Agenda Item: 14

Name of Committee:	**Cabinet**
Date of Meeting:	**18/02/2019**
Relevant Scrutiny Committee:	Corporate Performance and Resources
Report Title:	**Treasury Management and Investment Strategy 2019/20 and Update for 2018/19**
Purpose of Report:	To provide an interim report on the Council's Treasury Management operations for the period 1st April to 31st December 2018 and to submit for consideration the proposed 2019/20 Treasury Management and Investment Strategy.
Report Owner:	**Report of the Leader**
Responsible Officer:	**Carys Lord Section 151 Officer**
Elected Member and Officer Consultation:	None
Policy Framework:	This report needs to be referred to Council for approval

Executive Summary:

- This interim report provides an update on the Council's Treasury Management operations for the period 1st April to 31st December 2018. All activities were in accordance with the Council's approved strategy on Treasury Management. Details of monies borrowed and repaid and those invested are outlined in the report.
- The report presents the proposed 2019/20 Treasury Management and Investment Strategy at Appendix 1.
- The Council must ensure that the Prudential Code is complied with, which has been developed by CIPFA as a professional code of practice. To demonstrate the Council has fulfilled these objectives, the Code sets out prudential indicators that should be used and the factors that must be taken into account. These are shown in Appendix 1 as part of the Strategy.
- The Council also has a legal requirement to comply with the Welsh Government Guidance on Investments and has taken this into consideration when developing the Strategy.
- Capital expenditure when financed by long term debt incurs two elements of cost, interest on and repayment of the principal sum borrowed. The resources the Council must put aside in each year to repay the principal sum borrowed is known as Minimum Revenue Provision (MRP) and the Council's policy for calculation is detailed in the report.
- The Treasury Management Policy for 2019/20 is attached at Appendix 2.

1. Recommendation

1.1 That the Treasury Management interim report for the period 1st April to 31st December 2018 be endorsed.

1.2 The policy for making Minimum Revenue Provision in 2019/20 be approved.

1.3 That Cabinet recommend to Council that the proposed 2019/20 Treasury Management and Investment Strategy be approved including the following specific resolutions:

- The Authorised Limit for External Debt be set at £200.854M for 2018/19, £201.556M for 2019/20, £217.263M for 2020/21 and £234.895M for 2021/22.
- The Operational Boundary for External Debt be set at £185.812M for 2018/19, £194.831M for 2019/20, £198.861M for 2020/21 and £222.014M for 2021/22.
- The Section 151 Officer be given delegated authority within the total Authorised Limit and Operational Boundary as estimated for individual years to effect movement between the separately agreed limits for borrowing and other long term liabilities.
- An upper limit is set on its fixed interest rate exposures of £148.545M for 2018/19, for 2019/20 of £147.310M, for 2020/21 of £165.610M and for 2021/22 of £180.393M of its net outstanding principal sum on its borrowings / investments.

- An upper limit is set on its variable interest rate exposures of £0 for 2018/19, 2019/20, 2020/21 and 2021/22 of its net outstanding principal sum on its investments.
- An upper limit of £0M for 2018/19, £2M for 2019/20, £2M in 2020/21 and £2M in 2021/22 is set for total principal sums invested for over 364 days.
- The amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate for 2019/20 be set as below:

	Upper Limit	**Lower Limit**
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	0%
10 years and above	100%	0%

- The Prudential Indicators set out in Appendix 1 be approved.
- The Treasury Management Policy set out in Appendix 2 be approved

2. Reasons for Recommendations

2.1 To present the Treasury Management Interim Report.

2.2 To agree the basis of the Minimum Revenue Provision calculation for 2019/20.

2.3 The Treasury Management and Annual Investment Strategy is prepared as required by the Local Government Act 2003.

3. Background

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

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

3.3 The contribution the Treasury Management function makes to the Council is critical, as the balance of debt and investment operations ensure liquidity 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.

3.4 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 which may be undertaken by the Council. This Council has not engaged in any commercial investments and has no non-treasury investments.

3.5 The Capital Strategy is being reported to members as a separate report on this agenda.

3.6 The Welsh Government (WG) provides the Council with a General Capital Funding grant and the Council is also advised of a level of borrowing that WG is prepared to fund via the Revenue Support Grant Settlement (supported borrowing). If the Council wishes to borrow in excess of this level to increase its capital expenditure, then it can. However, it will either have to find the additional costs of borrowing through revenue savings in other services or increases in Council Tax.

3.7 In order to manage this increased flexibility, Part 1 of the Local Government Act 2003 requires local authorities to have regard to the Prudential Code, which has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) as a professional code of practice.

3.8 The key objectives of the fully revised Prudential Code are to ensure that the capital investment plans of local authorities:

- Are affordable;
- That all external borrowing and other long term liabilities are within prudent and sustainable levels; and

- The treasury management decisions are taken in accordance with professional good practice.

4. Key Issues for Consideration

Treasury Management Reporting

4.1 In March 2018 the Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which together with the WG revised guide on Local Government Investments (April 2010), requires the Council to receive and approve as a minimum three main treasury reports each year which incorporate a variety of policies, estimates and actuals. All reports will be reviewed at Cabinet and Scrutiny Committee before being reported to Council. These are as follows:

Treasury Management & Investment Strategy

A report presented and approved before the start of the financial year which is forward looking and covers the Authority's :

- Capital Plans (including prudential indicators);
- Minimum Revenue Provision (MRP);
- The Borrowing Strategy; and
- The Investment Strategy.

Mid-Year Treasury Management Report

A progress report to update members on Council's treasury activities to date and to provide an opportunity to revise policy or prudential indicators if required.

Annual Treasury Management Report

4.2 A backward looking review report comparing actual outturn to estimates together with a selection of actual prudential and treasury indicators.

4.3 The proposed Treasury Management and Investment Strategy for 2019/20, is attached at Appendix 1. The Treasury Management Strategy itself covers a rolling period of three years and is intended to link into the Medium Term Financial Planning process. The Investment Strategy covers the next financial year. The document also includes a number of statutory Prudential Indicators that may be used to support and record local decision-making.

Proposed Strategy 2019/20

Borrowing Strategy

4.4 As interest rates and investment returns are likely to remain low during 2019/20 the Council will continue the policy of avoiding new external borrowing by running down spare cash balances and reserves to finance capital expenditure. However this approach will be carefully reviewed to avoid higher borrowing costs in future years when the Council may not be able to avoid external borrowing at higher interest rates. The Council will need to consider the effect on revenue and credit risk if it opts to borrow externally in 2019/20.

Investment Strategy

4.5 In 2019/20 the Council will continue to place investments with either the Debt Management Account Deposit Facility (DMADF) of the Bank of England which are guaranteed by the UK Government, or with UK Local Authorities. The Council will continually review the financial stability of all local authorities with whom it places investments.

4.6 Although not guaranteed by the UK Government if a Local Authority with whom the Council has placed an investment were to default on repayment the Council would have recourse under the Local Government Act 2003 to collect any outstanding sums.

