# Treasury Management Strategy 2020/21-2024/25

Appendix 1

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SOUTH LAKELAND DISTRICT COUNCIL

# Treasury Management Strategy 2020/21-2024/25

## 1. Introduction

1.1. The council is required to set a balanced annual revenue budget. The timing and nature of income and expenditure within the budget needs to be understood and managed so that cash is available when it is required (**Liquidity**). This is a key function of the Treasury Management operation.

1.2. The second key function is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council. This may involve arranging new or replacement loans or the planned use of cash balances.

1.3. This Treasury Management Strategy for 2020/21 – 2024/25 sets out the Council's approach to ensuring cash flows are adequately planned, with surplus money being invested in low risk counterparties (**Security**), providing access to funds when required (**Liquidity)** before considering optimising investment return (**Yield**).

### Links to other plans and strategies

1.4. This Treasury Management Strategy links to, and is consistent with, the following other plans and strategies:

- Council Plan
- Service Plans & Strategies
- Medium Term Financial Plan
- Capital Strategy

## 2. The principles underpinning the Treasury Strategy

### Background

2.1. The Council's Treasury Management Strategy has been set in line with:

2.1.1. The Local Government Act 2003 (the Act)

2.1.2. The Ministry of Housing, Communities and Local Government (MHCLG) Guidance on Local Government Investments (2018)

2.1.3. MHCLG Capital Finance: guidance on minimum revenue provision (2018)

2.1.4. Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code (2017) and Treasury Management Code of Practice (2017)

2.2. The strategy also has regard to:

2.2.1. The Markets in Financial Instruments Directive II (MIFID II),

2.2.2. International Financial Reporting Standard (IFRS) 9 Financial Instruments

## Key Requirements

2.3. The above requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an annual investment strategy setting out the council's policies on managing its investments and for giving priority to the security and liquidity of those investments.

2.4. This strategy fulfills the following key requirements, setting the:

- **Prudential Indicators;** setting out the expected capital activities and managing its capital finances.
- Council's **Minimum Revenue Provision (MRP) Policy;** which sets out how the Council will pay for capital assets through revenue each year.
- **Treasury Management Strategy Statement;** which sets out how the Council's treasury service will support the capital decisions taken, the day to day treasury management and the limitations on activity through treasury prudential indicators;
- **Investment Strategy;** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss.

This report reflects the budget proposals considered by Council on 20th December 2019 for consultation.

2.5. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to Council. These are as follows:

- **Treasury Management and Investment Strategy -** setting out the expectations for a minimum of three years, linked into the Council's wider budget setting process.
- **A Mid-Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision. This report is incorporated into the Council's quarterly corporate monitoring reports.

- **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.

# 3. Prudential and Treasury Indicators 2020/21 – 2024/25

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

## Capital Expenditure

3.2. This indicator is a summary of the Council's capital expenditure plans based on the current capital programme projections and potential capital expenditure. This is summarised below along with the sources of finance.

**Table 1: Capital expenditure and financing**

| | 2019/20 Estimate £000 | 2020/21 Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|---|---|
| **Capital expenditure** | **7,478.75** | **18,874.70** | **15,926.40** | **5,169.10** | **2,822.00** | **2,983.00** |
| **Financed by:** | | | | | | |
| Capital receipts | 1,521.75 | 4,783.80 | 3,260.00 | 260.00 | 0.00 | 0.00 |
| Grants | 2,231.00 | 5,864.90 | 5,980.00 | 754.10 | 628.00 | 603.00 |
| Revenue and Reserves | 2,570.10 | 2,090.10 | 1,459.90 | 145.00 | 145.00 | 145.00 |
| **Increased borrowing need** | **1,155.90** | **6,135.90** | **5,226.50** | **4,010.00** | **2,049.00** | **2,235.00** |

## The Council's borrowing need

3.3. The Capital Financing Requirement (CFR) represents the Council's underlying need to borrow for a capital purpose. This is different to any actual borrowing. If the Council generates the same amount of resources in a year to meet its capital expenditure requirements, then there is no change to the CFR. However, if the Council spends more than the resources it generates in year, the CFR will increase as in effect the Council has created a borrowing requirement to bridge the gap in the resources it needs and the resources it has.

