

# APPENDIX 4

## Treasury Management Strategy Statement

### 1 BACKGROUND

1.1 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.

1.2 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 any debt previously drawn may be restructured to meet Council risk or cost objectives.

1.3 The Chartered Institute of Public Finance Accountants (CIPFA) defines treasury management as:

*"The management of the local 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."*

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

- I. A treasury strategy including Prudential and Treasury indicators (this report) - The first, and most important report covers:
  - the capital plans (including prudential indicators);
  - a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
  - the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
  - an investment strategy (the parameters on how investments are to be managed).
- II. A Mid-year Treasury Management Report – this will update the Council with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury activity is meeting the strategy or whether any policies require revision.

III. An Annual Treasury Report – this provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.5 That the Council nominates one of its committees to keep under review treasury management arrangements and to scrutinise reports before being recommended to the Council. This role is undertaken by both the Audit Committee and Overview and Scrutiny Management Board.

## **2 Treasury Management Strategy for 2018/19**

2.1 The Treasury Management Strategy for 2018/19 covers two main areas:

### Capital Issues

- The capital plans and the prudential indicators;
- The minimum revenue provision (MRP) policy.

### Treasury Management Issues

- current and projected treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on the use of external service providers.

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

2.3 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.

2.4 The training needs of treasury management officers are periodically reviewed.

- 2.5 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.
- 2.6 The Council 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.
- 2.7 The West of England Combined Authority (WECA) was established in 2017. The WECA have its own borrowing powers, and as expected transfers of responsibilities have led to changes in Bristol City Council's cash flows. However, it is not considered that any changes to the Council's Treasury Management Strategy are necessary and no changes are being recommended arising from the establishment of the WECA. This position will be reviewed as necessary and any changes reported within future Treasury reports.
- 2.8 The Chartered Institute of Public Finance and Accountancy, (CIPFA) consulted local authorities on revising the Treasury Management Code and the Prudential Code and recently issued revised codes to be implemented for 2018/19, with guidance notes to follow.

A number of these changes have already been implemented but there is a significant new requirement for authorities to produce a capital strategy that sets out the long-term context in which capital expenditure and investment decisions are made and gives due consideration to both risk and reward and impact on the achievement of priority outcomes.

The capital strategy will provide a high level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

It is recognised that this new requirement will require a longer lead-in period and therefore CIPFA acknowledge that this strategy may not be fully implemented until 2019/20 financial year.

Officers have begun developing this strategy and will provide an update over the coming months.

### 3 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2022/23

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

#### Capital expenditure

3.2 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. The table also summarises how the capital expenditure plans are being financed. Any shortfall of resources results in a borrowing need. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £m	2016/17 Act £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Non-HRA	147	111	189	217	120	85	24
Non – HRA*	-	-	8	9	10	6	-
HRA	49	34	47	63	56	55	56
<b>Total</b>	<b>196</b>	<b>145</b>	<b>244</b>	<b>289</b>	<b>186</b>	<b>146</b>	<b>80</b>
<b>Financed by:</b>							
Capital receipts	15	2	15	52	75	71	17
Capital grants	62	48	79	84	19	11	10
HRA Self financing	34	25	25	25	26	26	26
Revenue	18	9	13	10	8	10	13
<b>Net financing need for year</b>	<b>67</b>	<b>61</b>	<b>112</b>	<b>118</b>	<b>58</b>	<b>28</b>	<b>14</b>

\*Schemes pending subject to business case development

#### The Council's borrowing need (the Capital Financing Requirement)

3.3 The Capital Financing 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 underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

3.4 The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

3.5 The CFR includes any long-term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of schemes include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £141m of such schemes within the CFR.