4.7 The Treasury Management section will in 2019/20 retain the maximum principal investment at £5m and the maximum period of investment to 12 months. Any change on this position will be brought to Cabinet as part of future Treasury Management monitoring reports.

4.8 The Council will continue to pursue the possible use of other investment tools, i.e. Treasury Bills & Money Market Funds during 2019/20 and may introduce these once relevant appraisals have been undertaken. However the ongoing uncertainty in the financial markets will continue to dictate that capital security will still outweigh the importance of financial performance at present.

4.9 The Council will continue to use credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service and Standard & Poor's to assess the risk of loss of investments. The lowest available credit rating will be used to determine credit quality. In addition, regard will be given to other available information on the credit quality of banks and building societies.

Interim Report

4.10 In so far as the Council's Treasury Management operations entered into for the period 1st April to 31st December 2018 are concerned, all activities were in accordance with the Council's approved strategy on Treasury Management. The following table sets out the monies borrowed / repaid during the period.

Loan Type	**Opening Balance**	**Received**	**Repaid**	**Closing Balance**
	01/04/2018			**31/12/2018**
	£000	**£000**	**£000**	**£000**
PWLB	147,165	0	(719)	146,446
Other Long Term Loans	6,000	0	0	6,000
WG Concessionary Loan	2,100	0	0	2,100
Temporary Loans	100	0	0	100
Total	**155,365**	**0**	**(719)**	**154,646**

4.11 Loans borrowed from the Public Works Loan Board (PWLB) are intended to assist local authorities in meeting their longer term borrowing requirements. The above loans are all at fixed rates of interest. The rate paid on each loan is largely dependent upon the original duration of the loan and date taken out. The average interest rate on all the Council's outstanding PWLB debt has moved over the period 1st April - 31st December 2018 from 4.7425% to 4.7211%.

4.12 Other long term loans represent those non-PWLB loans that are repayable at least one year or more from the date they are advanced. The bulk of this debt is represented by two market loans of £2,000,000 and £4,000,000. The average interest rate on the Authority's outstanding market loans is 5.322%.

4.13 The Concessionary Loan was advanced to the Council by the Welsh Government on the 1st April 2015 for a period of 10 years. The loan will mature on the 31st March 2025 and is interest free.

4.14 Temporary loans represent loans that have no fixed maturity date. Current loans have been borrowed from The Vale of Glamorgan Welsh Church Act Fund. Interest is calculated on a monthly basis using the "Average 7 Day Rate".

4.15 The Council's investments for the period to 31st December 2018 are set out in the following table.

Investment Counterparty	**Opening Balance**	**Invested**	**Repaid**	**Closing Balance**
	01/04/2018			**31/12/2018**
	£000	**£000**	**£000**	**£000**
Local Authorities	60,000	255,450	(237,450)	78,000
Debt Management Account Deposit Facility	6,900	1,361,550	(1,362,450)	6,000
Total	**66,900**	**1,617,000**	**(1,599,900)**	**84,000**

4.16 Interest at an average rate of 0.58% and amounting to £311,003 has been received from maturing investments for the first 9 months of 2018/19.

Annual Minimum Revenue Provision Statement 2019/20

4.17 Capital expenditure when financed by long term debt incurs two elements of cost, interest on and repayment of the principal sum borrowed. The resource the Council must put aside in each year to repay the principal sum borrowed is known as the Minimum Revenue Provision (MRP). Pre 2008 there were detailed statutory rules for the calculation of MRP as laid down in the 2003 regulations but the introduction of the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2008 which became effective from the 31st March 2008, replaced these statutory rules with: 'A local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent'.

4.18 Welsh Government has issued guidance on what constitutes prudent provision and this requires the Council to approve an annual statement of its policy on calculating MRP. The broad aim of the WG Guidance is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits.

4.19 The following statement incorporates options recommended in the Guidance.

4.20 For supported capital expenditure the Council will implement the "Asset Life Method". MRP will be determined by charging the expenditure over the expected useful life of the average asset lives (40 years) of the (Non HRA) Council Assets in equal instalments, starting in the year after the asset becomes operational.

4.21 For unsupported capital expenditure incurred after 31st March 2008, the Council will also implement the "Asset Life method". MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational. Included in the 2019/20 revenue estimates are principal repayments totalling £497k in respect of Prudential (unsupported) Borrowing (i.e. not supported for Revenue Purposes). Of this funding £148k is in respect of 21st Century Schools. The provision made in respect of these schemes is commensurate with asset life as estimated by the Council's External Valuer. Provision of £171k has been made for the repayments against a loan of £1.2m for refuse vehicles over an expected life of 7 years and £178k in respect of loans raised for City Deal (20 years).

4.22 In addition £344k has been included in respect of the Local Government Borrowing Initiative (LGBI) funding from WG for 21st Century Schools and the Local Road Network Improvement scheme. The provision in respect of LGBI schemes is commensurate with the applicable WG funding streams through the

Revenue Support Grant. Loans have been raised on an annuity basis so MRP contributions vary annually.

4.23 MRP will be charged at 2% of the outstanding Housing Revenue Account Capital Financing Requirement in respect of housing assets.

4.24 Capital expenditure incurred during 2019/20 will not be subject to an MRP charge until 2020/21.

4.25 Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2019, the budget for MRP has been set as follows:

	31.03.2019 Estimated CFR £000	**2019/20 Estimated MRP £000**
General Fund		
Supported capital expenditure	107,636	2,757
Unsupported capital expenditure	17,018	841
Total General Fund	124,654	3,598
Housing Revenue Account	76,468	1,529
Total Housing Revenue Account	76,468	1,529
Total	**201,122**	**5,127**

4.26 The Section 151 Officer considers that the estimated costs of unsupported borrowing are both prudent and sustainable.

Treasury Management Policy

4.27 Whilst considerations, such as interest rate forecasts, will inevitably inform the Treasury Management Strategy to be adopted over the coming years, account must also be taken of certain fundamental parameters that the Council must work within. These may include political, environmental, social, technical, economic and legislative factors and form the basis of the Treasury Management Policy that underpins the Strategy. Adherence to its requirements is mandatory for all matters relating to Treasury Management and investments and the Policy for 2019/20 is attached at Appendix 2.

5. How do proposals evidence the Five Ways of Working and contribute to our Well-being Objectives?

5.1 The Treasury Management and Investment Strategy ensures that the financial plans of the Council are sustainable into the future and do not adversely impact on future generations.

5.2 The Treasury Management and Investment Strategy underpins the financial management of the Council and its ability to achieve its Well Being objectives as set out in the Corporate Plan.

6. Resources and Legal Considerations

Financial

6.1 Money is borrowed for capital purposes and interest is charged to revenue accounts.

Employment

6.2 There are no direct employment issues relating to this report.

Legal (Including Equalities)

6.3 Compliance with the Local Government Act 2003 and CIPFA's "Code of Practice for Treasury Management in the Public Services" is mandatory.