3.4. Although the CFR does not necessarily reflect actual borrowing taken from an external source, it can reflect the use of internal cash resources, i.e. internal borrowing.

3.5. Where the Council has a positive CFR, i.e. an underlying need to borrow, it must make provision to repay that 'debt'. This is known as Minimum Revenue Provision (MRP). The Council's current policy is set out in the MRP Strategy in part 4 of this report (page 10).

3.6. The current forecast for the CFR and MRP based on the current capital programme is shown in the table below:

**Table 2: CFR projection**

| **Capital Financing Requirement** | **2019/20 Estimate £000** | **2020/21 Estimate £000** | **2021/22 Estimate £000** | **2022/23 Estimate £000** | **2023/24 Estimate £000** | **2024/25 Estimate £000** |
|---|---|---|---|---|---|---|
| CFR opening | 18,354.27 | 18,791.37 | 24,142.57 | 28,118.67 | 30,757.67 | 31,239.87 |
| Add unfinanced capital | 1,155.90 | 6,135.90 | 5,226.50 | 4,010.00 | 2,049.00 | 2,235.00 |
| Less MRP | (718.80) | (784.70) | (1,250.40) | (1,371.00) | (1,566.80) | (1,566.80) |
| **CFR closing** | **18,791.37** | **24,142.57** | **28,118.67** | **30,757.67** | **31,239.87** | **31,908.07** |

## Prudence and Sustainability

3.7. Prudence and sustainability year on year are addressed through the prudential indicators for external debt, which must be set and revised taking into account their affordability.

3.8. External borrowing must not (except in the short term to support operational cash flow) exceed the underlying level of indebtedness (the CFR) and is intended to control any 'borrowing to on-lend' or borrowing to support the revenue account.

3.9. Table 3 confirms that the Council expects to be compliant with this indicator and should remain under-borrowed across the period. The increase in borrowing reflects the prudent assumption that the unfinanced element of the capital programme would be funded through external debt. The revenue budget for interest cost has been prepared on this basis to ensure that these investment plans are affordable. However, the actual cash need may be met from reduced investment balances.

**Table 3: Gross debt and the CFR**

| | 2019/20 Estimate £000 | 2020/21 Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|---|---|
| CFR at 31 March | 18,791.37 | 24,142.57 | 28,118.67 | 30,757.67 | 31,239.87 | 31,908.07 |
| Borrowing at 31 March | 12,800.00 | 13,955.90 | 28,118.67 | 30,757.67 | 31,239.87 | 31,908.07 |
| (Under)/over borrowing | (5,991.37) | (10,186.67) | 0.00 | 0.00 | 0.00 | 0.00 |
| Investments at 31 March | (17,732.39) | (18,418.05) | (22,041.15) | (28,156.55) | (32,620.75) | (37,270.45) |

## Affordability

3.10. The fundamental objective in determining the affordability of the authority's capital plans is to ensure that the total capital investment remains within sustainable limits.

3.11. 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. The estimates are presented in the table below:

**Table 4: Ratio of financing costs to net revenue stream**

| 2019/20 Estimate | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate | 2024/25 Estimate |
|---|---|---|---|---|---|
| 8.22% | 8.53% | 14.99% | 17.76% | 20.60% | 20.85% |

3.12. This shows that the amount of revenue budget spent financing debt is rising over the MTFP period. The main reasons for this trend are:

a. MRP is rising to the level required to sustain the vehicle and plant programme. Older vehicles were grant funded whereas replacement vehicles are financed through borrowing.
b. The net revenue stream (Council Tax, retained rates and non-service grant) is forecast to reduce over the period although reductions in grant are partially offset by increases to income from local taxation. And;
c. Increase in borrowing costs due to new property schemes within the capital programme which are likely to require funding from borrowing, and the decision by Central Government to increase the PWLB premium by 1%.

