North Somerset Council

REPORT TO THE AUDIT COMMITTEE

DATE OF MEETING: 30 JANUARY 2019

SUBJECT OF REPORT: TREASURY MANAGEMENT STRATEGY 2019/20

TOWN OR PARISH: ALL

OFFICER/MEMBER PRESENTING: RICHARD PENSKA, INTERIM HEAD OF FINANCE

KEY DECISION: YES

RECOMMENDATION

1. The Committee is requested to Note:

   i) the Treasury Management Strategy for 2019/20 as shown in Appendix 1 which includes the requirement to borrow £63.7m during the period 2018-2022 as funding for the approved capital programme,

   ii) the Prudential Indicators for 2019/20 as shown in Appendix 2,

   iii) the Minimum Revenue Provision policy for 2019/20.

1. SUMMARY OF REPORT

The purpose of the report is to present the council's treasury management strategy for the 2019/20 financial year as required by statute which incorporates the financial planning assumptions used within the financing of the capital programme considered elsewhere on the agenda.

This report also contains the proposed prudential indicators and the policy for making minimum revenue provision within the budget.

2. POLICY

The council's budget process should ensure that all resources are planned, aligned and managed effectively to achieve the corporate aims and objectives of the council. It is also essential to integrate treasury strategies into revenue and capital budget planning processes to optimise financial opportunities and minimise any risks which may be present.

3. DETAILS

3.1 Treasury Management Strategy 2019/20

The council's treasury management strategy, which can be seen in detail at Appendix 1, sets out the proposals and guidance that the council will use to manage its daily cash-flow activities during the 2019/20 financial year. The council must give due regard to the management of these sums which are more than £700m p.a., to ensure that it is sufficiently able to balance the daily cash requirements for all operational services whilst still achieving the strategic outcomes required within the medium-term financial plan.

There is a clear link between this strategy and the financial impact upon various elements of the council's revenue budget, for example, the **borrowing strategy** will affect how much borrowing the council plans to undertake, where this will come from and what rates will be charged and therefore how much external interest it will pay on its loans. Similarly, the **investment strategy** is a key component upon how much interest the council could achieve on its investments compared to budgeted levels.

These two key component parts of the overall TM Strategy cover all financing decisions and will be used flexibly to combine all the council's financial challenges, both in the short and medium term, with credit risk, liquidity risk and interest rate risk. Members will be aware that the strategies are not only linked with the revenue budget, but also the capital programme and the balance sheet. The balance sheet includes the council's net worth and highlights its level of gearing or net indebtedness (debt vs fixed assets), which is a consequence of using borrowing to finance the council's capital spending.

3.2 Investment Strategy

The council invests its money for three broad purposes:
- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

The **non-treasury management investment strategy** is a new element in the report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

With respect to the **treasury management investment strategy**, the primary objective is, and will continue to be the security of all principal sums, although officers will manage cash balances appropriately within a range of robust constraints to provide a balance of security, liquidity and return whilst at the same time mitigating risks where required.

The council continually assesses the various investment risks it faces in conjunction with the support of treasury advisors Arlingclose Ltd who have provided a range of financial services, advice and market intelligence to the council over recent years.

Members will be aware that in addition to traditional investments placed with banks and building societies, the council also places investments in pooled property funds and multi asset funds to provide diversity within the portfolio and to increase returns.

The current investment strategy also does allow the council to also place investments in products such as gilts, treasury bills, bonds and certificates of deposit although no sums are held in these products at this time, largely because of market conditions and risk levels.

Since 2008 the financial markets have continued to offer low levels of interest rates which has impacted on the council's ability to optimise returns within its revenue budget over that period. In addition to which, the options of prioritising security or liquidity whilst minimising bail-in risk will often result in the reduction of the rate of return achievable on traditional cash deposits, thereby heightening the financial challenge even further.

Negative interest rates: 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.