3.6 The Council is asked to approve the CFR projections below:

	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
CFR – non housing	396	452	561	675	728	748	752
CFR – PFI/Lease schemes	146	141	134	128	121	115	108
CFR – housing	245	245	245	245	245	245	245
<b>Total CFR</b>	<b>787</b>	<b>838</b>	<b>940</b>	<b>1,048</b>	<b>1,094</b>	<b>1,108</b>	<b>1,105</b>
<b>Movement in CFR</b>	<b>54</b>	<b>51</b>	<b>102</b>	<b>108</b>	<b>46</b>	<b>14</b>	<b>(3)</b>

Net financing need for year	67	61	112	118	58	28	14
Less MRP & other financing	(13)	(10)	(10)	(10)	(12)	(14)	(17)
<b>Movement in CFR</b>	<b>54</b>	<b>51</b>	<b>102</b>	<b>108</b>	<b>46</b>	<b>14</b>	<b>(3)</b>

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

3.7 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 allowed to undertake additional voluntary provision.

3.8 The Department of Communities and Local Government (CLG) have issued Regulations which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

*For capital expenditure incurred before 1 April 2008 and capital expenditure incurred on or after that date which forms part of its Supported Capital Expenditure - The MRP policy will be based on the pre 2007/08 borrowing and*

*post supported borrowing at 2% fixed so that the whole debt is repaid after 50 years.*

*Note a change in policy approved by Full Council on 13th December 2016 amended the rate that is used to calculate MRP from 4% reducing balance to 2% straight line as this is better aligned to the average lives of the authorities assets and results with the debt being fully repaid. This means that the authority has overprovided during the period 1st April 2008 through to 31st March 2016. The Council has reduced its MRP provision in 2017/18 and will reduce its MRP further, over an adequate timeframe (a further 5 years) to recover this overprovision while also ensuring a prudent annual provision is maintained. This additional reduction in MRP will be set aside to reserves to ensure the Council maintains reasonable provision as mitigation for financial risks outlined in the main body of the report. It is estimated that for 2018/19 £7.5m of this overprovided MRP will be made available to supplement general reserves.*

*From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be the Asset life method – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction);*

*Any loan or investment to an organisation defined as capital expenditure will not attract MRP. The original capital expenditure will be met from the capital receipt on the maturity of the loan/investment.*

*Other methods to provide for debt repayment may occasionally be used in individual cases where this is consistent with the statutory duty to be prudent, as justified by the circumstances of the case, as determined by the Chief Finance Officer.*

*These options provide for a reduction in the borrowing need over approximately the asset's life.*

- 3.9 There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).
- 3.10 Repayments included in annual PFI or finance leases are applied as MRP.
- 3.11 The Council participates in the Local Authority Mortgage Scheme (LAMS) using the cash backed option. The mortgage lenders require a five year cash advance from the local authority to match the five year life of the indemnity. The cash advance placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the local authority, the returned funds are classed as a

capital receipt, and the CFR will reduce accordingly. As this is a temporary (five years) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position is reviewed on an annual basis.

### **Affordability prudential indicators**

- 3.12 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 Council's overall finances. The Council is asked to approve the following indicators: The Prudential Code requires that the Council set a series of indicators on a minimum three year time frame. The Prudential Indicators are there to demonstrate that the Council can afford the proposed capital programme and that such expenditure is sustainable and prudent.
- 3.13 **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.

	<b>2016/17 Actual %</b>	<b>2017/18 Estimate %</b>	<b>2018/19 Estimate %</b>	<b>2019/20 Estimate %</b>	<b>2020/21 Estimate %</b>	<b>2021/22 Estimate %</b>	<b>2022/23 Estimate %</b>
General Fund	7.69	6.49	6.56	7.86	8.55	9.64	10.38
HRA	8.66	8.88	8.89	8.57	8.26	7.88	7.52

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

## 4 BORROWING

4.1 The capital expenditure plans set out in Section 3 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy.

### Current and projected portfolio position

4.2 The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt against the underlying capital borrowing need (the Capital Financing Requirement), highlighting any over or under borrowing.

