NEWCASTLE UNDER LYME
BOROUGH COUNCIL

Treasury Management Strategy

2019/20

Contents

Introduction

Treasury management is the management of the Council's cash flows, borrowing and investments, and the associated risks. The Council may invest or borrow substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Council's prudent financial management.

Treasury risk management at the Council is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year. This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit are considered in a different report, the Investment Strategy.

Treasury Management Consultants

The Council uses Arlingclose Ltd for its external treasury management advice service for the period 1st April 2017 to 31st March 2020.

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.

Economic Situation

Highlights of the report supplied by Arlingclose Ltd.

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Council's treasury management strategy for 2019/20.

Following a weak reading in the first quarter of 2018 attributed to weather-related factors, UK GDP growth rebounded in the second quarter to 0.4%, but at an annual rate of only 1.2% this remains below trend. As economic growth had evolved broadly in line with its May Inflation Report forecast, the Bank of England's Monetary Policy Committee (MPC) voted unanimously for a rate rise of 0.25% in August, taking Bank Rate to 0.75%. In November 2018 the MPC maintained Bank Rate at 0.75% while the Inflation Report showed that compared to the August report further interest rate increases may be required to bring inflation down to the 2% target over the forecast horizon.

The headline rate of UK Consumer Price Inflation fell back to 2.4% year-on-year in September 2018 from 2.7% in August, as higher import and energy prices continued to hold inflation above the Bank of England target.

While external inflationary pressures from energy costs and import prices are expected to subside, domestic pressures are projected to build over the forecast horizon with the balance of these effects likely to keep inflation above the Bank of England's target throughout most of their forecast horizon, meaning that strong real income growth is unlikely to materialise any time soon.

As the US economy has continued to perform well, the Federal Reserve maintained its monetary tightening stance and pushed up its target range for the Fed Funds Rate in September 2018 by 0.25% to 2% - 2.25%. One further rise is expected in 2018 and two more in 2019.

Credit outlook: The big four UK banking groups have now divided their retail and investment banking divisions into separate legal entities under ringfencing legislation. Bank of Scotland, Barclays Bank UK, HSBC UK Bank, Lloyds Bank, National Westminster Bank, Royal Bank of

Scotland and Ulster Bank are the ringfenced banks that now only conduct lower risk retail banking activities. Barclays Bank, HSBC Bank, Lloyds Bank Corporate Markets and NatWest Markets are the investment banks. Credit rating agencies have adjusted the ratings of some of these banks with the ringfenced banks generally being better rated than their non-ringfenced counterparts.

Interest rate forecast: Following the increase in Bank Rate to 0.75% in August 2018, the Council's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. Whilst assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity (at the time of writing this commentary in early November). As such, the risks to the interest rate forecast are considered firmly to the downside.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

Local Context

On 30th November 2018, the Council held no borrowing and £4.2m of investments. This is set out in further detail at Annex B.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Council has an increasing CFR due to the capital programme, but minimal investments and may therefore be required to borrow over the forecast period. More details in relation to the Council's CFR are included within the Capital Strategy.

Borrowing Strategy

The Council does not currently hold any loans, as per the previous year, as part of its strategy for funding previous years' capital programmes.

The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of [internal / short-term] borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the

Council borrows additional sums at long-term fixed rates in 2019/20 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2019/20, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council may borrow short-term loans to cover unplanned cash flow shortages.

Sources of borrowing:

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body;
- any institution approved for investments (see below);
- any other bank or building society authorised to operate in the UK;
- any other UK public sector body;
- UK public and private sector pension funds;
- capital market bond investors; and
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing;
- hire purchase; and
- sale and leaseback.

The Council has raised its long-term borrowing through the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

The UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to Council.

Short-term and variable rate loans: These loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Investment Strategy

The Council can hold significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between nil and £10 million.

The CIPFA Code requires the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The

Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

If the UK enters into a recession in 2019/20, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2019/20. This diversification will represent a substantial change in strategy over the coming year.

Under the new IFRS 9 standard, the accounting for certain investments depends on the Council's "business model" for managing them. The Council aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

The Council may invest its surplus funds with any of the counterparty types in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Approved investment counterparties and limits

Credit rating	**Banks unsecured**	**Banks secured**	**Government**	**Registered Providers**
UK Govt / LA's (exc. S114)	n/a	n/a	£ Unlimited 50 years	n/a
AAA	£7m 5 years	£7m 20 years	£7m 50 years	£2.5 m 20 years
AA+	£7m 5 years	£7m 10 years	£7m 25 years	£2.5 m 10 years
AA	£7m 4 years	£7m 5 years	£7m 15 years	£2.5 m 10 years
AA-	£7m 3 years	£7m 4 years	£7m 10 years	£2.5m 10 years
A+	£7m 2 years	£7m 3 years	£7m 5 years	£2.5 m 5 years
A	£7m 13 months	£7m 2 years	£7m 5 years	£2.5m 5 years
A-	£7m 6 months	£7m 13 months	£7m 5 years	£2.5m 5 years
None	£0	n/a	£0	£0
Pooled funds and real estate investment trusts			£1m per fund or trust	

The above limits apply to individual counterparties and represent the maximum amount and maximum duration of any investment per counterparty.

Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Operational bank accounts: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £7,000,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Council's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Investment limits: In order that the Council will not be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £7 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Investment limits

	Cash limit
Any single organisation, except the UK Central Government	£7m each
UK Central Government	unlimited
UK Local Authorities	unlimited
Any group of organisations under the same ownership	£7m per group
Any group of pooled funds under the same management	£7m per manager

Negotiable instruments held in a broker's nominee account	£7m per broker
Foreign countries	£7m per country
Registered providers and registered social landlords	£7m in total
Unsecured investments with building societies	£7m in total
Money market funds	unlimited
Real estate investment trusts	£7m in total

Liquidity management: The Council uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

Non-treasury investments are now covered by the Council's Investment Strategy.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Security

The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

Credit risk indicator	Target
Portfolio average credit rating	A+

Maturity structure of borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

Refinancing rate risk indicator	Upper limit	Lower limit
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal sums invested for periods longer than a year

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

Price risk indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£5m	£5m	£5m

Related Matters

The CIPFA Code requires the Council to include the following in its treasury management strategy.

Financial Derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Markets in Financial Instruments Directive (MiFID II): The Council has retained retail client status with its providers of financial services, including advisers and banks, allowing it access to a smaller range of services but with the greater regulatory protections afforded to individuals and small companies. This is believed to be the most appropriate status given the size and range of the Council's treasury management activities.

Financial Implications

The budget for investment income in 2019/20 is £49k. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CIPFA Code does not prescribe any particular treasury management strategy for local authorities to adopt. It is believed that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Annex A – Arlingclose Economic & Interest Rate Forecast October 2018

Underlying assumptions:

- The MPC left Bank Rate unchanged at the September meeting, after voting unanimously to increase Bank Rate to 0.75% in August.
- Our projected outlook for the UK economy means we maintain the significant downside risks to our interest rate forecast. The UK economic environment is relatively soft, despite seemingly strong labour market data. GDP growth recovered somewhat in Q2 2018, but the annual growth rate of 1.2% remains well below the long term average. Our view is that the UK economy still faces a challenging outlook as the country exits the European Union and Eurozone economic growth softens.
- Cost pressures were projected to ease but have risen more recently and are forecast to remain above the Bank's 2% target through most of the forecast period. The rising price of oil and tight labour market means inflation may remain above target for longer than expected. This means that strong real income growth is unlikely in the near future.
- The MPC has a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. We believe that MPC members consider both that: 1) ultra-low interest rates result in other economic problems, and 2) higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise and cuts are required.
- The global economy appears to be slowing, particularly the Eurozone and China, where the effects of the trade war has been keenly felt. Despite slower growth, the European Central Bank is adopting a more strident tone in conditioning markets for the end of QE, the timing of the first rate hike (2019) and their path thereafter. Meanwhile, European political issues, mostly lately with Italy, continue.
- The US economy is expanding more rapidly. The Federal Reserve has tightened monetary policy by raising interest rates to the current 2%-2.25% range; further rate hikes are likely, which will start to slow economic growth. Central bank actions and geopolitical risks have and will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- The MPC has maintained expectations of a slow rise in interest rates over the forecast horizon. Our central case is for Bank Rate is to rise twice in 2019. The risks are weighted to the downside.
- Gilt yields have remained at low levels. We expect some upward movement from current levels based on our interest rate projections, the strength of the US economy and the European Central Bank's forward guidance on higher rates. However, volatility arising from both economic and political events will continue to offer borrowing opportunities.