## Estimates of the incremental impact of capital investment decisions on council tax

3.13. This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the Council's existing approved commitments and current plans. This reflects interest income foregone on the use of reserves and additional costs where schemes are funded by external borrowing.

**Table 5: Incremental impact of capital investment**

| | 2019/20 Estimate | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate | 2023/24 Estimate | 2024/25 Estimate |
|---|---|---|---|---|---|---|
| Council tax - band D | £7.31 | £9.79 | £8.69 | £17.45 | £15.62 | £13.57 |

3.14 The Change shown is reflective of the revised timescales for existing projects and new capital schemes, along with their anticipated use of reserves and potential borrowing requirements. This also shows the impact of rising MRP as discussed in 3.13 above.

## Treasury Indicators for External Debt

3.15. Within the Prudential Code are a number of key treasury management indicators which are focused on gross debt and involve setting limits on external debt.

3.16. The Operational Boundary; is the limit beyond which external debt is not normally expected to exceed. This is set at a level consistent with the borrowing need (CFR).

3.17. The Authorised Limit; reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is a limit on the maximum level of debt, beyond which external debt is prohibited and the limit can only be set or revised by Full Council.

3.18. The Authorised Limit is set as the borrowing need (CFR) plus any anticipated further borrowing that may be required to manage operational cash balances. This may be required, for example, at year end when operational cash balances are at their lowest due to the timing of local taxation collection.

**Table 6: Authorised limit and operational boundary**

| | 2019/20 Estimate £000 | 2020/21 Estimate £000 | 2021/22 Estimate £000 | 2022/23 Estimate £000 | 2023/24 Estimate £000 | 2024/25 Estimate £000 |
|---|---|---|---|---|---|---|
| CFR at 31 March | 18,791.37 | 24,142.57 | 28,118.67 | 30,757.67 | 31,239.87 | 31,908.07 |
| Under borrowing 31 March | (5,991.37) | (10,186.67) | 0.00 | 0.00 | 0.00 | 0.00 |
| Add operational cash limit | 6,215.00 | 6,215.00 | 6,215.00 | 6,215.00 | 6,215.00 | 6,215.00 |
| **Operational boundary** | **18,800.00** | **24,200.00** | **28,200.00** | **30,800.00** | **31,300.00** | **32,000.00** |
| **Authorised limit** | **25,015.00** | **30,415.00** | **34,415.00** | **37,015.00** | **37,515.00** | **38,215.00** |

## Treasury Management Limits on Activity

3.19. In addition to the limits on external debt there are three more debt related treasury activity indicators. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

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

**Table 7: Interest rate exposure limits**

| | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|
| **Interest Rate Exposures** | | | | | |
| **£m Principal** | **Upper** | **Upper** | **Upper** | **Upper** | **Upper** |
| Limits on fixed interest rates based on net debt | Authorised limit | Authorised limit | Authorised limit | Authorised limit | Authorised limit |
| Limits on variable interest rates | | | | | |
| Investments | £20m | £20m | £20m | £20m | £20m |
| Borrowing | £0m | £0m | £0m | £0m | £0m |

| **Maturity Structure of fixed interest rate borrowing 2020/21** | **Lower** | **Upper** |
|---|---|---|
| Under 12 months | 0% | 25% |
| 12 months to 2 years | 0% | 25% |
| 2 to 5 years | 0% | 25% |
| 5 to 10 years | 0% | 100% |
| 10 to 20 years | 0% | 100% |
| 20 to 30 years | 0% | 100% |
| 30 to 40 years | 0% | 100% |
| 40 years and above | 0% | 100% |

## Other indicators

3.20. The Council has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectorial Guidance Notes.

3.21. As part of this it also adopts the following four clauses

1. The Council will create and maintain, as the cornerstones for effective treasury management:

   - A treasury management policy statement, slating the polices, objectives and approach to risk management of its treasury management activity (this report)

   - Suitable treasury management practices (TMPs), setting the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control these activities.