7. Background Papers

CIPFA's "Code of Practice for Treasury Management in the Public Services" (2017 Edition), "The Prudential Code" (2017 Edition) and WG guidance on local authority investments

Committee papers for Audit Committee 31st January 2018 - Proposal to Amend the Minimum Revenue Proposals 2018-19 Policy.

Appendix 1

Treasury Management and Investment Strategy 2019/20

Introduction

The Treasury Management Strategy sets out the Council's plan for treasury management for the period 2019/20 to 2021/22. The plan forms an integral part of the Council's strategic planning process, linking in with the Medium Term Financial Plan, Capital Strategy and annual budget cycle.

This Treasury Management Strategy has been prepared taking into account the following:

- CIPFA Code of Practice on Treasury Management 2017
- CIPFA Prudential Code 2017
- CIPFA Treasury Management in the Public Services Guidance Notes 2018
- CIPFA Statement (17/10/18) on borrowing in advance of need and investment in commercial properties
- Local Government Act 2003
- Welsh Government Guidance on Investments

Prudential Code

The key objectives of the Prudential Code are to ensure within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable and that treasury management decisions are taken in accordance with good professional practice and in full understanding of the risks involved and how the risks will be managed to levels that are acceptable to the organisation.

To demonstrate the Council has fulfilled these objectives, the Code sets out prudential indicators that should be used and the factors that must be taken into account.

The prudential indicators required by the Prudential Code are designed to support and record local decision making in a manner that is publicly accountable.

Welsh Government Guidance

The Welsh Government guidance notes lay down the requirements with regard to the need to set out the Council's policies for the prudential management of its investments giving regard to firstly security and secondly liquidity. It covers the definition of specified and non-specified investments and the approach to investment risk.

The Council has a legal obligation under the Local Government Act 2003 to have regard to the Prudential Code and the Welsh Government guidance.

In line with the Welsh Government Guidance this document has been prepared as a single strategy document covering both the requirements of the CIPFA Treasury Management Code and the Welsh Government's guidance.

The Strategy

The Strategy for 2019/20 covers two main areas:

Capital Issues

- Economic background
- Capital expenditure plans and the associated prudential indicators
- Minimum revenue provision (MRP) policy

Treasury Management Issues

- Prospects for interest rates
- Borrowing Strategy (including Current Treasury Position)
- Treasury indicators which limit the treasury risk and activities of the Council
- Policy on borrowing in advance of need
- Debt rescheduling
- Management of Housing Revenue Account (HRA) Debt
- Investment Strategy
- Creditworthiness policy
- Other investment tools
- External service providers
- Other issues

Economic Background

The UK has produced a flow of positive economic statistics since the end of the first quarter of 2018 and has shown that forecasters were over pessimistic about the poor growth forecast in quarter 1 when adverse weather caused a temporary downward blip. The UK reported GDP growth in Quarter 1 at 0.1%, 0.4% in quarter 2 and 0.6% in quarter 3. However quarter 4 is expected to weaken from that level.

The Consumer Price Index (CPI) measure of inflation fell from a peak of 3.1% in November 2017 to 2.4% in October 2018. The Bank of England's November quarterly inflation report, forecasts inflation 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.

In September 2018, unemployment in the UK was recorded at 4.1% with wage inflation at 3.2%. In real terms, (i.e. wage rates less CPI inflation) earnings grew at a rate of 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 Monetary Policy Committee (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.

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. However 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.

The major external influence on the Council's Treasury Management Strategy for 2019/20 continues to be the period of uncertainty surrounding the UKs potential exit from the European Union in March 2019.

Capital Expenditure Plans and the Associated Prudential Indicators

The Council'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.

Capital Expenditure – Prudential Indicator No. 1

The figures shown in the following table are a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of this budget cycle.

Capital Expenditure	**2017/18**	**2018/19**	**2019/20**	**2020/21**	**2021/22**
	Actual £000	**Estimate £000**	**Estimate £000**	**Estimate £000**	**Estimate £000**
Learning & Skills	6,013	8,927	41,401	61,196	29,481
Social Services	222	842	627	1,439	100
City Deal	2,052	1,501	436	429	675
Environment & Transport	13,287	15,848	8,966	2,703	3,012
Resources & Managing Director	8,429	15,968	10,777	3,706	2,687
Non HRA total	30,003	43,086	62,207	69,473	35,955
HRA	14,358	14,900	17,898	19,980	19,544
Total	**44,361**	**57,986**	**80,105**	**89,453**	**55,499**

The estimates reflect the Draft Housing Business Plan Proposals and figures also reflect the Draft Final Capital Proposals.

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 need to borrowing.

	2017/2018	2018/2019	2019/2020	2020/2021	2021/22
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	**£000**	**£000**	**£000**	**£000**
GCF Grant	2,045	2083	3,230	2,846	2,077
GCF Supported Borrowing	3,360	3,422	3,413	3,413	3,413
GF Reserves & Revenue	6,237	7,937	9,359	7,213	4,940
HRA Reserves & Revenue	7,217	7,100	5,846	5,268	5,691
Prudential Borrowing	3,700	3,160	9,293	10,958	13,095
Prudential Borrowing City Deal	2,052	1,501	436	429	675
S106	3,613	3,309	7,556	7,844	2,709
WG Grant	12,912	22,286	39,362	42,176	21,429
Capital Receipt	3,225	7,188	1,610	9,306	1,470
Net Financing Need For Year CFR	**44,361**	**57,986**	**80,105**	**89,453**	**55,499**

The Council’s Borrowing Need - Capital Financing Requirement (CFR) – Prudential Indicator No. 2

The Capital Finance Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council’s indebtedness and so it’s 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 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. PFI schemes, finance leases). Whilst these increase the CFR and therefore the Council’s borrowing requirement, these types of scheme include a borrowing facility by the PFI, PPP lease provider and so the Council is not required to separately borrow for these schemes.

The Council’s CFR projections are listed below:

	2017/2018	2018/2019	2019/2020	2020/2021	2021/22
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	£000	**£000**	**£000**	**£000**	**£000**
Non HRA CFR	123,157	124,654	124,905	125,315	127,504
HRA CFR	74,804	76,468	84,232	93,200	102,430
Total CFR	**197,961**	**201,122**	**209,137**	**218,515**	**229,934**

In-Year Movement CFR	2017/18 Actual £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Non HRA	3,329	1,497	251	410	2,189
HRA	(506)	1,664	7,764	8,968	9,230
Total	**2,823**	**3,161**	**8,015**	**9,378**	**11,419**

Core Funds and Expected Investment Balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.).

Minimum Revenue Provision (MRP)

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), 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 Council to approve a 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's MRP Statement is set out below.

