Agenda Item 11

The report is Not Exempt	
The report is for Decision	
REPORT TO: FIRE AUTHORITY	**MEETING DATE: 18 March 2019**

SUBJECT:
TREASURY MANAGEMENT STRATEGY STATEMENT 2019-20

SUMMARY:

Prior to the start of the financial year, the Fire and Rescue Authority is required to approve its Treasury Management Strategy Statement for that year.

The Treasury Management Strategy Statement (TMSS) sets out Background, Capital Prudential Indicators including Minimum Revenue Provision Policy, Borrowing, and Annual Invest Strategy. Included within the TMSS are the Prudential Indicators and Treasury Management Indicators.

RECOMMENDATIONS:
That the Fire Authority approves the Treasury Management Strategy Statement for 2019-20.

REPORT APPROVAL	
Clerk:	**Comments:** Approved **Date:** 11.03.19
Director:	**Comments:** Approved **Date:** 08.03.19
Finance/Treasurer:	**Comments:** Approved **Date:** 11.03.19
Chief Fire Officer	**Comments:** Approved **Date:** 10.03.19

BACKGROUND PAPERS USED IN PREPARATION OF THIS REPORT:
Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (CIPFA);
The Prudential Code for Capital Finance in Local Authorities (CIPFA);
The Prudential Indicators.

Presenting the Report:	Chris Moore, Section 151 Officer
Report Author(s) and Designation	Sarah Mansbridge Head of Finance
Date original report written	22/02/2019

Eitem 11 ar yr Agenda

Mae'r adroddiad Heb ei Eithrio	
Mae'r adroddiad ar gyfer Penderfyniad	
ADRODDIAD I: YR AWDURDOD TAN	**DYDDIAD Y CYFARFOD: 18 MAWRTH 2019**

PWNC: DATGANIAD SATRATEGAETH RHEOLI'R TRYSORLYS 2019-20

CRYNODEB:

Cyn dechrau'r flwyddyn ariannol, mae'n ofynnol i'r Awdurdod Tân ac Achub gymeradwyo Datganiad Strategaeth Rheoli'r Trysorlys ar gyfer y flwyddyn honno.

Mae Datganiad Strategaeth Rheoli'r Trysorlys yn nodi'r Cefndir, Dangosyddion Darbodus y Cyfalaf gan gynnwys y Polisi Darpariaeth Isafswm Refeniw, Benthyca, a'r Strategaeth Fuddsoddi Flynyddol. Wedi'u cynnwys yn y Datganiad hwn mae'r Dangosyddion Darbodus a'r Dangosyddion Rheoli'r Trysorlys.

ARGYMHELLION:

Bod y Pwyllgor Rheoli Adnoddau yn argymell i'r Awdurdod Tân gymeradwyo Datganiad Strategaeth Rheoli'r Trysorlys ar gyfer 2019-20.

CYMERADWYO'R ADRODDIAD	
Clerc:	**Sylwadau: Cymeradwywyd** **Dyddiad:**
Cyfarwyddwr:	**Sylwadau: Cymeradwywyd** **Dyddiad:**
Cyllid/Trysorydd:	**Sylwadau: Cymeradwywyd** **Dyddiad:**
Prif Swyddog Tân	**Sylwadau: Cymeradwywyd** **Dyddiad:**

PAPURAU CEFNDIR A DDEFNYDDIWYD WRTH BARATOI'R ADRODDIAD HWN:

a) Rheoli'r Trysorlys yn y Gwasanaethau Cyhoeddus : Cod Ymarfer a Nodiadau Canllaw ar draws y sectorau (Sefydliad Siartredig Cyllid Cyhoeddus a Chyfrifyddiaeth –CIPFA)
b) Y Cod Darbodus ar gyfer Cyllid Cyfalaf mewn Awdurdodau Lleol (CIPFA)
c) Y Dangosyddion Darbodus

Yn cyflwyno'r Adroddiad:	Chris Moore Swyddog Adran 151
Awdur(on) yr Adroddiad a'u Swyddi	Sarah Mansbridge Pennaeth Cyllid
Dyddiad yr ysgrifennwyd yr adroddiad gwreiddiol	22/02/2019

FIRE AUTHORITY
18th MARCH 2019
TREASURY MANAGEMENT STRATEGY STATEMENT 2019-20

1 Summary

1.1 Prior to the start of the financial year, the Fire and Rescue Authority is required to approve its Treasury Management Strategy Statement for that year.