2. Full Council will receive reports on the treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in the TMPs

3. The Council delegates responsibility for the implementations and regular monitoring of its treasury management policies and practices to Cabinet/Full Council and for the executing and administration of treasury management decisions to the Lead Finance Specialist and Section 151 Officer, who will act in accordance with the Councils policy statement and if they are a CIPFA member with CIPFA's Standard of Professional Practice on Treasury Management.

4. The Council nominates Overview and Scrutiny Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and polices.

## 4. Minimum Revenue Provision (MRP) Policy Statement

4.1. The Council is 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).

4.2. MHCLG Regulations have been issued which require the full Council 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. The Council is recommended to approve the following MRP Statement.

4.3. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Previous practice** - MRP will follow the practice outlined in former CLG regulations (option 1); this option provides for an approximate 4% reduction in the borrowing need (CFR) each year on eligible debt.

4.4. From 1 April 2008 for all unsupported borrowing (including Private Finance Initiative and finance leases) the MRP policy will be

- **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

  This method allows for annual payment to be calculated as equal instalments or set as an annuity (increasing payments) over the life of the asset. The exact repayment calculation will be determined on a case by case basis.

- **For Finance leases,** the MRP will be calculated to match the capital repayment identified within the annual lease payments.

For assets under constructions MRP will not be applied until the earlier of entering external borrowing or when the asset comes into use. However if there is expected to be a significant delay between expenditure and the asset coming into use then we will consider, on a case by case basis, applying MRP sooner.

## 5. Treasury Management Policy Statement

5.1. This organisation defines its treasury management activities as:

5.2. "The management of the 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".

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

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

## 6. Economic Background and prospects for Interest Rates

6.1. The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

6.2. It is important to note that interest rate projections are estimates at a point in time and are subject to constant revision. However, in terms of managing interest rate risk, it is important to be aware of expert opinion around the magnitude, timings and direction of travel on rates. Link Asset Services' view on rates is presented in the table below:

| Link Asset Services Interest Rate View | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Mar-23 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 1.00 | 1.00 | 1.00 | 1.00 | 1.00 | 1.25 | 1.25 | 1.25 | 1.25 |
| 5yr PWLB Rate | 2.30 | 2.40 | 2.40 | 2.50 | 2.50 | 2.60 | 2.70 | 2.80 | 2.90 | 2.90 | 3.00 | 3.10 | 3.20 | 3.20 |
| 10yr PWLB Rate | 2.60 | 2.70 | 2.70 | 2.70 | 2.80 | 2.90 | 3.00 | 3.10 | 3.20 | 3.20 | 3.30 | 3.30 | 3.40 | 3.50 |
| 25yr PWLB Rate | 3.20 | 3.30 | 3.40 | 3.40 | 3.50 | 3.60 | 3.70 | 3.70 | 3.80 | 3.90 | 4.00 | 4.00 | 4.10 | 4.10 |
| 50yr PWLB Rate | 3.10 | 3.20 | 3.30 | 3.30 | 3.40 | 3.50 | 3.60 | 3.60 | 3.70 | 3.80 | 3.90 | 3.90 | 4.00 | 4.00 |

6.3. The above forecasts takes account of the recent increase in PWLB rate margin by 1% on 9 October 2019 and assumes that a deal on Brexit, including agreement on the terms of trade between the UK and EU will take place at some point in time.

6.4. So far this year the Monetary Policy Committee (MPC) of the Bank of England has held the Bank Rate at 0.75%, as uncertainty continued to ebb and flow in 2019. With the expectation that uncertainty should start dissipating during 2020 the next rate rise is currently forecast to be in March 2021 to 1%.

6.5. UK inflations as measured by the Consumer Price index (CPI) has fell to 1.5% in October 2019 from 2.4% in October 2018. Inflation is forecasted to remain close to or under 2% over the next two years and so does not pose any immediate concern to the MPC at the current time.

6.6. Unemployment is currently back at its 44 year low of 3.8%, Wage inflation has recently also started to edge down and in September 2019 was at 3.6%. Real earnings growth is currently circa 2.1%.

6.7. The overall longer run future trend for gilt yields and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geo-political matters, a sovereign debt crisis, emerging market developments or sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.