	2016/17 Actual £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
External Debt 1 April	417	434	431	551	671	751	791
Expected change in debt	17	(3)	120	120	80	40	10
Other long-term liabilities	152	146	141	134	128	121	115
Expected change in other long-term liabilities	(6)	(5)	(7)	(6)	(7)	(6)	(7)
Debt Administered on behalf of the Unitary authorities	(46)	(44)	(43)	(41)	(39)	(38)	(36)
<b>Actual gross debt 31 March</b>	<b>534</b>	<b>528</b>	<b>642</b>	<b>758</b>	<b>833</b>	<b>868</b>	<b>873</b>
<b>Capital Financing Requirement</b>	<b>787</b>	<b>838</b>	<b>940</b>	<b>1,048</b>	<b>1,094</b>	<b>1,108</b>	<b>1,105</b>
<b>Under borrowing</b>	<b>(253)</b>	<b>(310)</b>	<b>(298)</b>	<b>(290)</b>	<b>(261)</b>	<b>(240)</b>	<b>(232)</b>

### Gross Debt and the Capital Financing Requirement

4.3 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 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 purposes.

- 4.4 The Chief Finance Officer 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 current commitments, existing plans, and the proposals in this budget report.

#### Treasury Indicators: limits to borrowing activity

- 4.5 **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.

	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Debt	434	531	631	721	761	771
Other long-term liabilities	146	141	134	128	121	115
<b>Total</b>	<b>580</b>	<b>672</b>	<b>765</b>	<b>849</b>	<b>882</b>	<b>886</b>

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

	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
<b>Total</b>	<b>900</b>	<b>960</b>	<b>1,080</b>	<b>1,120</b>	<b>1,140</b>	<b>1,130</b>

- 4.7 **HRA CFR limit.** Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
HRA debt limit	257	257	257	257	257	257
HRA CFR	245	245	245	245	245	245
<b>HRA Headroom</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>	<b>12</b>

As part of the autumn budget, central government announced that it will invite local authorities with high demand housing areas to bid for increases in their debt limit

(cap) from 2019/20 with up to a total of £1 billion by the end of 2021/22. Further information will be reported in future reports.

### Prospects for interest rates

4.8 The Council has appointed a treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their view.

Period	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)			
		5 year	10 Year	25 year	50 year
Mar 2018	0.50	1.60	2.20	2.90	2.60
Mar 2019	0.75	1.80	2.50	3.10	2.90
Mar 2020	1.00	2.10	2.70	3.40	3.20
Mar 2021	1.25	2.30	3.00	3.60	3.40

- 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 with further details set out in Annex 2. In summary,
- Counterparty risks appear to have eased but market sentiment remains changing and economic forecasts uncertain.
- Investment returns are likely to remain relatively low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back again somewhat. Apart from that, there has been little general trend in rates during the current financial year.
- The overall longer run trend is for gilt yields and PWLB rates to rise gently.
- 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 to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### **Borrowing Strategy**

- 4.9 Based on current cash flow forecasts, it is estimated that the Council will have a net borrowing requirement of £370m over the MTFS period. The most significant consideration from a treasury management perspective is the timing and duration of that borrowing. Should the financial environment change and borrowing is deemed advantageous the Council will seek to borrow long-term loans below a target rate of 3.00% and short-term medium term loans below a target rate of 2.50%.
- 4.10 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 relatively high.
- 4.11 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Chief Finance Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- *If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.*
  - *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and 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.*
- 4.12 Any decisions will be reported to the appropriate decision making body at the next available opportunity.
- Long-term and short term fixed interest rates are expected to rise modestly over the medium term. The Chief Finance Officer, under delegated powers, will take the most appropriate form of borrowing depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

- The option of postponing borrowing and running down investment balances strategy has been applied so far throughout 2017/18. This approach will continue until balances are reduced to adequate liquidity requirements unless it was felt that there was a significant risk of a sharp rise in interest rates.
- The Councils borrowing strategy will give consideration to new borrowing in the following ways:
  - The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs if the opportunity is missed for taking loans at long term rates which will be higher in future years;
  - PWLB loans for up to 10 years where rates are expected to be significantly lower than rates for longer periods. This offers a range of options for new borrowing, which will spread debt maturities away from a concentration in longer dated debt;
  - PWLB loans in excess of 10 years where rates are considered to be low and offer the Council the opportunity to lock into low value long-term finance;
  - Long term fixed rate market loans at rates significantly below PWLB rates for the equivalent maturity period (where available) and to maintaining an appropriate balance between PWLB and market debt in the debt portfolio;
  - Long term borrowing from the Municipal Bond Agency if available and appropriate and rates are lower than those offered by the Public Works Loan Board (PWLB).