1.2 The Treasury Management Strategy Statement (TMSS) sets out Background, Capital Prudential Indicators including Minimum Revenue Provision Policy, Borrowing, and Annual Invest Strategy. Included within the TMSS are the Prudential Indicators and Treasury Management Indicators.

2 National/Wales Position

2.1 All Local Authorities and Fire and Rescue Authorities are required by statute to approve their Treasury Management Policy and Strategy each year.

3 Mid and West Wales Fire and Rescue Service Current Position

3.1 The current Treasury Management Strategy Statement covers the period 1 April 2018 to 31 March 2019. The new Treasury Management Strategy Statement cover the period 1 April 2019 to 31 March 2020.

3.2 The Treasury Management Strategy Statement were drafted in accordance with the versions of the CIPFA Codes and Guidance in force at that time.

4 Proposal

4.1 The proposed Treasury Management Strategy Statement for 2019-20 is set out in Appendix 1.

5 Financial/Procurement Implications

5.1 The Treasury Management Strategy Statement sets out the limits and controls to be applied when borrowing and investing funds.

5.2 The Capital Prudential Indicators show the financial impact of capital expenditure decisions so that it can be assessed if those decisions are affordable, prudent, and sustainable.

5.3 The Treasury Management Prudential Indicators set constraints on Treasury Management decisions to ensure that they are made in accordance with good practice.

5.4 The Minimum Revenue Provision (MRP) Policy determines how the Authority will determine the amount that must be set aside from revenue each year to repay external debt.

6 Risk Assessment/Legal Implications

6.1 The approval of the TMSS is a statutory requirement. It forms part of the financial governance arrangements as it sets out the controls over managing the cash flow within the Service and the way the Service manages the borrowing and investment of cash.

6.2 Failure to adhere to the indicators as set out in the strategy could lead to overspends, cash being unavailable to meet liabilities as they fall due, and capital projects becoming unaffordable.

7 Equality and Diversity Including Welsh Language

7.1 Considered not relevant.

8 Human Resource and People Development

8.1 Considered not relevant.

9 Information and Communications Technology (ICT)

9.1 Considered not relevant.

10 Estates

10.1 Considered not relevant.

11 Service Delivery

11.1 Not considered relevant.

12 Fire Authority Governance

12.1 The approval of the TMSS is a statutory requirement. It forms part of the financial governance arrangements as it sets out the controls over managing the cash flow within the Service, it sets out controls in the way the Service manages the borrowing and investment of cash.

12.2 The Prudential Indicators are one of the statutory requirements to ensure good governance of the Fire Authority.

13 Consultation & Communication

13.1 The TMSS have been considered by senior officers.

14 Evaluation

14.1 Considered not relevant.

15 Well-being of Future Generations (Wales) Act 2015

15.1 The TMSS ensures the Authority operates a balanced budget and the Authority's Capital Programme is affordable, prudent and sustainable.

16 Data Protection and Privacy Issues

16.1 The report does not involve any personal data. There are no General Data Protection Regulation (GDPR) or Data Privacy issues to report.

17 Recommendations

17.1 That the Fire Authority approves the Treasury Management Strategy Statement for 2019-20.

Mid and West Wales Fire and Rescue Authority

Treasury Management Strategy Statement (TMSS) 2019/20
Minimum Revenue Policy Statement and Annual Investment Statement

1. Introduction

1.1 Background

The Mid and West Wales Fire and Rescue Authority (the Authority) is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Authority's low risk appetite, providing adequate liquidity initially before considering investment return.

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

The Authority has fully adopted the CIPFA Code of Practice on Treasury Management. CIPFA defines treasury management as:

> *"The management of the authority's borrowing, investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."*

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

This authority has not engaged in any commercial investments and has no non-treasury investments.

1.2 Reporting requirements

1.2.1 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, which will provide the following:

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

The aim of this capital strategy is to ensure that all elected members on the Authority fully understand the overall long-term policy objectives and resulting capital strategy requirements, governance procedures and risk appetite.

1.2.2 Treasury Management reporting

The Authority is currently required to receive and approve, as a minimum, three main treasury reports each year, which incorporate a variety of policies, estimates and actuals.

a. **Prudential and treasury indicators and treasury strategy** (this report) - The first, and most important report is forward looking and 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).

b. **A mid-year treasury management report** – This is primarily a progress report and will update members on the capital position, amending prudential indicators as necessary, and whether any policies require revision.

c. **An annual treasury report** – This is a backward-looking review document and 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 adequately scrutinised before being recommended to the Fire Authority. This role is undertaken by the Resources Management Committee.