MRP Statement

For supported capital expenditure the Council will implement the "Asset Life Method". MRP will be determined by charging the expenditure over the expected useful life of the average asset lives (40 years) of the (Non HRA) Council Assets in equal instalments, starting in the year after the asset becomes operational.

For unsupported capital expenditure incurred after 31st March 2008, the Council will also implement the "Asset Life method". MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments, starting in the year after the asset becomes operational.

Included in the 2019/20 revenue estimates are principal repayments totalling £497k in respect of Prudential (unsupported) Borrowing (i.e. not supported for revenue purposes). Of this funding £148k is in respect 21st Century Schools. The provision made in respect of these schemes is commensurate with asset life as estimated by the Council's external valuer. Provision of £171k has been made for the repayments against a loan of £1.2m for refuse vehicles over an expected life of 7 years and £178k in respect of loans raised for City Deal over 20 years.

In addition £344k has been included in respect of the Local Government Borrowing Initiative (LGBI) funding from WG for 21st Century Schools and the Local Road Network Improvement scheme. The provision in respect of LGBI schemes is commensurate with the applicable WG funding streams through RSG. Loans have been raised on an annuity basis so MRP contributions vary annually.

MRP will be charged at 2% of the outstanding Housing Revenue Account Capital Financing Requirement in respect of housing assets.

Capital expenditure incurred during 2019/20 will not be subject to a MRP charge until 2020/21.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2019, the budget for MRP has been set as follows:

	31.03.2019 Estimated CFR £000	**2019/20 Estimated MRP £000**
General Fund		
Supported Capital Expenditure	107,636	2,757
Unsupported Capital Expenditure	17,018	841
Total General Fund	124,654	3,598
Housing Revenue Account	76,468	1,529
Total Housing Revenue Account	76,468	1,529
Total	**201,122**	**5,127**

Where the Council makes any voluntary provision for debt repayment this will be disclosed separately as part of year-end financial reporting.

Prospects for Interest Rates

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. The following table gives their central view.

Link Asset Services Interest Rate View	Dec-18	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%	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	0.80%	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	0.90%	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	1.10%	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	2.00%	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%	2.50%	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%	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%	2.70%	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 30th June 2018 meant that it came as no surprise that the Monetary Policy Committee (MPC) came to a decision on 2nd August 2018 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 the 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 the Bank Rate in February 2019, ahead of the deadline in March 2019 for Britain's exit from Europe. The next increase in the 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.

Borrowing Strategy

The Council is 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 Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is 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 is felt that there is 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 is felt that there is 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 Cabinet at the next available opportunity.

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 as the Council 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.

Borrowing

The capital expenditure plans previously detailed, highlight the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's Capital Strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The Strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the Annual Investment Strategy.

Current Portfolio Position

The overall treasury management portfolios as at 31 March and 31st December 2018 are shown below for both borrowing and investments.

Treasury Portfolio	**31.03.18**	**31.03.18**	**31.12.18**	**31.12.18**
Treasury Investments	**£000**	**% Return**	**£000**	**% Return**
Local Authorities	60,000	0.38	78,000	0.62
Debt Management Account Deposit Facility	6,900	0.14	6,000	0.39
Total Investments	**66,900**		**84,000**	
Borrowing				
Public Works Loan Board	147,165	4.74	146,446	4.72
LOBOS	6,000	5.32	6,000	5.32
Concessionary Loans	2,100	0	2,100	0
Temporary Loans	100	0.35	100	0.48
Total External Borrowing	**155,365**		**154,646**	
Net Borrowing	**88,465**		**70,646**	

Gross Debt and the Capital Financing Requirement - Prudential Indicator No. 3

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

External Debt	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual £000	Estimate £000	Estimate £000	Estimate £000	Estimate £000
External Debt as at 1April	157,199	155,365	154,645	153,410	171,710
Expected Change In Debt	(1,834)	(720)	(1,235)	18,300	14,783
Other Long Term Liabilities	0	0	0	0	0
Expected Change In Other Long Term Liabilities	0	0	0	0	0
Gross Debt 31st March	155,365	154,645	153,410	171,710	186,493
The Capital Financing Requirement	197,961	201,122	209,137	218,515	229,934
Under Borrowing	42,596	46,477	55,727	46,805	43,441

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

The Head of Finance reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account the final proposals for capital & revenue.

Borrowing Requirement

The Borrowing Requirement represents the estimated amount that the Council will borrow externally for this year and the next 3 years.

	2017/18	2018/19	2019/20	2020/21	2021/22
	£000	£000	£000	£000	£000
	Probable	Estimate	Estimate	Estimate	Estimate
New Borrowing	0	0	0	14,800	17,183
Replacement Borrowing	0	0	0	4,288	3,510
Total	**0**	**0**	**0**	**19,088**	**20,693**

Approved Methods of Raising Capital Finance

The Local Government Act 2003 provides that a local authority may borrow money for any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs. The Council will continue to borrow from the following sources: -

- by overdraft or short term from Financial Services Authority authorised banks;
- from the Public Works Loan Board (PWLB);
- by means of loan instruments;
- other local authorities;
- stock issues;
- short – term borrowing from any source;
- other credit arrangements; and
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues.

LOBO (Lender Option Borrower's Option)

The Council holds £6M of LOBO (Lender Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £6M.

Municipal Borrowing Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Council may make use of this new source of borrowing as and when appropriate. Any intention to borrow will be authorised by the Section 151 Officer and reported to Cabinet for approval prior to any action being taken.

Treasury Indicators: Limits to Borrowing Activity

The Operational Boundary – Prudential Indicator No. 4

This is the proposed 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. The proposed Operational Boundary for external debt is based upon estimates of the most likely, prudent, but not worst case scenario. The Operational Boundary links to the Council's plans for capital expenditure, estimates of capital financing requirement and the estimate of cash flow requirements for the year. This is the expected maximum limit for external debt. It is lower than the Authorised Limit and cash flow variations may lead to the occasional breach of the Operational Boundary.

Operational Boundary	**2018/19**	**2019/20**	**2020/21**	**2021/22**
£m	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Debt	185.812	194.831	198.861	222.014
Other Long Term Liabilities	0	0	0	0
Total	**185.812**	**194.831**	**198.861**	**222.014**

The Authorised Limit for External Debt – Prudential Indicator No. 5

This is a key prudential indicator and represents a control on the maximum level of borrowing. This represents a legal limit beyond which external debt is prohibited. 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. The Authorised Limit is the affordable borrowing limit determined in compliance with section 3 (1) of the Local Government Act 2003. It is not a limit that the Council will expect to borrow up to on a regular basis and provides headroom over and above the Operational Boundary.

These authorised limits set out below are considered to be consistent with the Council's current commitments and proposals for capital expenditure and financing and with its Treasury Management Policy. The estimates are based on most likely, (i.e. prudent but not worst case), scenario for external debt with sufficient headroom over and above this to allow for operational management (e.g. unusual cash movement).