4.13 The authority is planning net borrowing of £370m over the period as set out in table 4.2, to finance the expected Prudential Borrowing requirement of £331m as set out in table 3.2 as set out in the Capital programme. The additional borrowing of £39m finances the expected net reduction in cash resources to maintain adequate liquidity levels as set out in the strategy. This will also partly reverse the current internal borrowing position, reducing the interest risk exposed to the authority, minimising the increase in net debt financing costs and reducing counterparty risk.

4.14 The Council will seek to undertake temporary borrowing (less than one year) loans to cover day-to-day cashflow requirements as and when required. Such a decision will be based on the availability of and access to cash in deposit accounts and money market funds to cover the cashflow requirement, whilst also considering the most efficient method for the authority.

- 4.15 Temporary borrowing will also be considered when the draw down deadline for a deposit account for same day transfer has passed, thus resulting in borrowing cash from the money markets.
- 4.16 The Chief Finance Officer will be kept informed of the temporary loans outstanding on a monthly basis and reviewed at the regular Treasury Management Group meeting.

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

- 4.17 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.
- 4.18 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.

### **Debt rescheduling**

- 4.19 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).
- 4.20 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).
- 4.21 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.
- 4.22 All rescheduling will be reported to the Council at the earliest meeting following its action.

### **Municipal Bond Agency**

- 4.23 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

Authority may make use of this new source of borrowing as and when appropriate.

## **5 ANNUAL INVESTMENT STRATEGY**

### **Investment policy**

- 5.1 The Council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.
- 5.2 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.
- 5.3 Ratings will not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such a 'credit default swaps' and overlay that information on top of the credit ratings.
- 5.4 Other information sources including 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.
- 5.5 Investment instruments identified for use in the financial year are listed in Annex 3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

### **Creditworthiness policy**

- 5.6 The primary principle governing the Council's investment criteria is the security of its investments, whilst liquidity and the yield on the investment is also a key consideration. After this main principle, the Council will ensure that:
  - It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
  - It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

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

5.8 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council's minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council's criteria, the other does not, the institution will fall outside the lending criteria. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are considered before making investment decisions.

5.9 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) is:

- **Banks 1** - good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA

and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

- i. Short term – F1 (or equivalent)
  - ii. Long term – A- (or equivalent)
- **Banks 2** – Part nationalised UK banks – Royal Bank of Scotland. This bank can be included if they continue to be part nationalised or they meet the ratings in Banks 1 above.
  - **Banks 3** – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
  - **Bank subsidiary and treasury operation** - the Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
  - **Building societies** - the Council will use all societies which meet the ratings for banks outlined above.
  - **Money market funds (CNAV<sup>Constant Net Asset Value</sup>)** – AAA rated (sterling)
  - **Money Market Funds (LVAV<sup>Low Volatility Asset Value</sup>)** – AAA rated (sterling)

- **Money Market Funds (VNAV <sup>Variable Net Asset Value</sup>) – AAA rated (sterling)**
- **Ultra-Short dated Bond Funds with a volatility rating of S1+**
- **UK Government** (including gilts and the DMADF)
- **Local authorities, parish councils etc**
- **Supranational institutions**
- **Local Authority Mortgage Scheme.** Under this scheme the Council is required to place funds of £1m, with Lloyds Bank Plc for a period of 5 years. This is classified as being a service investment, rather than a treasury management investment, and is therefore outside of the specified/non specified categories.
- **Council owned subsidiaries.** The Council invests in wholly owned Council subsidiaries. Depending on the nature of the investment this will either be classified as a Service investment or a Treasury investment. Service investments fall outside the scope of the specified/ non specified categories and currently investments of this type are classified as service investments.