1.3 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 Authority;
- 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, Welsh Government MRP Guidance, the CIPFA Treasury Management Code and Welsh Government Investment Guidance.

1.4 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. Treasury Management training was undertaken by members in 2017 and further training will be arranged as required.

The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management consultants

The Authority uses Link Asset Services, Treasury solutions as its external treasury management advisors.

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

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 Authority 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.

2 The Capital Prudential Indicators 2019/20 – 2021/22

The Authority's 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.

2.1 Capital expenditure

This prudential indicator is a summary of the Authority's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to note the capital expenditure forecasts as approved by the Fire Authority in February 2019:

Capital Expenditure	2017/18 Actual £000s	2018/19 Revised Estimate £000s	2019/20 Estimate £000s	2020/21 Indicative £000s	2021/22 Indicative £000s
Total	**6,041**	**5,421**	**13,143**	**11,272**	**6,828**

The most significant element of this forecast requirement is due to the replacement of existing fire appliances and pumps.

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

Financing of capital expenditure	2017/18 Actual £000s	2018/19 Revised Estimate £000s	2019/20 Estimate £000s	2020/21 Indicative £000s	2021/22 Indicative £000s
Capital receipts	21	0	125	200	500
Capital grants	862	56	0		
Capital contributions	107	84	61	61	61
Capital donations	10	0	0	0	0
Capital reserves	1,320	0	1,000	0	0
Net financing need for the year	**3,721**	**5,281**	**11,957**	**11,011**	**6,267**

Members should note that the 2019/20 figures represent firm spending plans whilst outer years are indicative only and should only be used as a guide.

2.2 The Authority's borrowing need - the Capital Financing Requirement

The second prudential indicator is the Authority's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Authority's indebtedness and so its underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, 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 indebtedness in line with each assets' life, and so charges the economic consumption of capital assets as they are used.

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

The Authority is asked to approve the CFR projections below:

Capital Financing Requirement	**2017/18 Actual £000s**	**2018/19 Revised Estimate £000s**	**2019/20 Estimate £000s**	**2020/21 Indicative £000s**	**2021/22 Indicative £000s**
Opening CFR	24,096	25,955	29,293	38,816	46,153
Movement in CFR represented by:					
Net financing need for the year	3,721	5,281	11,957	11,011	6,267
Less MRP/VRP	(1.862)	(1,943)	(2,434)	(3,674)	(4,537)
Movement in CFR	1,859	3,338	9,523	7,337	1,730
Closing CFR	**25,955**	**29,293**	**38,816**	**46,153**	**47,883**

2.3 Minimum Revenue Provision policy statement

The Authority 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), although it is also allowed to undertake additional voluntary payments if required (Voluntary Revenue Provision - VRP).

Welsh Government regulations have been issued which require the full Authority to approve an MRP Statement in advance of each year. A variety of options are provided to Authorities, so long as there is a prudent provision. The Authority is recommended to approve the following MRP Statement:

- For capital expenditure incurred before or on 31st March 2009 – the Regulatory Method as outlined in Welsh Government regulation (option 1). This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.
- For expenditure incurred on or after 1st April 2009 funded by loan – the Asset Life Equal Instalments method (Regulation Option 3). The first charge to be made in the year after the asset comes in to use.
- For expenditure incurred on or after 1st April 2009 funded by finance lease – the Asset Life Annuity method. The first charge to be made in the year the first lease rental is payable. Repayments included in finance leases are applied as MRP.

2.4 Affordability prudential indicators

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

Ratio of financing costs to net revenue stream	2017/18 Actual %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
Total	5.38	5.50	6.54	9.95	12.39

The estimates of financing costs include current commitments and the indicative proposals in this budget report. The 2019/20 revenue budget contains sufficient capacity to meet the borrowing requirements of the capital programme. For future years, any spending commitments which would increase the revenue budget requirement would require explicit Fire Authority Approval.

The potential increases from 2020/21 and beyond will require either a reprioritisation of budget areas, additional grant funding or an increase in constituent authorities levies.

3 Borrowing

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

3.1 Current portfolio position

The overall treasury management portfolio as at 31 March 2018 and for the position as at 31st January 2018 are shown below for both borrowing and investments.