Strategy: Much of the council's surplus cash remains invested in short-term unsecured bank deposits, local authorities, and money market funds. The low yields resulting from the current interest environment could be mitigated against by either increasing the average duration of investments or through additional investments in alternative products such as pooled funds. Members will be aware that increasing the average durations currently offers limited scope to increase yield due to the limited number of counterparties in which investments can be placed for 12 months or greater, due to advice from the council's treasury advisors.

Given the increasing risk and very low returns from short-term unsecured bank investments, the council aims to further diversify into more secure and/or higher yielding asset classes during 2019/20. This diversification will represent a continuation of the strategy adopted in 2017/18 and 2018/19.

Business models: 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 has chosen to maximise returns using pooled investment funds, which do offer higher levels of returns, and which compensate for risks associated with capital losses. In addition, the pooled fund investment products provide a further diversification for the council in respect of the bail-in risk and yields above inflation.

Before any additional investments are made into pooled funds due regard will need to be given to IFRS 9. At present a five-year temporary statutory override means any movements in the fair value of such an investment are taken to an accounting reserve to avoid any adverse impact upon on the revenue accounts and tax payers, under the current accounting convention this gain, or loss would only crystallise if the investment were to be withdrawn from the fund.

Under IFRS 9, after 2023/24 when the statutory override period expires, movements in fair value will be charged to the revenue accounts with no powers to reverse out the movement. By way of example if the council's pooled fund investments were valued at less than their original cost, based on their share prices, under IFRS9 this loss would be charged to the revenue budget as an overspend.

At this stage it is therefore proposed that there are **no fundamental changes** to the investment strategy and that the counterparty limits should not be changed as it offers the required flexibilities and does not introduce further risk.

3.3 Non-Treasury Management Investment Strategy

The council's draft commercial investment strategy was approved by Council in July 2017 and updated in January 2019 following advice provided by Montagu Evans. The purpose being to acquire a portfolio of investments which generate a steady income and provide capital appreciation whilst contributing to the alleviation of service pressures and contribute to regeneration.

The strategy provides guidelines to aid investment decisions and create a balanced portfolio with weightings by sector and target yields above the cost of financing. Each investment is considered by the Property Investment Board (PIB) before seeking approval from Council under its own terms of reference.

Further details can be found in Appendix 1 Section 7.

3.4 Borrowing Strategy

The summary below identifies the estimated level of borrowing that will be required to be undertaken over the next few years to fund both the schemes currently included within the approved capital programme and those being requested for approval in the capital strategy report for 2019.

Capital Funding Resources	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000	Total £000
Capital Expenditure	**59,245**	**85,645**	**42,207**	**15,700**	**202,797**
Financed by: Capital receipts	1,510	0	0	0	**1,510**
Grants & contributions	38,529	40,410	24,918	0	**103,857**
Reserves & RCCO's	555	5	5	0	**565**
S106 contributions	5,476	5,258	1,000	0	**11,734**
Non-earmarked capital receipts & grants	5,130	12,402	3,132	700	**21,364**
Borrowing	8,045	27,570	13,152	15,000	**63,767**
Total Funding	**59,245**	**85,645**	**42,207**	**15,700**	**202,797**

As can be seen above the overall level of new borrowing required over the period is estimated to be £63.767m, with approximately £27.57m being required to finance capital expenditure before the end of March 2020. This increase is mainly a result of the continuation of the council's commercial investment strategy totalling £100m over the 3 years ending 31 March 2020, which will aim to deliver cashable financial benefits of 2% above the capital financing costs.

This additional borrowing requirement will mean that additional capital financing costs of servicing and the associated costs of servicing this debt will need to be reflected in the MTFP, further information will be included within future reports.

Clearly the inclusion of the additional of £27m of long-term borrowing will require changes to the council's existing borrowing strategy. At this time, it is assumed that a significant proportion of the loans will come from the PWLB or other local authorities, although options will remain flexible to ensure that costs are lowered wherever possible. In addition, a blended maturity profile will be adopted to spread the repayment profile of capital repayments and reduce the interest payable annually.