Authorised Limit	**2018/19**	**2019/20**	**2020/21**	**2021/22**
£m	**Estimate**	**Estimate**	**Estimate**	**Estimate**
Debt	200.854	201.556	217.263	234.895
Other Long Term Liabilities	0	0	0	0
Total	**200.854**	**201.556**	**217.263**	**234.895**

Affordability Prudential Indicators

The objective of the affordability indicator is to assess the affordability of the Council's investment plans by considering the impact on the council tax and for the HRA, the level of rent to be charged. To achieve this, the Council has to consider all of the resources available to it, together with the totality of its capital plans, revenue income and revenue expenditure forecast for the coming year and the following two years. These should be rolling scenarios and not fixed for three years.

The indicators in this category which are required to be approved by Council are set out below:

Ratio of Relevant Financing Costs to Net Revenue Stream – Prudential Indicator No. 6

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of any investment income.

	2017/18	2018/19	2019/20	2020/21	2021/22
	Actual	**Estimate**	**Estimate**	**Estimate**	**Estimate**
	%	%	%	%	%
HRA (Rents)	23.74	23.16	23.11	24.61	25.84
Non HRA (Council tax)	4.11	3.53	3.56	3.59	3.56

The analysis above shows the Council Fund implications remain relatively stable throughout the period. The HRA cost is increasing over the period in line with the aspirations for maintenance and regeneration set out in the draft Housing Business Plan. The plan demonstrates that this level of investment is affordable over the 30 year period of the plan.

Upper Limits on Fixed Interest Rate and Variable Interest Rate Exposure – Prudential Indicator No. 7

Fixed Interest Rate Exposure	2018/19 Probable Outturn £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Net Principal Fixed Rate Borrowing	148,545	147,310	165,610	180,393

This is a control over a Council having large concentrations of fixed rate debt needing to be replaced at the same time when interest rates may be relatively high. The upper limit for variable rate exposure measures the extent to which the Council is exposed to the effects of changes in interest rates.

Variable Interest Rate Exposure	2018/19 Probable outturn £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Net Principal Upper Limit Variable Rate	0	0	0	0

Currently the Council's variable rate exposure is on net investments rather than as a result of borrowing at variable rates. By setting the upper limit as £0 this means the Council will not have more variable rate debt than variable rate investment.

Upper Limit for Principal Sums Invested for Longer Than 364 Days - Prudential Indicator No. 8

	2018/19 Probable outturn £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Upper limit principal sums invested for over 364 days (per maturity date)	0	2,000	2,000	2,000

The Council does not currently invest beyond 364 days to minimise the investment risk.

Fixed Rate Borrowing Maturity Limit - Prudential Indicator No. 9

Amount of Projected Borrowing that is Fixed Rate Maturing in Each Period as a Percentage of Total Projected Borrowing that is Fixed Rate for 2019/20	Upper Limit	Lower Limit
Under 12 months	20%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	40%	0%
10 years and above	100%	0%

Policy on Borrowing in Advance of Need

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

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.

Having considered the advice of the Council's treasury advisors, the Council will not be seeking to borrow sums in advance of need unless it is considered to be of significant economic benefit by the Section 151 Officer.

The maximum period between borrowing and expenditure is expected to be two years, although the Council does not link particular loans with particular items of expenditure.

Debt Rescheduling/Repayment

The Public Works Loan Board allows authorities to prematurely repay loans. 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; and
- 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 in the current climate short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be approved by the Section 151 Officer under delegated powers as set out in the Council's Constitution (Officer Delegations) and reported to Cabinet as part of the agreed monitoring procedure at the earliest meeting following its action.

Management of Housing Revenue Account Debt

On 2nd April 2015 as part of the agreed Housing Subsidy (HRAS) Buyout process a Public Works Loan Board loan of £63.186 million was drawn down and subsequently paid over to WG on behalf of HM Treasury.

HRA Limit of Indebtedness

Under the UK Wales Bill, Welsh Ministers were required to issue a determination to calculate the amount of housing debt each local housing authority is treated as holding and the maximum housing debt each housing authority may hold or their limit of indebtedness. Under the terms of the voluntary agreement (March 2015) and the variation to the voluntary agreement (January 2016), the Council is required to demonstrate that it will comply with the limit of indebtedness set by Welsh Government.

The limit of indebtedness for the Vale of Glamorgan was calculated as follows;

Existing Borrowing as at 31-Mar-14	Borrowing to meet WHQS/New Build	Fixed Settlement Value	Borrowing Headroom	Final Limit of indebtedness
£M	**£M**	**£M**	**£M**	**£M**
2.079	33.9	63.156	4.588	103.723

Under the amended Prudential Code the local authority is required to report on the limit of indebtedness imposed and compare the Housing CFR to this limit.

HRA Debt Limit	2018/19	2019/20	2020/21	2021/22
£m	**Estimate**	**Estimate**	**Estimate**	**Estimate**
HRA Debt Cap	103.723	103.723	103.723	103.723
HRA CFR	76.468	84.232	93.200	102.430
HRA Headroom	27.255	19.491	10.523	1.293

The UK Government announced plans to lift the Housing Revenue Account Borrowing Cap at the UK Autumn Budget on 29th October 2018 and agreed for the Cap to be fully abolished in Wales. At the time of publication, Welsh Government officials continue to work closely with the Welsh Local Government Association (WLGA) and LHAs to put the necessary arrangements in place. This includes discussions to ensure the Voluntary Agreements in Wales are terminated as soon as possible.

Policy on Apportioning Interest to the HRA

As part of the HRAS Buyout process the Council has reviewed its arrangements for dealing with the pooling of debt. The current approach is that the Council will continue to use a single pool for administering its debt. It is intended that interest will continue to be charged to the HRA using a consolidated rate.

Annual Investment Strategy

The strategy of the Council will have regard to the availability of capital receipts and financial reserves. The Investment Strategy is determined in parallel with Borrowing Strategy.

Management of Risk

The Council has borrowed and invested significant sums of money and is therefore exposed to financial risks such as the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's Treasury Management Strategy.

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

The Council's Investment Policy has regard to the following: -

- The Welsh Government's Guidance on Local Government Investments ("the Guidance") issued in April 2010;
- CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA Treasury Management Code");
- The Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 Statutory Instrument 3239 (W 319) (as amended); and
- CIPFA Treasury Management Guidance Notes 2018.

The Welsh Government Guidance and the CIPFA Code of Practice place a high priority on the management of risk. This Council has adopted a prudent approach to managing risk and defines its risk appetite by the following means:

Creditworthiness

Credit Rating Criteria

The Council uses credit ratings (long and short term) from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service and Standard & Poor's to assess the risk of default. This allows the Council to generate a list of highly creditworthy counterparties and enables diversification and thus avoidance of concentration risk. The lowest available credit rating will be used to determine credit quality. Credit ratings are obtained and monitored by the Council's Treasury Advisers, who will notify changes in ratings as they occur. Where an institution has its credit rating downgraded so that it fails to meet the minimum credit rating criteria then:

- No new investments will be made;
- Any existing investments that can be recalled at no cost will be recalled; and
- Full consideration will be given to the recall of any other existing investments.