	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	Average
Official Bank Rate														
Upside risk	*0.00*	*0.00*	*0.00*	*0.00*	*0.25*	*0.25*	*0.25*	*0.25*	*0.25*	*0.25*	*0.25*	*0.25*	*0.25*	*0.17*
Arlingclose Central Case	0.75	1.00	1.00	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.25	1.17
Downside risk	*0.00*	*0.50*	*0.50*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.65*
3-mth money market rate														
Upside risk	*0.10*	*0.10*	*0.10*	*0.10*	*0.15*	*0.20*	*0.20*	*0.20*	*0.20*	*0.20*	*0.20*	*0.20*	*0.20*	*0.17*
Arlingclose Central Case	0.80	1.00	1.10	1.20	1.30	1.30	1.25	1.20	1.20	1.20	1.20	1.20	1.20	1.17
Downside risk	*0.20*	*0.50*	*0.60*	*0.70*	*0.80*	*0.80*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.68*
1-yr money market rate														
Upside risk	*0.20*	*0.30*	*0.30*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.33*
Arlingclose Central Case	1.05	1.25	1.35	1.40	1.50	1.45	1.40	1.40	1.40	1.40	1.40	1.40	1.40	1.37
Downside risk	*0.35*	*0.50*	*0.60*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.75*	*0.69*
5-yr gilt yield														
Upside risk	*0.15*	*0.20*	*0.25*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.32*
Arlingclose Central Case	1.15	1.20	1.25	1.35	1.40	1.40	1.35	1.35	1.30	1.30	1.30	1.30	1.30	1.30
Downside risk	*0.30*	*0.35*	*0.45*	*0.50*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.54*
10-yr gilt yield														
Upside risk	*0.20*	*0.25*	*0.25*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.32*
Arlingclose Central Case	1.60	1.65	1.65	1.70	1.75	1.75	1.75	1.70	1.70	1.70	1.70	1.70	1.70	1.70
Downside risk	*0.30*	*0.45*	*0.50*	*0.55*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.60*	*0.55*
20-yr gilt yield														
Upside risk	*0.20*	*0.25*	*0.25*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.32*
Arlingclose Central Case	1.90	1.95	1.95	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	2.00	1.98
Downside risk	*0.30*	*0.40*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.43*
50-yr gilt yield														
Upside risk	*0.20*	*0.25*	*0.25*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.35*	*0.32*
Arlingclose Central Case	1.80	1.85	1.85	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.90	1.88
Downside risk	*0.30*	*0.40*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.45*	*0.43*

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%

PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B – Existing Investment & Debt Portfolio Position

	30/11/2018 Actual Portfolio £m	30/11/2018 Average Rate %
Treasury investments:		
Banks & building societies (unsecured)	2.2	0.40
Government (incl. local authorities)	2.0	0.75
Money Market Funds	0.0	0.00
Total treasury investments	4.2	
Total external borrowing	0.0	
Net investments	**4.2**	

Annex C – Minimum Revenue Provision Policy

Background

In instances whereby Local Authorities have a positive Capital Financing Requirement (CFR), Ministry of Housing, Communities and Local Government (MHCLG) Guidance requires them to adopt a prudent approach in order to fund the repayment of debt. This may be achieved by setting aside a minimum amount from revenue, known as the Minimum Revenue Provision (MRP). This means that the Council would be required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP).

MHCLG Regulations and Guidance have been issued which require the Full Council to approve **an MRP Statement** in advance of each year. Four options for prudent provision of the MRP are provided to councils, these being:

Option 1 – Regulatory Method

For debt which is supported by the Government through the Revenue Support Grant system, authorities may continue to use the formulae in the current regulations, since the Revenue Support Grant is calculated on that basis. Although the existing regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities will be able to calculate MRP as if it were still in force. Solely as a transitional measure, this option will also be available for all capital expenditure incurred prior to 1 April 2008.

Option 2 – Capital Financing Requirement Method

This is a technically much simpler alternative to Option 1 which may be used in relation to supported debt. While still based on the concept of the CFR, which is easily derived from the balance sheet, it avoids the complexities of the formulae in the old regulation 28 (though for most authorities it will probably result in a higher level of provision than Option 1).

Option 3 – Asset Life Method

For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, there are two options included in the guidance.

Option 3 is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach.

Within option 3, two methods are identified. The first of these, the equal instalment method, will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure (“A” in the formula) remains constant.

The cumulative total of the MRP made to date (“B” in the formula) will increase each year. The outstanding period of the estimated life of the asset (“C” in the formula) reduces by 1 each year.

For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year, C will be equal to 24, and so on. The original estimate of the life is determined at the outset and should not be varied thereafter, even if in reality the condition of the asset has changed significantly

The formula allows an authority to make voluntary extra provision in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.

The alternative is the annuity method, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be particularly attractive in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time.

Option 4 – Depreciation Method

Alternatively, for new borrowing under the Prudential system for which no Government support is being given, Option 4 may be used.

This means making the MRP in accordance with the standard rules for depreciation accounting. A step in this direction was made in the last set of amendments to the MRP rules [SI 2007/573]. However, the move to reliance on guidance rather than regulations will make this approach more viable in future.

Authorities will normally need to follow the standard procedures for calculating depreciation provision. But the guidance identifies some necessary exceptions:

The MRP continues until the total provision made is equal to the original amount of the debt and may then cease.