6.8. 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.

## 7. Current Portfolio position

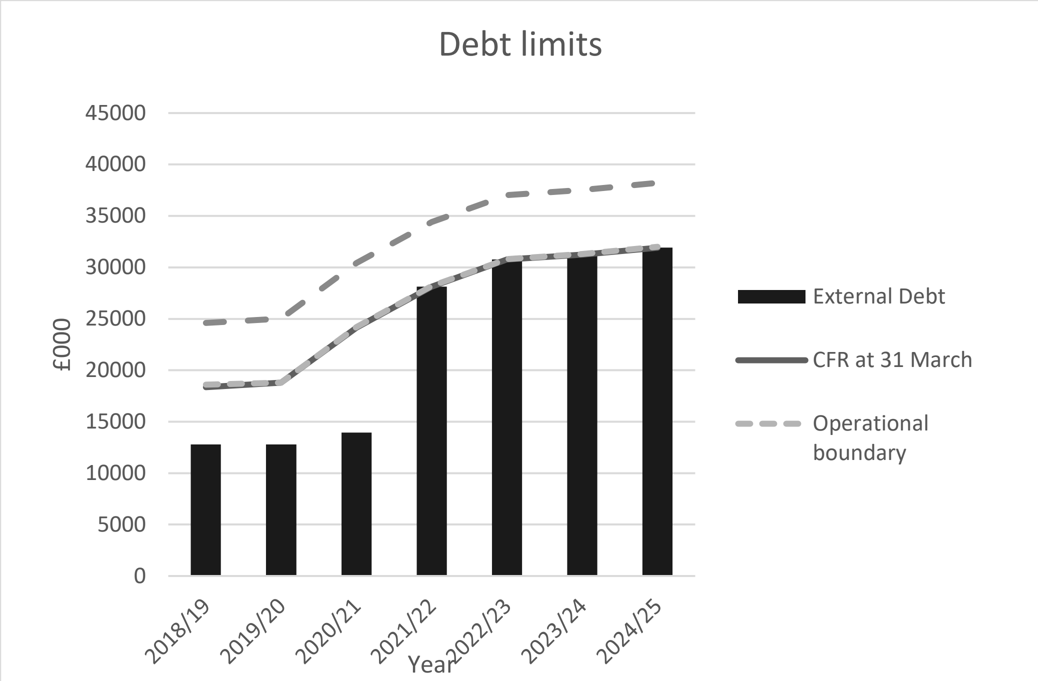
7.1. The Council currently has borrowings of £12.8 million from the Public Works Loans Board at an average rate of 4.3% with the first maturity not due until 2046/47.

7.2. As at 12/12/2018, the council had £39.8 million invested, made up of £28.8 million of operational cash balances and £11 million of core cash balances. Operational balances relate to short term cash management, whereas the core cash balances reflect longer term strategic resources (such as the General Fund balance and useable capital receipts).

## 8. Borrowing Strategy

8.1. Chart 1 below brings to together and shows the Council's external debt position, Capital Financing Requirement and debt limits together.

**Chart 1 Borrowing v Debt limits**




8.2. The Council is currently maintaining an under-borrowed position, where borrowing is lower than the Capital Financing Requirement (CFR). As a result we are using internal cash balances to fund the capital program. This is estimated to be £5.6 million in 2019/20.

8.3. To put this into perspective the Annual Accounts for 2018/19 shows the Council has £24.6 million in useable reserves. Assuming the level of reserves stay the same, then we are currently using 23% of cash supporting the reserves for internal borrowing to support the capital programme.

8.4. The policy of avoiding new borrowing and minimising cash balances has been a prudent strategy while investment returns are low, helping to keep borrowing costs down and minimising counterparty risk. This policy will be kept under review to manage the risk of changes to the availability of internal cash and future borrowing costs.

8.5. The projections include an assumption that the "under borrowing" will be reversed in 2021/22. This is to ensure that the medium term projections are prudent, it does not mean that the Council will definitely borrow (up to the CFR) in that year.

