasury management dealing. By so doing it contributes towards the Council priorities contained in Platforms for our Places.

4.2 The operation of the treasury management function is as approved by the Councils' Treasury Management Strategy and Annual Investment Strategy 2019/20 - 2021/22, submitted and approved before the commencement of the 2019/20 financial year.

4.3 In the current economic climate the security of investments is paramount, the management of which includes regular monitoring of the credit ratings and other incidental information relating to credit worthiness of the Councils' investment counterparties.

Appendix A

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2019/20 – 2021/22

1.1 The Councils' capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

Adur District Council

Adur Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Non-HRA	5.785	16.041	3.304	1.841	1.432
HRA	2.936	5.305	8.420	8.437	6.790
Commercial activities	11.579	45.193	18.228	0.000	0.000
TOTAL	**20.300**	**66.539**	**29.952**	**10.278**	**8.222**

Worthing Borough Council

Worthing Capital expenditure	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	£m	£m	£m	£m	£m
Non-HRA	29.550	14.941	7.749	4.399	4.147
Commercial activities	0.000	45.228	16.835	0.000	0.000
TOTAL	**29.550**	**60.169**	**24.584**	**4.399**	**4.147**

1.2 **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. These provide an indication of the impact of the capital investment plans on the Councils' overall finances. The Councils are asked to approve the following indicators:

Ratio of financing costs to net revenue stream

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.

Adur District Council

Adur %	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	%	%	%	%	%
Non-HRA	17.68	20.67	21.15	20.14	20.39
HRA	25.43	25.19	25.49	26.39	26.06
Commercial activities		(5.16)	(10.41)	(15.00)	(14.68)
TOTAL	**43.11**	**40.70**	**36.23**	**31.53**	**31.77**

WORTHING BOROUGH COUNCIL

Worthing %	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
	%	%	%	%	%
Non-HRA	8.78	10.44	10.66	12.22	12.33
Commercial activities		(1.57)	(4.20)	(7.09)	(7.07)
TOTAL	**8.78**	**8.87**	**6.46**	**5.13**	**5.26**

The estimates of financing costs include current commitments and the proposals in this budget report.

HRA Ratio

Adur	2017/18 Actual	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
HRA debt £m	**57.875**	**56.168**	**56.832**	**58.623**	**59.249**
Number of HRA dwellings	**2591**	**2582**	**2580**	**2576**	**2563**
Debt per dwelling	**£22.3k**	**£21.8k**	**£22.0k**	**£22.8k**	**£23.1k**

1.3 **Maturity structure of borrowing**

These gross limits are set to reduce the Councils' exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. Neither Council has any variable rate borrowing.

Adur District Council

Limits to maturity structure of fixed interest rate borrowing 2019/20		
	Lower Limit	**Upper Limit**
Under 12 months	0%	20%
12 months to 2 years	0%	25%
2 years to 5 years	0%	40%
5 years to 10 years	0%	50%
10 years to 20 years	0%	60%
20 years to 30 years	0%	60%
30 years to 40 years	0%	60%
40 years to 50 years	0%	45%

WORTHING BOROUGH COUNCIL

Limits to maturity structure of fixed interest rate borrowing 2019/20		
	Lower Limit	**Upper Limit**
Under 12 months	0%	45%
12 months to 2 years	0%	75%
2 years to 5 years	0%	75%
5 years to 10 years	0%	75%
10 years to 20 years	0%	75%
20 years to 30 years	0%	75%

APPENDIX B

TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The MHCLG issued Investment Guidance in 2018, and this forms the structure of the Councils' policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Councils to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes, which will apply to all investment activity. In accordance with the Code, the Chief Financial Officer has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of the annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Councils will use. These are high security (i.e. high credit rating, although this is defined by the Councils, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

<u>SPECIFIED AND NON SPECIFIED INVESTMENTS</u>

Specified Investments identified for use by the Councils

Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year or where the Councils have the right to be repaid within 12 months
- meets the "high" credit criteria as determined by the Councils or is made with the UK government or is made with a local authority in England, Wales and Scotland.

- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

“Specified” Investments identified for the Councils’ use are:

- Deposits in the DMO’s Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV) or appropriate Low Volatility Net Asset Value (LVNAV) under the new regulations.
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

** Investments in these instruments will be on advice from the Councils’ treasury advisor.*

For credit rated counterparties, the minimum criteria, excepting for the Councils’ own banker and the specified building societies, (see below) will be the short-term / long-term ratings assigned by various agencies which may include Moody’s Investors Services, Standard and Poor’s, Fitch Ratings, being:

Long-term investments (over 365 days): minimum: A- (Fitch) or equivalent
Or
Short-term investments (365 days or less): minimum: F1 (Fitch) or equivalent

For all investments the Councils will also take into account information on corporate developments of, and market sentiment towards, investment counterparties.