If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

MRP Policy in respect of Finance Leases

The introduction of International Financial Reporting Standards in 2011/12 resulted in some leases being reclassified as finance leases instead of operating leases. This resulted in a positive CFR and as such the need to set aside a MRP.

In accordance with the revised MHCLG Guidance this Council will set aside an annual MRP equal to the amount of the lease that has been taken to the Balance Sheet to reduce the finance lease liability i.e. the principal amount of the finance lease. This approach will produce an MRP charge which is the same as Option 3 in the guidance (Asset Life Method – annuity method). The revised guidance aims to ensure that authorities are in the same position as if the change in accounting standards had not occurred.

MRP Policy – Other Capital Expenditure

Capital Financing Requirement (CFR)

The Council's CFR is currently positive. This means that there is a requirement to set aside a MRP for the redemption of debt. The Prudential Indicator for the CFR, shown at Table 1 in the Treasury Management Strategy, indicates that the CFR will become positive within the period covered by the Strategy. This is based on the assumption that there will be a general overall increase in expected capital expenditure, which cannot be funded from revenue or capital resources. Accordingly, the Council needs to determine the option it will employ to make the necessary MRP in respect of the amount borrowed, when this occurs.

Option for making MRP

The most appropriate of the four options permitted by the Regulations is Option 3, the Asset Life Method, within which there are two further options, an equal instalment method and an annuity method (as detailed in 1.1 – option 3). The Council is permitted to apply either of these two further options to projects on a scheme by scheme basis.

It should be noted that MRP does not commence until the year following that in which the asset concerned became operational; however, voluntary MRP can be made at any given time if considered prudent.

Annex D – Treasury Management Glossary of Terms

- *Basis Points* – there are 100 basis points to 1%.
- *CDS* – 'Credit Default Swap' is an additional assessment of credit worthiness by providing a risk analysis of changes in credit quality as perceived by the market.
- *CFR* – the Capital Financing Requirement is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources.
- *CIPFA* – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.
- *Counterparty* – an institution with whom a borrowing or investment transaction is made.
- *CPI* – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
- *Credit Rating* – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. The main rating agencies are Fitch. Standard and Poor's and Moody's.
- *Depreciation* – the measure of the cost or revalued amount of the benefits of the fixed asset that have been consumed during the period. Consumption includes wearing out, using up or other reduction in the useful life of a fixed asset whether arising from use, time or obsolescence through either changes in technology or demand for the goods and services produced by the asset.
- *DMADF and DMO* – the DMADF is the 'Debt Management Account Deposit Facility' which is a highly secure fixed term deposit account with the Debt Management Office, part of Her Majesty's Treasury.
- *Forward Commitments* - agreeing in advance to place an investment with a borrower at a future specified date at an agreed interest rate.
- *GDP* – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.
- *GILTS* – the name given to bonds issued by the UK Government. Gilts are issued bearing interest at a specified rate, however, they are traded on the markets like shares and their value rises of falls accordingly. The 'yield' on a gilt is the interest paid divided by the market value of that gilt.
- *IFRS (International Financial Reporting Standards)* – International accounting standards that govern the treatment and reporting of income and expenditure in an organisation's accounts, which came fully into effect from 1 April 2010.
- *Impairment Charges* – a reduction in the value of a fixed asset below its carrying amount on the balance sheet.
- *Intangible Assets* – non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the Council through custody or legal rights. Specifically purchased software licenses are included in this category of asset.
- *Leasing* - a lease is a contractual arrangement calling for the lessee (user) to pay the lessor (owner) for use of an asset.

- *Liquidity* – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- *MHCLG* – Ministry of Housing, Communities, and Local Government (formerly the Department for Communities and Local Government).
- *Money Market Funds (MMF)* – Money Market Funds are investment funds that are invested by a Fund Manager in a wide range of money market instruments. MMF's are monitored by the official ratings agencies and due to many requirements that need to be fulfilled; the funds usually receive the highest quality rating (AAA) so provide minimal risk. They are very flexible and can be withdrawn in the same way as any other call deposit.
- *MPC* – interest rates are set by the Bank of England's Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met
- *MRP* – the Minimum Revenue Provision represents the revenue charge for the repayment of debt.
- *PWLB* – the Public Works Loan Board is a statutory board that is run within the UK Debt Management Office (DMO), its function is to lend money to Local Authorities and other prescribed bodies.
- *QE* – is a tool that central banks can use to inject money directly into the economy.
- *Section 151 Officer* – it is a legal requirement that councils must appoint a named accountant to give them financial advice. The accountant in question is usually a chief finance officer, director of finance or treasurer.
- *Supranational Bonds* – bonds issued by institutions such as the European Investment Bank.