A limit of £100m will be applied to the use of non-specified investments

### **Country and sector considerations**

- 5.10 Due care will be taken to consider the country, group and sector exposure of the Council's investments. The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). In addition:
- no more than 25% will be placed with any non-UK country at any time;
  - limits in place above will apply to a group of companies;
  - sector limits will be monitored regularly for appropriateness.
- 5.11 **Use of additional information other than credit ratings.** Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision. This additional market information (for example Credit Default Swaps (CDS), negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

**Time and monetary limits applying to investments.**

5.12 Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	<b>Fitch Long term Rating (or equivalent)</b>	<b>Money Limit</b>	<b>Time Limit</b>
Banks 1 - higher quality	AAA	£50m	5 Years
Banks 1 - medium quality	AA-	£20m	3 Years
Banks 1 - lower quality	A-	£10m	1 Year
Banks 2 – part-nationalised	N/A	£10m	1 Year
Limit 3 category – Council's banker (not meeting Banks 1/2)	-	£100k	Liquid
Other institutions limit*	-	£50m	1 Year
DMADF	UK Sovereign rating	unlimited	1 Year
Local authorities	-	£40m	5years
Money market funds (MMF) (Including CNAV, LVNAV & VNAV)	AAA	£40m	liquid

*\*The Other Institution Limit will be for Gilt and Supranational investments*

The proposed criteria for specified and non-specified investments are shown in Annex 3 for approval.

5.13 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).

5.14 For its cash flow generated balances, the Council will seek to utilize its business reserve 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.

5.15 **Investment return expectations.** Bank Rate is forecast to remain unchanged at 0.50% until quarter 4 of 2018 and not to rise above 1.25.% by quarter 1 of 2021. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

Budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next three years are as follows:

- 2018/19 0.60%

- 2019/20 0.90%
- 2020/21 1.25%
- 2021/22 1.50%
- 2022/23 1.75%

The overall balance of risks to these forecasts is currently to the upside and are dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

### Treasury management limits on activity

5.16 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. The indicators are:

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

	2018/19	2019/20	2020/21 & Beyond
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	40%	40%	40%
<b>Maturity structure of fixed interest rate borrowing 2018/19</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	30%	
12 months to 2 years	0%	40%	
2 years to 5 years	0%	40%	
5 years to 10 years	0%	50%	
10 years and above	25%	100%	

### Investment treasury indicator and limit

5.17 Total principal funds invested for greater than 365 days. These limits are set with regard to the Council'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.

<b>Maximum principal sums invested &gt; 365 days</b>			
<b>£m</b>	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21 &amp; Beyond</b>
Principal sums invested > 364 days	£100m	£100m	£100m

### **Ethical Investment Policy**

5.18 The Ethical Investment Policy was approved by Cabinet on the 15<sup>th</sup> December 2011 (updated 2015). The City Council will not knowingly invest in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the City Council.

### **Investment Risk Benchmarking**

5.19 These benchmarks are simple guides to maximum risk, so they may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the mid-year or Annual Report.

5.20 Security - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

- 0.00% (AAA rated) to 0.07% (A rated) historic risk of default when compared to the whole portfolio.

Liquidity – in respect of this area the Council seeks to maintain:

- Bank overdraft - £500k.
- Liquid short term deposits of at least £40m available within a rolling three month period.
- Weighted average life benchmark is expected to be a minimum of a day with a maximum of 1 year.

Yield - local measures of yield benchmarks are:

- Investments – internal returns above the 7 day LIBID rate.

And in addition that the security benchmark for each individual year is:

	<b>1 year</b>	<b>2 years</b>	<b>3 years</b>	<b>4 years</b>	<b>5 years</b>
<b>Maximum</b>	<b>0.07%</b>	<b>0.19%</b>	<b>0.36%</b>	<b>0.55%</b>	<b>0.78%</b>

This benchmark is an average risk of default measure, and would not constitute an expectation of loss against a particular investment.