The summary above and all the borrowing calculations only reflect proposals which are to be included within the approved capital programme. Should any further borrowing or forward funding decisions be made over these levels during the year then council approval will be required, and additional revenue resources will need to be identified to fund debt repayment costs. In addition, the council's prudential indicators would also need to be revisited in accordance with the requirements of the Prudential Code to provide the assurances of affordability.

3.5 Prudential Indicators

Under the provisions of the Local Government Act 2003, and the associated CIPFA Prudential Code for Capital Finance in Local Authorities, certain 'Prudential Indicators' relating to the revenue implications of capital programme decisions need to be considered when setting the revenue and capital budgets. These indicators provide information to Members on the affordability of borrowing plans, and the sustainable impact upon the council's revenue budget. North Somerset Councils MRP policy is in line with the current guidance.

The updated Code included a requirement for its implementation in 2019/20. In addition, the Treasury Management Code of Practice also requires certain 'Indicators' relating to treasury activities to be approved, both sets of Indicators are detailed in Appendix 2.

3.6 Policy for Minimum Revenue Provision

The council is also required to determine a policy to ensure the "prudent" provision for the repayment of all long-term borrowing. MHCLG has published guidance on what constitutes prudent provision, which requires the full Council to approve an annual MRP statement before the start of each financial year.

This charge is calculated in two parts, a statutory charge and a voluntary charge. With statutory charges based on the average life of all assets, currently 33 years and the individual life of assets driving the cost of all voluntary payments.

Shown at Appendix 3 is the current policy for calculating the MRP for 2019/20 and incorporates options recommended in the Guidance.

4. CONSULTATION

N/A

5. FINANCIAL IMPLICATIONS

Financial implications are contained throughout the report and advise on the impact on both the annual revenue budget as well as the balance sheet.

6. RISK MANAGEMENT

Members will be aware that there is a direct link between the levels of risk and the levels of return achieved on investment, although there are many other factors which also affect the capital financing budgets. It is proposed that the priority of the Treasury Management Strategy will be the reduction of risk to safeguard public resources.

7. EQUALITY IMPLICATIONS

N/A

8. CORPORATE IMPLICATIONS

The safeguarding of public money is critical to the council's reputation, and the measures contained within the report are intended to address public concerns and ensure an appropriate balancing of return on investment against security and risk management.

9. OPTIONS CONSIDERED

None

APPENDICES

1. Treasury Management Strategy for 2019/20
2. Prudential Indicators for 2019/20
3. Minimum Revenue Provision Policy for 2019/20

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BACKGROUND PAPERS

None

Treasury Management Strategy for 2019/20

1 INTRODUCTION

The council has adopted 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 it to approve a treasury management strategy before the start of each financial year.

In addition, the Ministry for Homes, Communities and Local Government (MHCLG) issued revised guidance on local authority investments in January 2018 that requires the council to approve an investment strategy before the start of each financial year.

The council manages 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 risk are therefore central to the council's treasury management strategy.

This report fulfils the council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance.

Any external investment managers employed by the council are required, contractually, to comply with this Strategy.

2 STRATEGY OVERVIEW

The suggested strategy for 2019/20 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the council's treasury advisors, currently Arlingclose Ltd. The strategy covers:

- Section 3 – current and expected treasury portfolios
- Section 4 - the annual treasury management investment strategy
- Section 5 - the annual borrowing strategy
- Section 6 - other treasury management matters
- Section 7 – the annual non-treasury management investment strategy

3 CURRENT & EXPECTED TREASURY PORTFOLIOS

3.1 Current portfolio

The council's current treasury portfolio, as at 31st December 2018 is as follows.