8.6. As required by the Prudential Code, the MTFP reflects the cost of potential further borrowing and sufficient budget is available to ensure that, if requried, an increased borrowing requirement is affordable.

## Policy on Borrowing

8.7. The Lead Finance Specialist will continue to mnitor the Councils borrowing position through out the year and will respond to changing circumstances, and any decisions taken will be reported to members at the next available opportunity.

8.8. When considering whether to borrow or not for capital schemes the following factors will be considered:

8.8.1. Is it new or significant refurbishment of property or for the vehicle and plant programme? If yes then borrow.

8.8.2. Maximum duration of borrowing undertaken will not exceed useful life of asset.

8.8.3. Consideration will be given to staggering maturities where amount borrowed exceeds £1 million.

8.8.4. Staggered maturities will also be considered when/if reversing the under borrowed position.

8.8.5. Borrowing will be in the form annuity or equal installment of principal (EIP) loans.

8.9. Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 basis points to 180 bps on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:

8.9.1. Local authorities (primarily shorter dated maturities)
8.9.2. Financial institutions (primarily insurance companies and pension funds but also some banks)
8.9.3. Municipal Bonds Agency (no issuance at present but there is potential)

The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing but our advisors will keep us informed.

## Policy on Borrowing in Advance of Need

8.10. The Council will not borrow in advance of its needs in order to on lend. Any decision to borrow will be within the approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated, and that gross long term borrowing will not exceed the CFR.

8.11. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the five year planning period and then only where there is sufficient certainty that expenditure will be incurred to prevent borrowing exceeding the CFR at any year end within the planning period; and
- The Council would not look to borrow more than 6 months in advance of need.

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

## 9. Investment Strategy

9.1. As a holder of public funds, the Council recognises its responsibility to the prudent management of public funds, and follows relevant Government and CIPFA guidance.

9.2. The Council's overiding policy objective is to prudently manage council funds; ensuring risks are minimised whilst maximising returns. The Councils investment priorities, in order, are:

- **S**ecurity of the invested capital
- **L**iquidity of the invested capital
- **Y**ield (return on investment), which is in line with security and liquidity

9.3. In order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk.

### Investment Counterparty Selection Criteria

9.4. The Finance Lead Specialist and Section 151 Officer, will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria provide an overall pool of counterparties considered high quality which the Council may use.

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

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

9.6. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of bands which indicate the relative creditworthiness of counterparties and provide a suggested duration for investments.

9.7. The Council will apply a duration overlay to banks selected under the credit worthiness service, such that the investment duration will be the lessor of 1 year for UK banks, or 190 days for non Uk banks, and Links's suggested duration with the exception of part nationlised banks.

9.8. With the exception of the UK, the minimum soverign rating is AAA by 2 out 3 of the main rating agencies. The minimum counterparty credit rating criteria is a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-.

9.9. In addition the the council will also invest in;

- Building Societies
- Multilateral Development Banks and Supranational Organisations
- Money Market Funds
- Other collective investment schemes

provided they meet the criteria laid out in Table 5 Counterparty limits.

9.10. Sole reliance will not be placed on the use of Link's external service. In additon the Council will also use market information, economic data and information on any external support for banks to help support its decision making process.

9.11. The time and monetary limits for institutions on the Council's counterparty list are as follows:

9.12. **Table 8: Counterparty limits**

| | **Criteria** | **Money Limit** | **Time Limit** |
|---|---|---|---|
| UK Banks | Yellow, Purple, Blue or Orange | £3m | 1 year |
| UK Banks | Red | £3m | 6 Months |
| UK Banks | Green | £3m | 100 Days |
| Non UK Banks | Yellow, Purple, Blue or Orange | £3m | 190 Days |
| Non UK Banks | Red | £3m | 6 Months |
| Non UK Banks | Green | £3m | 100 Days |
| Banks | No colour | £0m | n/a |
| Building Societies | Top 5 by Asset size and assets> £2 billion | £3m | 6 months |
| Building Societies | Top 6-10 by Asset size and assets> £2 billion | £2m | 6 months |