Treasury Portfolio	Actual 31st March 2018		Actual 31st January 2019	
	£000s	%age	£000s	%age
Investments:				
Bank	1,720	46%	2,850	42%
Treasury deposits	2,000	54%	4,000	58%
Total Investments	**3,720**	**100%**	**6,850**	**100%**
External Borrowing:				
PWLB	(16,185)	76%	(17,056)	79%
Invest to save	(344)	2%	(123)	1%
Finance Leases	(4,819)	22%	(4,407)	20%
Total External Borrowing	**(21,348)**	**100%**	**(21,586)**	**100%**
Net Investments / (Borrowings)	**(17,628)**		**(14,736)**	

The Authority's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing need, (CFR), highlighting any over or under borrowing.

External Debt as at 31st March	2017/18 Actual £000s	2018/19 Revised Estimate £000s	2019/20 Estimate £000s	2020/21 Indicative £000s	2021/22 Indicative £000s
External Borrowing	16,185	16,936	27,000	37,700	43,700
Other long-term liabilities (OLTL)	5,163	4,213	3,452	2,925	2,518
Total External Debt	**21,348**	**21,149**	**30,452**	**40,625**	**46,218**
Capital Financing Requirement	25,955	29,293	38,.816	46,153	47,883
Under / (over) borrowing	**4,607**	**8,144**	**8,364**	**5,528**	**1,665**

Within the range of prudential indicators there are a number of key indicators to ensure that the Authority operates its activities within well-defined limits. One of these is that the Authority needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2019/20 and the following two financial years. This allows some flexibility for limited early borrowing for future years but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Head of Finance reports that the Authority 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 the budget report.

3.2 Treasury Indicators: limits to borrowing activity

The Operational Boundary

This is the limit beyond 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.

Operational boundary	2018/19 Estimate £000s	2018/19 Revised Estimate £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
Debt	28,300	17,810	29,000	40,400	46,700
Other long-term liabilities	4,200	4,090	3,500	3,000	2,500
Total	32,500	21,900	32,500	43,400	49,200

The Authorised Limit for external debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Authority. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all Authority's plans, or those of a specific Authority, although this power has not yet been exercised.

The Authority is asked to approve the following Authorised Limit:

Authorised Limit	2018/19 Estimate £000s	2018/19 Revised Estimate £000s	2019/20 Estimate £000s	2020/21 Estimate £000s	2021/22 Estimate £000s
Debt	29,700	18,700	30,500	42,400	49,000
Other long-term liabilities	4,400	4,300	3,700	3,200	2,700
Total	34,100	23,000	34,200	45,600	51,700

3.3 Prospects for interest rates

The Authority has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Authority to formulate a view on interest rates. The following table provided by Link Asset Services 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 2018 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 became increasingly strong during 2018 until slowing significantly during the last quarter. At their November quarterly Inflation Report 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. On a major assumption that Parliament and the EU agree a Brexit deal in the first quarter of 2019, then the next increase in Bank Rate is forecast to be in May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022.

The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. However, over about the last 25 years, we have been through a period of falling bond yields as inflation subsided to, and then stabilised at, much lower levels than before, and supported by central banks implementing substantial quantitative easing purchases of government and other debt after the financial crash of 2008. Quantitative easing, conversely, also caused a rise in equity values as investors searched for higher returns and purchased riskier assets. In 2016, we saw the start of a reversal of this trend with a sharp rise in bond yields after the US Presidential election in November 2016, with yields then rising further as a result of the big increase in the US government deficit aimed at stimulating even stronger economic growth. That policy change also created concerns around a significant rise in inflationary pressures in an economy which was already running at remarkably low levels of unemployment. Unsurprisingly, the Fed has continued on its series of robust responses to combat its perception of rising inflationary pressures by repeatedly increasing the Fed rate to reach 2.25 – 2.50% in December 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 therefore saw US 10 year bond Treasury yields rise above 3.2% during October 2018 and also investors causing a sharp fall in equity prices as they sold out of holding riskier assets. However, by early January 2019, US 10 year bond yields had fallen back considerably on fears that the Fed was being too aggressive in raising interest rates and was going to cause a recession. Equity prices have been very volatile on alternating good and bad news during this period.

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 while they were on a rising trend during the first half of the year, they have backtracked since then until early January. 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.

3.4 Borrowing strategy

The Authority is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Authority's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is 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 Head of Finance 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. Most likely, fixed rate funding will be drawn whilst interest rates are 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.

In determining whether further borrowing will be undertaken the Authority shall:

- ensure that long term borrowing is required to fund the CFR;
- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest bases available, the most appropriate periods to fund and repayment profiles to use;
- consider internal borrowing.