The Section 151 Officer will be notified immediately to consider the appropriate action to be taken, if any, where a credit rating agency announces that it is actively reviewing an organisations credit rating with a view to downgrading it so that it is likely to fall below the Council's minimum criteria.

The categories and definitions are set out below:

Fitch's Credit Ratings and Definitions

Short Term Investments		
F1	Highest short-term credit quality	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature.
F2	Good short-term credit quality	Good intrinsic capacity for timely payment of financial commitments.
F3	Fair Credit Quality	Capacity for timely payment is adequate, however near term changes could result in a reduction to non investment grade.
B	Speculative	Minimal Capacity for timely payment, vulnerability to near term adverse changes.
Long Term Investments		
AAA	Highest credit quality	Lowest expectation of default risk. Exceptionally strong capacity for payment of financial commitments which is highly unlikely to be adversely affected by foreseeable events.
AA:	Very high credit quality.	Very low default risk with very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.
A:	High credit quality.	Expectations of low default risk. The capacity for payment of financial commitments is considered strong but may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.
BBB	Good credit quality	Expectations of default risk are currently low. The capacity for payment of financial commitments is considered adequate but adverse business or economic conditions are more likely to impair this capacity.
BB	Speculative	Elevated vulnerability to default risk, particularly in the event of adverse changes in business or economic conditions over time.
B	Highly speculative	material default risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is vulnerable to deterioration in the business and economic environment.

Moody's Credit Rating and Definitions

Short Term Investments	
P1	Prime 1 - Issuers have a superior ability to repay short term debt obligations
P2	Prime 2 – Issuers have a strong ability to repay short term debt obligations
P3	Prime 3 – Issuers have an acceptable ability to repay short term debt obligations
NP	Not Prime – No prime rating
Long Term Investments	
Aaa	Judged to be highest quality and subject to the lowest level of risk
Aa	Judged to be high quality and subject to very low credit risk
A	Judged to be upper medium grade and subject to low credit risk
Baa	Judged to be medium, grade and subject to moderate credit risk
Ba	Judged to be speculative and subject to high credit risk
B	Considered speculative of poor standing and are subject to very high credit risk
Caa	Judged to be speculative of poor standing and are subject to very high credit risk
Ca	Highly speculative and are likely in, or very near, default, with some prospect of recovery of principal or interest.
C	Lowest rated and are typically in default

Standard and Poor's Credit Ratings and Definitions

AAA	Investment Grade – Extremely strong capacity to meet financial commitments
AA	Investment Grade – Very strong capacity to meet financial commitments
A	Investment Grade – Strong capacity to meet financial commitments but susceptible to adverse economic conditions and changes in circumstances
BBB	Investment Grade – Adequate capacity to meet financial commitments but susceptible to adverse economic conditions and changes in circumstances
BB	Speculative Grade – Less vulnerable in the near term but faces major ongoing uncertainties
B	Speculative Grade – Vulnerable to adverse conditions but still has capacity to meet financial commitments
CCC	Speculative Grade – Currently vulnerable and dependent on favourable conditions to meet financial commitments
CC	Speculative Grade – Highly vulnerable default has not yet occurred but is expected to as a virtual certainty
C	Speculative Grade –Currently highly vulnerable to non payment
D	Payment breach of a financial commitment or in breach of an imputed promise

Other Information

Additional requirements under the Code require the Council to supplement credit rating information therefore credit 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 treasury advisers to maintain a monitor on market pricing such as **“**credit default swaps**”** and overlay that information on top of the credit ratings.

Other Information Sources

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.

Categories of Investments

Investments fall into 1 of 2 categories, specified and non-specified investments.

Specified Investments

Specified investments are those expected to offer relatively high security and liquidity and can be entered into with the minimum of formalities. The WG Guidance defines an investment as a specified investment if all of the following apply:

- The investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling.
- The investment is not a long-term investment (i.e. due or available to be repaid within 12 months).
- The making of the investment is not defined as capital expenditure by virtue of regulation 20 (1)(d) of the Local Authorities (Capital Finance and Accounting) (Wales) Regulations 2003 Statutory Instrument 3239 (W319) (as amended)
- The investment is made with a body or in an investment scheme of high credit quality or with one of the following public-sector bodies:
    - the United Kingdom Government
    - a local authority in England or Wales (as defined in section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland
    - a parish or community council.

The Council defines “high credit quality” organisations and securities as those having a long term credit rating of A- or higher that are domiciled in the UK or a Non UK country with a sovereign rating of AA- or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

Brexit

At the time of writing the UK’s sovereign rating is AA long term and F1+ short term. If there were to be a disorderly Brexit, the Council will apply a sovereign rating at least equal to that of the United Kingdom for any UK based counterparty. This approach will not limit the number of UK counterparties available to the Council. To ensure the Council’s credit risk is not increased outside the UK, the sovereign rating requirement for investments to Non UK countries will be a minimum of AA-.

Non-Specified Investments

Any investment not meeting the definition of a specified investment is classed as Non-Specified. The Council does not intend to make any investments in foreign currencies, nor any with low credit quality bodies, nor any that are defined as capital expenditure by legislation.

Non-specified investments will therefore be limited to long-term investments. The Council does not currently hold any non-specified investments but will consider opportunities in this area subject to the advice of the Council’s treasury advisers and the views of the Section 151 Officer.

Investment Limits

	Short Term (under 12 months)	**Long Term (12 months+)**
UK Government incl. Treasury Bills, Gilts and DMADF	Unlimited	Unlimited
UK Local Authorities	£5M per organisation.	£5M per organisation
UK and Foreign Financial Institutions (A-)	£5M per organisation	£5M per organisation
UK Call Bank Accounts in UK Banks (F1/P-1/A-1)	£5M per organisation	Not required

The Council does not currently invest in any individual country outside the UK and it is intended that this approach will continue in 2019/20. The total investment in individual UK institutions that are part of the same UK owned group will not exceed the limit set out in the table above.

Investment Contingencies

Certain contingencies are required to be included in the Strategy for instances where sums of money cannot be invested on the money market either because it is received too late in the working day or for any other reason.

These monies will be deposited in the Council’s current account. All deposits will be subject to the limit included in specified investments. Any such deposit must be withdrawn from the account and invested on the money market in the usual manner at the earliest opportunity.

Liquidity of Investments

The Council’s expenditure programmes together with the maintenance of adequate reserves etc. will be used to determine the maximum period for which funds may prudently be committed. The maximum period for which funds may prudently be committed in any individual investment shall not exceed 10 years.

The Council's investments for the period to 31st December 2018 are set out below.