| | Criteria | Money Limit | Time Limit |
|---|---|---|---|
| Debt Management Account Deposit Facility - DMADF | n/a | Unlimited | 6 months |
| UK Gilts, Treasury Bills | n/a | Unlimited | 5 years |
| Local Authorities | n/a | £5m | 2 years |
| Money Market Funds<br>- LVNAV<br>- CNAV Government Funds | AAA | £5m | Liquid |
| Multilateral Development Banks and Supranational Organisations | AAA | £3m | 2 years |
| Other Collective Investment Schemes e.g. Enhanced Money Market Funds & Bond Funds | AAA S1/V1 | £2m | 1 year |

9.13. The Council is alerted to changes to ratings of all three agencies through its use of the Link's credit worthiness service. In addition a full review will be carried out at least monthly.

9.14. In the event of a downgrade resulting in a counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use for new investments will be withdrawn immediately.

9.15. Any changes in counterparty ratings or other criteria that put the counterparty below the minimum criteria, whilst holding a deposit for the Council, will be brought to the attention of the Finance Lead Specialist and Section 151 Officer and the Portfolio Holder with responsibility for Finance. Further action will be decided on a case-by-case basis.

9.16. Specified investments are investments less than 1 year in duration meeting the criteria for high quality above.

9.17. Non specified investments are all investments with a duration of 1 year or greater and/or not meeting the definition of high credit quality. A maximum of 75% of investments can be non-specified.

9.18. A copy of the Council's counterparty list under the above criteria is attached as **Appendix 2**

## Other Considerations

9.19. In addition to the credit criteria, due care will be taken to consider the country, group and sector exposure of the Council's investments.

9.20. In part the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition no more than £3 million will be placed with counterparties from any one non-UK country at any one time up to a maximum of £9 million being held in non UK countries at any one time (excluding Money Market Funds, Multilateral Development Banks and Supranational Institutions and Collective Investment Schemes).

9.21. Limits in place above will apply to a group of companies

9.22. Sector limits will be monitored regularly for appropriateness, to help mitigate against concentration risk. This is the risk of having a significant proportion of your investments in one sector of the market and that sector failing

9.23. To ensure sufficient liquidity, detailed cash flow forecasts will be kept by the financial services team to give as accurate a picture as possible of the movement and timing of income & expenditure and the resulting daily cash balances.

9.24. When placing investments, officers will refer to the cash flow forecast to determine the best duration for the investment.

9.25. Funds invested for greater than 365 days are set with regard to the Council's security and liquidity requirements. They are based on the lowest expected availability of funds after each year-end (ie the core balances) within the five year plan. To allow longer term investment of the core balances, subject to satisfying security and liquidity, the Council is asked to approve the treasury indicator and limit:-

**Table 9 Maximum principal sums invested for more than 365days**

| £m | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 |
|---|---|---|---|---|---|
| Principal sums invested > 365 days | £12m | £12m | £12m | £12m | £12m |

9.26. When placing investments the Council will seek to optimise returns commensurate with the management of the associated risks, limiting its investment activities to the approved financial instruments. The financial instruments authorised for use by officers are;

a. Fixed Deposits; deposits at a fixed interest rate for a fixed duration.

b. Certificate of Deposits; similar to fixed deposits but tradeable in a secondary market

c. Government Treasury Bills & Gilts; UK Government debt instruments

d. Call accounts; instant access accounts with banks at a variable interest rate,

e. Notice accounts; Savings accounts where by we have to give the bank/building society notice to withdraw our money.

f. Money Market Funds; collective investment accounts with a Low Volatility Net Asset Value) LVNAV or constant net asset value, generally these allow investors instant access and have a variable interest rate.

g. Other Collective Investment Schemes; similar to money market funds these are funds with a variable net asset value, which can invest in a wider range of instruments. These are generally instruments whereby the Council would invest for longer periods and receive a greater return over time, though the value of the fund can modestly fluctuate.