3.5 Policy on borrowing in advance of need

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

3.6 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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

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

3.7 Treasury indicators for debt

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments. It is recommended that the Authority sets an upper limit on its variable interest rate exposures for 2018/19, 2019/20 and 2020/21 of 5% of its net outstanding principal sums.
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates; It is recommended that the Authority sets an upper limit on its fixed interest rate exposures for 2018/19, 2019/20 and 2020/21 of 120% of its net outstanding principal sums.
- Maturity structure of borrowing. These gross limits are set to reduce the Authority's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits:

Maturity Period	Lower	Upper
Under 12 months	0%	30%
12 months to 2 years	0%	30%
2 years to 5 years	0%	50%
5 years to 10 years	0%	75%
10 years and above	25%	90%

4 Annual Investment Strategy

4.1 Investment policy

The Authority's investment policy has regard to the following:

- The Welsh Government'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 Authority's investment priorities will be security first, portfolio liquidity second and then yield (return).

The above guidance from the Welsh Government and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

1. 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.

2. **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 Council will engage with its advisors to maintain a monitor on market pricing such as **"credit default swaps"** and overlay that information on top of the credit ratings.

3. **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.

4. This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use.

    - **Specified investments**

    These are investments which are ranked as low risk because the possibility of loss of principal or investment income is low. Under this policy they comprise of all deposits having fixed interest rates of under 364 days duration made with:

    - The UK Government
    - A Local Authority
    - Part-nationalised UK registered banks
    - UK registered resident banks and building societies.

- **Non-specified investments**

  Non-specified investments are any other type of investment not meeting the above definition and which by implication carry a higher risk having variable interest rates and/or being for longer than 364 days duration. Under this policy it is proposed they are defined as all such deposits placed with:

  - The UK Government
  - A Local Authority
  - Part-nationalised UK registered banks

5. **Transaction limits** are set for each type of investment.

6. This authority will set a limit for the amount of its investments which are invested for **longer than 365 days**.

7. Investment in Money Market Funds will be restricted to those with AAA rating, which provide good security and good access to funds. The use of money market funds will not affect the limits of any other investment. The Authority does not currently hold any Money Market Fund Accounts.

8. Investments will only be placed with counterparties from countries with a specified minimum **sovereign rating.**

9. This authority has engaged **external consultants**, (see paragraph 1.5), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.

10. All investments will be denominated in sterling.

11. As a result of the change in accounting standards for 2018/19 under IFRS 9, this authority 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.

However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

4.2 Creditworthiness policy

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

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

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 colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Authority to determine the suggested duration for investments. The Authority will therefore use counterparties within the following durational bands:

- Blue - 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange - 1 year
- Red - 6 months
- Green - 100 days
- No colour - not to be used

The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically, the minimum credit ratings criteria the Authority use will be a Short Term rating (Fitch or equivalents) of F1 and a Long-Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances, consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Authority is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.

- if a downgrade results in the counterparty / investment scheme no longer meeting the Authority's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the Authority will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Authority's lending list.

Sole reliance will not be placed on the use of this external service. In addition, this Authority will also use market data and market information, information on any external support for banks to help support its decision-making process.

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 Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

4.3 Diversification and Limits

The policy is to minimise risk by placing funds with counterparties in accordance with the above creditworthiness methodology but with the maturity period for any one investment limited to a maximum of 2 years or less if indicated by the creditworthiness ranking.

The Council has determined that it will only use approved counterparties from the UK and from countries with a minimum sovereign credit rating of AAA. Funds shall be spread through those counterparties with no more than £2m being invested with any one institution or banking group with the following exceptions:

- a £10m limit applying to the authority's bankers;
- an unlimited amount may be placed with the UK Government's Debt Management Account.

4.4 Investment strategy

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).

- 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.

Investment returns expectations.

Bank Rate is forecast to increase steadily but slowly over the next few years to reach 2.00% by quarter 1 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:

- 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.

Investment treasury indicator and limit - total principal funds invested for greater than 365 days. These limits are set with regard to the Authority's 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 Authority is asked to approve the treasury indicator and limit:

Maximum principal sums invested > 364 & 365 days			
£m	**2019/20**	**2020/21**	**2021/22**
Principal sums invested > 364 & 365 days	£2m	£2m	£2m

For its cash flow generated balances, the Authority will seek to utilise its business premium account, instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days), in order to benefit from the compounding of interest.

4.6 End of year investment report

At the end of the financial year, the Authority will report on its investment activity as part of its Annual Treasury Report.