Investment Counterparty	Opening Balance 01/04/2018	Invested	Repaid	Closing Balance 31/12/18
	£000	**£000**	**£000**	**£000**
Local Authorities	60,000	255,450	(237,450)	78,000
Debt Management Account Deposit Facility (DMADF)	6,900	1,361,550	(1,362,450)	6,000
Total	**66,900**	**1,617,000**	**(1,599,900)**	**84,000**

Interest, at an average rate of 0.58% and amounting to £311,003 has been received from maturing investments for the first 9 months of 2018/19.

The above analysis shows that 92.72% of the Council's investments were placed with local authorities as at 31st December 2018. The Council has increased the average interest rate return from investments with other local authorities from 0.38% in 2017/18 to 0.62% in the first 9 months of 2018/19 partly due to an increase in the base rate to.075%. Funds placed with the DMADF have yielded investment income at a rate of 0.39%.

Whilst the Council has no specific exposure, the Section 151 Officer intends to follow closely the emerging picture in relation to a number of Council's financial positions and has decided to temporarily suspend the placement of investments with certain councils. The Section 151 Officer considers that having taken the advice of Link Asset Management and with regard to the provisions in respect of any default set out in the Local Government Act 2003 that it is prudent for the Council to continue to invest with local authorities. However, given increasing media speculation regarding the growing pressures on English authorities the Council will temporarily reduce the maximum term to 6 months for all new local authority investments.

<u>Other Investment Tools</u>

During 2019/20 the Council intends to continue to review the use of the following types of investments, to maximise return for the Council whilst continuing to prioritise the security of investments;

- Treasury Bills
- Money Market Funds.

Treasury Bills

A Treasury Bill (T-Bill) is a short-term debt obligation backed by the Treasury Department of the U.K. Government with a maturity of less than one year, sold in denominations of a minimum of £500,000 with £50,000 increments thereafter. There is a weekly auction held on a Friday with settlement due the following Monday. T-bills have various maturities and are issued at a discount from par.

In order to be able to utilise Treasury Bills the Council will need access to a Custodian Account. The Council has identified an appropriate provider of this facility with King & Shaxson Ltd.as they provide a tailor made service for local authorities and are the only one available on the market at this time.

Contracts for financial services related to the issue or transfer of shares and other instruments are excluded contracts under the Public Contracts Regulations 2015 legislation. Services in relation to our investment in Treasury Bills would fall into this exclusion.

It is the Council's intention to only bid on new issues of Treasury Bills and if successful hold them to maturity and not trade them on the secondary market. The Council's maximum holding of treasury bills will not exceed £5 million. The contract documentation is in the process of being reviewed by the Council's Legal Section.

Money Market Funds

The change in legislation in 2018/19 by the Welsh Government now permits the Council to consider the use of Money Market Funds when placing very short term investments as an alternative to the Debt Management Account Deposit Facility (DMADF).

Money Market Funds (MMFs) are pooled funds that invest in short- term debt instruments. They provide the benefits of pooled investment as investors can participate in a more diverse and high quality portfolio than they would otherwise individually. Each investor who invests in a money market fund is considered a shareholder of the investment pool, a part owner of the fund.

The principal objectives of MMF's are preservation of capital, very high liquidity and competitive returns commensurate with security and liquidity. The most important characteristic of a MMF is the highly diversified, high credit quality investments in the fund.

Assets that a MMF may invest in are securities issued by sovereign governments, treasury bills, investments with the DMADF, certificates of deposits issued by financial institutions, floating rate and medium term notes, commercial paper and very short dated term deposits.

The Council has a comprehensive list of the best performing MMF's commensurate with risk. Any appointments will be reported to Cabinet at the earliest opportunity.

The maximum funds to be deposited in an individual MMF will be £5m.

<u>External Service Providers</u>

Treasury Management Advisors

The Council appointed Link Asset Management as their external treasury management advisors from September 2018. The services received include:

- Advice and guidance on relevant policies, strategies and reports;
- Advice on investment decisions;
- Notification of credit ratings and changes;

- Other information on credit quality;
- Advice on debt management decisions;
- Accounting advice;
- Reports on treasury performance;
- Forecasts of interest rates; and
- Training courses.

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 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 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.

The Section 151 Officer may appoint cash or fund managers to manage on its behalf all or part of the Council's investments. Any external manager so appointed will be expected to comply with the Annual Investment Strategy.

External Fund Managers (other than Superannuation Fund)

External cash or fund managers may be appointed by the Section 151 Officer to manage all or a proportion of its available cash balances. The external managers are also required to comply with Guidance on Local Government Investments issued by Welsh Government. The investment criteria imposed on the external managers will be included in the Investment Management Agreement**.** The Council at present do not engage external fund managers.

Investment Training

The CIPFA Code requires that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training provided by the Council's treasury advisor was undertaken by members in December 2017 and further training has been arranged for February 2019. The training needs of treasury management officers are periodically reviewed and are assessed as part of the staff appraisal process and from the frequent in-house meetings between the Treasury Management Team and the Section 151 Officer.

<u>Other Issues</u>

Use of Financial Derivatives

The Localism Act 2011 includes a general power of competence that removes the uncertain legal position over English local authorities' use of standalone financial derivatives (.i.e. those that are not embedded into a loan or investment). Although this change does not apply to Wales, the latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

In the absence of any legislative power, the Council's policy is not to enter into standalone financial derivatives transactions such as swaps, forwards, futures and options. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall Treasury Risk Management Strategy.

Cardiff Capital Region City Deal

The Vale of Glamorgan Council is a participant in the Cardiff Capital Region City Deal which has been established between the UK Government, the Welsh Government and 10 local authorities in South East Wales. The agreement with the UK and Welsh Governments' provides £1.2 billion of which £734m is allocated to the Metro, with the balance of £495m being made available as the Wider Investment Fund.

The Vale of Glamorgan's share of the estimated total costs (8.5%) is projected to be in the order of £17.9m and will be funded by unsupported borrowing with a 20 year repayment period. The Vale of Glamorgan Council's contribution to expenditure was £2.052m in 2017/18 and this cost has been funded from borrowing which will be financed from the Council's own resources.

The Section 151 Officer considers that it is prudent to reflect the current funding proposals in the Treasury Management indicators and the Strategy, however, they will be updated as and when changes in expenditure plans are advised to the Council.

Project Bank Account

Welsh Government is committed to ensuring that sub-contractors involved in the delivery of public sector contracts in Wales are treated fairly. Previous experience suggests that payment practices have been historically poor throughout the supply chain and has led to cashflow pressures, which can have a greater effect on smaller companies further down the supply chain.

In order to improve this situation and to provide greater certainty of payment through the supply chain and to optimise payment periods to minimise financing charges, Welsh Government procurement policy requires Project Bank Account (PBA) arrangements to be used for publicly funded construction/infrastructure projects.

PBAs are ring fenced bank accounts with trust status which act solely as a receptacle for transferring funds from the client to the lead contractor and its sub-contractors. PBAs allow simultaneous payments to all levels of the supply chain.