9.27. Under the Markets in Financial Derivatives 2 (MIFID II) directive the Council is classified as a retail investor with the option to opt-up to professional status, provide certain conditions are met. The Council meets these conditions and has decided to Opt-up to Professional Status to maintain the level of access to the money markets it has always had.

## 10. Non Treasury Management Investments

10.1. Some investments are taken out for non-treasury management purposes, and these are held primarily or partially to generate a profit. Examples of this include investment properties and loans supporting service outcomes.

### Investment Properties

10.2. The Council has 23 Investment properties including retails units and industrial sites. Which at 31st March 2019 had a value of £4.59 million and after expenses earned the council £0.406 million in income, creating a return on investment of 8.85% overall. This will vary year on year depending on maintenance required.

10.3. As part of the changes to the Treasury and Prudential Codes of Practice and the MHCLG guidance a list of non-treasury investments is being compiled and will be kept up-to-date.

10.4. In the future such investments will have to go through a robust procedure to ensure that they fit in with the council's plans, are affordable and sustainable. The principles of the procedure are:

- Ensuring the investment meets the councils risk profile
- Ensuring the portfolio of assets is prudently balanced to minimise risk of income fluctuations and loss of capital value.
- Ensuring the rate of return exceeds that which could be achieved through traditional sources of investments
- Establishing a comprehensive due diligence process to minimise risks including use of specialist external advice where appropriate
- Establishing appropriate governance arrangements to ensure decisions are made in a streamlined and efficient way.

### Service Loans

10.5. The Council makes loans for a number of reasons primarily economic development and investment objectives or to help meet other Council priorities. These are often outside of normal commercial terms The Council in making these loans ensure they are prudent and secured by:

- Carrying out a full independent due diligence exercise
- Using an expected loss model to assess the impact on the balance budget requirement if the loan was at risk
- On-going monitoring of the loans
- Ensuring adequate security is in place
- The financial exposure of the Council is proportionate to its size.

- All loans are agreed by the Council's Cabinet

10.6. The loans are accounted for as soft loans and the Council's accounting policy on soft loans is described in the Accounting Policies of the Statement of Accounts.

10.7. The balance outstanding of these loans as at 31st March 2019 was £51,056.

10.8. Once such loan that the Council has agreed to make is to South Lakes Housing and other housing providers. The aim of the loan is to provide low cost finance in order to enable a house building programme to meet the Council Plan target of delivering 1000 affordable homes for rent. A loan of £6m over 25 years has been agreed in principle by the Council's Cabinet.

## Commercial Activity

10.9. The Council is also developing a Commercial Strategy because reductions in funding mean the Council Should look at whether it is appropriate to engage in commercial activities to supplement its income and support service delivery. However, to minimise risk of potential loss of income in the longer term it needs to ensure that any investment opportunities are based upon sound decision making that consider the future likelihood of investment income reducing.

## 11. Knowledge and Skills

11.1. The Council utilises the knowledge and skills of its internal officers when considering treasury investment and borrowing decisions and where necessary it also relies on the expert knowledge of specialist external advisors.

### Staff

11.2. Finance staff are professionally qualified to advise the Council on all areas of finance. Included within the team is an officer with specialist knowledge of Treasury Management. All finance staff undertake Continuous Professional Development and they maintain knowledge and skills through regular technical updates from appropriate bodies and attending specialist courses.

11.3. Staff follow Treasury management Practices (TMP) approved by the Finance Lead Specialist and Section 151 Officer.

### Members

11.4. Training is given to Overview and Scrutiny Committee on treasury management, this training annually, this training is also open to all members to assist in their understanding of the treasury management strategy

### External Advice

11.5. The Council has appointed Link Asset Services as it treasury advisors and part of their service is to assist the Council to formulate a view on interest rates.

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

11.7. It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council 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

## 12. Review and monitoring of the Treasury Management Strategy

12.1. This Treasury Management Strategy is based on the proposed Budget and Capital Programme for 2020/21 to 2024/25 which will be approved by Council on the 25th February 2020. The strategy will be monitored and reviewed throughout the financial year and may be updated if required.