Where appropriate the Ring Fenced entities of banks will be used.

APPENDIX B - ANNEX 1

ADUR DISTRICT COUNCIL - SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK	Santander (UK)	£4m
Term Deposits/Call Accounts	UK	Bank of Scotland/Lloyds	£4m
Term Deposits/Call Accounts	UK	Barclays	£4m
Term Deposits/Call Accounts	UK	Clydesdale	£4m
Term Deposits/Call Accounts	UK	Svenska Handelsbanken UK	£3m
Term Deposits/Call Accounts	UK	HSBC	£4m
Term Deposits/Call Accounts	UK	Royal Bank of Scotland Group	£4m
Term Deposits /Call / Overnight Accounts	UK	Close Brothers Limited	£4m
Term Deposits/Call Accounts	Germany – AAA	Deutsche Bank AG	£3m
Term Deposits/Call Accounts	Australia – AAA	National Australia Bank	£3m
Term Deposits/Call Accounts	US – AA+	JP Morgan Chase Bank	£3m
Term Deposits/Call Accounts	UK	Goldman Sachs International Bank	£3m
Gilts	UK	Debt Management office (DMO)	£3m or 25% of funds
Bonds	EU	European Investment Bank/Council of Europe	£3m or 25% of funds

ADUR DISTRICT COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country	Counterparty	Maximum Exposure Limit £m
AAA Rated Money Market Funds		Constant Net Asset Value or appropriate replacement LVNAV MMFs	£5m or 30% of funds
Other MMFs and CIS	UK	Collective Investment Schemes	25%
Term Deposits	UK	Nationwide BS	£4m
Term Deposits	UK	Yorkshire BS	£2m
Term Deposits	UK	Coventry BS	£2m
Term Deposits	UK	Skipton BS	£2m
Term Deposits	UK	Leeds BS	£2m
Share Capital	n/a	Local Capital Finance Company.	£0.05m
Share Capital/Loans	n/a	West Sussex Credit Union	£0.025k Share Capital

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

NB No more than 25% of funds shall be invested in Non-UK financial institutions whether by term deposits, call accounts or Money Market Funds, or any combination thereof, except that this limit may be breached for liquidity purposes for up to 1 week at any time.

NB Investments in AAA rated Money Market Funds are limited to £5m or 30% of funds except that this limit may be breached for liquidity purposes for up to 1 week at any time.

APPENDIX B - ANNEX 1

ADUR DISTRICT COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies • Certificates of deposit with banks and building societies • Deposits with Local Authorities • The UK Government	√ √ √ √	√ √ √ √	5 years	The higher of £8m or 50% of funds, maximum of £2m per institution No limit	No
Gilts and Bonds: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £5m or 30% of funds, maximum of £3m per fund	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes

APPENDIX B - ANNEX 1

ADUR DISTRICT COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority, such as the Local Authorities' Property Fund	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	£3m	To be confirmed
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Yes

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

3. The Council's own banker may also be used if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as possible.

WORTHING BOROUGH COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council
New specified investments will be made within the following limits:

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Term Deposits	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities	No limit
Term Deposits/Call Accounts	UK	Santander UK	£4m
Term Deposits/Call Accounts	UK	Bank of Scotland/Lloyds	£4m
Term Deposits/Call Accounts	UK	Barclays	£4m
Term Deposits/Call Accounts	UK	Clydesdale	£4m
Term Deposits/Call Accounts	UK	HSBC	£4m
Term Deposits /Call / Overnight Accounts	UK	Close Brothers Limited	£4m
Term Deposits/Call Accounts	UK	Royal Bank of Scotland Group	£4m
Term Deposits/Call Accounts	Australia – AAA	National Australia Bank Limited	£3m
Term Deposits/Call Accounts	Germany - AAA	Deutsche Bank AG	£3m
Term Deposits/Call Accounts	UK	Svenska Handelsbanken UK	£3m
Term Deposits/Call Accounts	US – AA+	JP Morgan	£3m
Term Deposits/Call Accounts	UK	Goldman Sachs International Bank	£3m
Gilts	UK	Debt Management Office (DMO)	£3m or 25% of funds