## **Annexes**

Annex 1 - Treasury Management Policy Statement

Annex 2 – Economic Background

Annex 3 – TMP1 Credit and Counterparty risk management

### Treasury Management Policy Statement

1. The Council defines its treasury management activities as follows:

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

2. 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.
3. 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.
4. The Council's high level policies for borrowing and investments are:
  - The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt
  - The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

## Economic Background / Interest Rate forecast

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLBRate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLBView	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLBView	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLBRate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The forecast set out above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Federal Reserve has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Federal Reserve has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

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

- Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Federal Reserve Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then

leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

### **Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management**

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The Council has adopted the Code and will apply its principles to all investment activity. In accordance with the Code, the Chief Finance Officer has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

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

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

The investment policy proposed for the Council is:

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

**Specified investments** – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.

3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
5. A body that is considered of a high credit quality (such as a bank or building society). For this category this covers bodies with a minimum short term rating of A- (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies. This criteria is set out below:-

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	AAA	£50m	5 Years
Banks 1 medium quality	AA-	£20m	3 Years
Banks 1 lower quality	A-	£10m	1 Year
Banks 2 – part nationalised	N/A	£10m	1 Year
Limit 3 category – Council's banker (not meeting Banks 1/2)	-	£100k	Liquid
Other institutions limit*	-	£50m	1 Year
DMADF	AAA	unlimited	5 Years
Local authorities	-	£40m	5 Years
Money market funds (Including CNAV, LVNAV & VNAV)	AAA	£40m	liquid

\*The Other Institution Limit will be for Gilt and Supranational investments

**Non-specified investments** –are any other type of investment (i.e. not defined as specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments is limited to an overall exposure of £100m and would include any sterling investments with:

	Non Specified Investment Category	Limit (£ or %)
a.	<b>Supranational bonds greater than 1 year to maturity</b> <b>(a) Multilateral development bank bonds</b> - These are bonds defined as an international financial institution having as one of its objects economic development, either generally or in any region of the world (e.g. European Reconstruction and	AAA long term ratings £50m

	<p>Development Bank etc.).</p> <p><b>(b) A financial institution that is guaranteed by the United Kingdom Government</b> (e.g. The Guaranteed Export Finance Company {GEFCO})</p> <p>The security of interest and principal on maturity is on a par with the Government and so very secure. These bonds usually provide returns above equivalent gilt edged securities. However the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	
b.	<p><b>Gilt edged securities</b> with a maturity of greater than one year. These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity. Similar to category (a) above, the value of the bond may rise or fall before maturity and losses may accrue if the bond is sold before maturity.</p>	£50m
c.	<p><b>The Council's own banker</b> if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.</p>	Minimal
d.	<p>Any <b>bank or building society</b> that has a minimum long term credit rating of A-, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).</p>	£40m
e.	<p>Any <b>non rated subsidiary</b> of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to:</p> <ul style="list-style-type: none"> <li>• Parent company guarantee</li> <li>• Parent company to be a UK institution.</li> </ul>	£10m
f.	<p><b>Share capital or Loan Capital</b> in a body corporate – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. There is a higher risk of loss with these types of instruments.</p>	£10m
g.	<p><b>Share capital or Loan Capital to Council owned companies</b> – The use of these instruments will be deemed to be capital expenditure, and as such will be an application (spending) of capital resources.</p>	£50m
h.	<p><b>Bond funds</b> – There is a high risk of loss with this type of instrument.</p>	£10m
i.	<p><b>Pooled property funds</b> – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources. The key exception to this is an investment in the CCLA Local Authorities Property Fund. This Authority will seek guidance</p>	£50m

	on the status of any fund it may consider using	
	The authority has invested £10m in a Property Fund (Cabinet 03/11/15 & 19/09/17) to support Homelessness in Bristol.	
j.	<b>Property funds managed by a wholly owned Council subsidiary</b> – The use of these instruments will normally be deemed to be capital expenditure, and as such will be an application (spending) of capital resources.	£50m

In respect of category f, g and h, these will only be considered after obtaining external advice and subsequent member approval.

### **Council owned companies**

The Council has purchased share capital / provided loans to wholly owned Council subsidiaries amounting £20m at the turn of the calendar year.

These are classified as service investment's, rather than treasury management investment's, and are therefore outside the specified / non specified categories.

### **Local Authority Mortgage Scheme.**

Under this scheme the Council is currently required to place funds with Lloyds Bank Plc (£1m) for a period of 5 years. The scheme is anticipated to finish in 2018/19 with the deposit returning.

**The monitoring of investment counterparties** - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Link Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Chief Finance Officer, and if required new counterparties which meet the criteria will be added to the list.