As the PBA has trust status, monies can only be paid to the named beneficiaries of the PBA. These would be the lead contractor and other sub-contractors within the project's supply chain. The Vale of Glamorgan Council and the lead contractor would both be trustees of the bank account, however the account would be set up by the lead contractor The Council will only place its funds with institutions which have a credit rating of A- or higher. The PBA would therefore need to be opened with an institution which meets this minimum requirement.

Welsh Government had requested that a Project Bank Account was to be used as a vehicle to making payments under the design and build contract for the Five Mile Land Scheme, however, a PBA has not been put in place for the project as the contractor was not able to source a suitable product. Welsh Government has been advised of this situation.

MiFID II

Local authorities had been treated by regulated financial services firms as professional clients who can opt down to be treated as retail clients instead, however, from January 3rd 2018, as a result of the second Markets in Financial Instruments Directive (MiFID II), local authorities are treated as retail clients who can opt up to be professional clients, provided that they meet certain criteria.

Regulated financial services firms include banks, brokers, advisers, fund managers and custodians, but only where they are selling, arranging, advising or managing designated investments. In order to opt up to professional, the authority must have an investment balance of at least £10 million and the person authorised to make investment decisions on behalf of the authority must have at least one year's relevant professional experience. In addition the firm must assess that, that person has the expertise, experience and knowledge to make investment decisions and understand the risks involved.

The main additional protection for retail clients is a duty on the firm to ensure that the investment is suitable for the client. However, local authorities are not protected by the Financial Services Compensation Scheme nor are they eligible to complain to the Financial Ombudsman Service whether they are retail or professional clients. It is also likely that retail clients will face an increased cost and potentially restricted access to certain products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. The Council has declined to opt down to retail client status in the past as the costs were thought to outweigh the benefits.

The Council meets the conditions to opt up to professional status and has opted to do so with the Council's treasury advisers Link Asset Management and the brokers that it transacts with in order to maintain their current MiFID status.

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Appendix 2

Treasury Management Policy

Whilst considerations, such as interest rate forecasts, will inevitably inform the Treasury Management Strategy to be adopted over the coming year(s), account must also be taken of certain fundamental parameters that the Council must work within. These may include political, environmental, social, technical, economic and legislative factors and form the basis of the Treasury Management Policy that underpins the Strategy.

The following statement therefore, constitutes the Treasury Management Policy of the Council. Adherence to its requirements is mandatory for all matters relating to Treasury management and Investment.

Definition

The Council defines Treasury Management as:

"The management of the Council'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."

Objectives and Purpose

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

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

The objectives of the policy are to: -

- Support the quality and status of Treasury Management; and
- Provide guidance on the proper practices to be employed for Treasury Management.

The purpose of this Policy is to give guidance and advice on such matters as: -

- The allocation of responsibility among the relevant staff;
- Reconciliation of the need for rapid decisions on dealing with the need to be accountable for use of delegated authority;
- Mechanisms to satisfy the statutory obligations placed upon the Monitoring Officer and the Section 151 Officer; and
- Good practice in reporting at various levels in the Council.

Procedure

All investments of money under the Council's control shall be made in the name of the Council or in the name of the nominees approved by the Council. Bearer securities shall be excluded from this regulation, but any purchase of such securities shall be reported to the Council.

All borrowings shall be effected in the name of the Council and must be authorised by the Section 151 Officer (subject to the Policy on Delegation set out below).

All money in the hands of the Council shall be under the control of the Section 151 Officer.

The Section 151 Officer shall be the Council's Registrar of Bonds and shall maintain records of all borrowings of money by the Council.

All officers acting as trustees by virtue of their official position shall deposit all securities, etc. relating to the trust with the Head of Legal Services unless the deed otherwise provides.

Formulation of Treasury Management/Investment

At or before the start of the financial year, the Section 151 Officer shall report to the Council on the Treasury Management Strategy it is proposed to adopt for the coming financial year (including Prudential Indicators for the coming three financial years). At the same time the Council will consider for adoption for the coming financial year an Annual Investment Strategy.

Borrowing Policy

Revenue budget stability is desirable and with this in mind the Council would usually borrow the majority of its long-term funding needs at long-term fixed rates of interest. Short-term and variable rate loans will only be borrowed to the extent that they either offset short-term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003 and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

Investment Policy

The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss and to ensure liquidity. Investment income is important but a secondary objective.

The Council will have regard to the Welsh Government Guidance on Local Government Investments and will approve an Investment Strategy each year as part of the Treasury Management strategy. The Strategy will set criteria to determine suitable organisations with which cash may be invested and limits on the amount of cash that may be invested with any one organisation.

Policy on Custodians

To facilitate the use of some approved investment instruments (eg Treasury Bills), the use of custodian facilities are required. The Section 151 Officer may appoint a custodian to administer and safeguard any investments on behalf of the Council providing that this custodian operates at all times within the Authority's Treasury Management Policy & Investment Strategy framework.

Policy on Delegation

All executive decisions on borrowing, investment or financing shall be delegated to the Section 151 and the Deputy Section 151 Officer (in his / her absence) or through the following posts, who shall all be required to act in accordance with CIPFA's "Code for Treasury Management in the Public Services".

- W-RM-AC003 Principal Accountant
- W-RM-AC015 Senior Accounting Technician
- W-RM-AC006 Capital Accountant
- W-RM-AC014 Corporate Accountant

Review Requirements and Reporting Arrangements

The Section 151 Officer shall report to the Council as follows: -

Before the 31st March each year

- The Treasury Management Prudential Indicators for the forthcoming three years; and
- The Treasury Management Strategy and Annual Investment Strategy for the following year (the Treasury Management Strategy also incorporates the indicators for the forthcoming three years).

A revised Investment Strategy may be prepared if at any time it is considered appropriate.)

A mid-year review during the current year.

As soon as possible after the end of the financial year - report on the out-turn for the previous year.

The Section 151 Officer shall also report to Cabinet and/or Scrutiny Committee other monitoring reports that are considered necessary to comply with CIPFA's "Code for Treasury Management in the Public Services".

Scheme of Delegation

(i) Full Council

- Receiving and reviewing reports on Treasury Management policies, practices and activities; and
- Approval of annual Treasury Management & Investment Strategy.

(ii) Cabinet

- Approval of/amendments to the organisation's adopted clauses, Treasury Management Policy Statement and Treasury Management practices;
- Budget consideration and approval;
- Receiving and reviewing regular monitoring reports and acting on recommendations; and

(iii) Scrutiny Committee

- Reviewing the Treasury Management policy and procedures and making recommendations to the responsible body.

The Role of the Section 151 Officer

The S151 Officer will be responsible for the following:

- 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;
- 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;
- The appointment of external service providers;
- Preparation of a capital strategy to include capital expenditure, capital financing, and treasury management, with a long term timeframe;
- Ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money; and
- Ensuring that due diligence has been carried out on all investments and is in accordance with the risk appetite of the authority.