APPENDIX B - ANNEX 2

WORTHING BOROUGH COUNCIL
SPECIFIED AND NON SPECIFIED INVESTMENTS

Instrument	Country and Sovereign Rating	Counterparty	Maximum Exposure Limit £m
Bonds	EU	European Investment Bank/Council of Europe	£3m or 25% of funds
AAA Rated Money Market Funds		Constant Net Asset Value or appropriate replacement LVNAV MMFs	£5m or 30% of funds
Other MMFs and CIS	UK	Collective Investment Schemes	25%
Term Deposits	UK	Nationwide BS	£4m
Term Deposits	UK	Yorkshire BS	£2m
Term Deposits	UK	Coventry BS	£2m
Term Deposits	UK	Skipton BS	£2m
Term Deposits	UK	Leeds BS	£2m
Share Capital	n/a	Local Capital Finance Company.	£0.05m
Share Capital	n/a	West Sussex Credit Union	£0.05m Deferred shares
Term Deposits	n/a	Worthing Homes Limited (10 year loan)	£10m
Temporary Loans	n/a	Worthing Leisure Trust	£0.5m

NB Any existing deposits outside of the current criteria will be reinvested with the above criteria on maturity.

NB No more than 25% of funds shall be invested in Non-UK financial institutions whether by term deposits, call accounts or Money Market Funds, or any combination thereof, except that this limits may be breached for liquidity purposes for up to 1 week at any time.

NB Investments in AAA rated Money Market Funds are limited to £5m or 30% of funds except that this limit may be breached for liquidity purposes for up to 1 week at any time.

APPENDIX B - ANNEX 2

WORTHING BOROUGH COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
- Deposits with banks and building societies - Certificates of deposit with banks and building societies - Deposits with Local Authorities - The UK Government	√ √ √ √	√ √ √ √	5 years	The higher of £8m or 50% of funds, maximum of £2m per institution No limit	No
Gilts and Bonds: - Gilts - Bonds issued by multilateral development banks - Bonds issued by financial institutions guaranteed by the UK government - Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £5m or 30% of funds, maximum of £3m per fund	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes

APPENDIX B- ANNEX 2

WORTHING BOROUGH COUNCIL
NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL:

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Yes
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority, such as the Local Authorities' Property Fund	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	£3m	To be confirmed
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Yes

1. In determining the period to maturity of an investment, the investment should be regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

2. The use of the above instruments by the Council's fund manager(s) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.

3. The Council's own banker may also be used if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as possible.

APPENDIX C

COUNTERPARTIES WHERE THE COUNCILS HAVE OPTED UP TO PROFESSONAL INVESTOR STATUS

(i) **Money Market Funds**

Invesco
Federated Investors
CCLA

(ii) **Building Societies**

Skipton Building Society
Coventry Building Society

(iii) **Brokers**

BGC (Sterling)
Tradition
ICAP

(iv) **Other**

ICD (Portal used for money market fund investments)
Link Asset Services

These arrangements will be regularly reviewed as appropriate.

APPENDIX D

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) **Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual Treasury Management Strategy Statement and Annual Investment Strategy
- approval of MRP Statement

(ii) **Joint Strategic Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment.

(iii) **Joint Governance Committee**

Receiving and reviewing the following, and making recommendations to the Joint Strategic Committee

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.

(iv) **The S151 (responsible) officer**

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

APPENDIX D

TREASURY MANAGEMENT SCHEME OF DELEGATION

The revised CIPFA Treasury Management and Prudential Codes have extended the functions of the S151 role in respect of non-financial investments

- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management
- ensuring that the capital strategy is prudent, sustainable and affordable in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authorities
- ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities
- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed

APPENDIX E

ECONOMIC BACKGROUND

GLOBAL OUTLOOK World growth has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

Inflation has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period has already started in the US, and more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This now means that both asset categories are vulnerable to a sharp downward correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt. In addition, the European Central Bank has cut back its QE purchases substantially and is likely to end them completely by the end of 2018.

UK The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also raise Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

Inflation The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.4% in October. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's inflation report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in September, unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3. 2%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 0.8%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit.

However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

USA President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation. The results of the mid-term elections are not expected to have a material effect on the economy.

Eurozone Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

China Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

Japan - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

Emerging countries Argentina and Turkey are currently experiencing major headwinds
and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

INTEREST RATE FORECASTS

The interest rate forecasts provided by Link Asset Services in paragraph 5.3 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, 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. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

The balance of risks to the UK

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.

- 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. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government**. In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments**. Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with.
- Austria, the Czech Republic and Hungary now form a strongly anti-immigration bloc within the EU while Italy, this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.
- Further increases in 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. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of US corporate debt which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such

corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.

- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

Upside risks to current forecasts for UK gilt yields and PWLB rates

- Brexit – if both sides were to agree a compromise that removed all threats of economic and political disruption.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of QE, 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 we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.