LONG-TERM DEBT	**Principal £m**		**Ave Rate**	**Ave Term**
Fixed Rate – PWLB	£148.32	£148.32	4.0%	1-39 Years
Other Long-Term Liabilities; - Ex Avon Loan Debt - Other (incl leasing)*	 £13.85 £2.69	 £16.54	 6.15% 8.05%	 1-31 Years 1-40 Years
TOTAL DEBT		**£164.86m**		
SHORT-TERM TREASURY	**Principal**		**Ave**	**Ave Term**

INVESTMENTS	£m		Rate	
Managed In-House;				
- UK Banks	£46.0		0.85%	7 months
- Building Societies	£12.0		0.75%	5 months
- Local Authority/ DMO	£28.0	£86.0	0.84%	8 months
Cash Managed by Tradition;				
- UK Banks	£2.0		0.74%	13 months
- Building Societies	£3.0		0.71%	7 months
- Local Authority/ DMO	£5.0	£10.0	0.73%	12 months
LONG-TERM TREASURY INVESTMENTS	**Principal £m**		**Ave Rate**	**Ave Term**
Managed In-House;				
- CCLA	£5.0		4.0%	3-5 Years
- UBS Multi Asset Income Fund	£1.0		3.5%	3-5 Years
- Investec Diversified Income Fund	£4.0	£10.0	3.0%	3-5 Years
TOTAL TREASURY INVESTMENTS		**£106.0m**		
TOTAL NET DEBT		**£58.86m**		

*Excludes the Sovereign Centre lease principal, rate and term which will be calculated at the end of the financial year.

The maturity profile of the council's PWLB borrowing and investments is as follows (excluding Avon loan debt).

MATURITY PROFILE	LONG-TERM DEBT £m	SHORT-TERM INVESTMENTS £m	NET (INVEST) DEBT £m
Maturing Jan to March 2019	£0.1	£62.0	(£61.9)
Maturing 2019/20 & 2020/21	£1.3	£34.0	(£32.7)
Maturing 2022 to 2023	£12.5	£10.0	£2.5
Maturing 2023 to 2028	£34.4	£0	£0
Maturing 2028 to 2038	£63.0	£0	£0
Maturing 2038 to 2048	£17.0	£0	£0
Maturing after 2048	£20.0	£0	£0
TOTALS	**£148.3**	**£106.0**	**£42.3**

3.2 Expected cash-flow changes

The cash flow forecasts above are based on the current portfolio. There remains a requirement to borrow in 2018/19. The decision of whether, and when, to take external borrowing will be made considering current and forecast interest rates.

Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	Actual 31/3/18 £m	Estimate 31/3/19 £m	Forecast 31/3/20 £m	Forecast 31/3/21 £m	Forecast 31/3/22 £m
General Fund CFR	174.6	216.3	242.9	279.3	286.4
Less: Other debt liabilities *	-16.4	-51.0	-49.9	-48.8	-47.8
Loans CFR	**158.2**	**165.3**	**193.0**	**230.5**	**238.6**
Less: External borrowing **	-148.0	-156.0	-187.6	-231.4	-240.2
Internal borrowing	**10.2**	**9.3**	**5.4**	**-0.9**	**-1.6**

* finance leases and transferred debt that form part of the council's total debt
** shows only loans to which the council is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the council expects to comply with this recommendation during 2019/20.

3.3 Budget Implications

The main change to the council's corporate budget in relation to treasury activities in 2019/20 relates to the reduced MRP contributions. This is detailed further in Appendix 3.

- Savings plans of £2.5m have been included within the council's medium term financial plan in 2019/20 to reflect a net reduction in capital financing costs relating to MRP.

- A further savings target of £565k has also been included within 2019/20 for income in relation to the commercial investment strategy, this being the net target yield of 2% over and above the financing costs in respect of decisions relating to the North Worle District Centre and the Sovereign Centre sites.

3.4 Prospects for interest Rates

Arlingclose have been appointed the council's treasury advisors and part of their service is to assist the council in formulating a view on interest rates. 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. While 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 mid-December). As such, the risks to the interest rate forecast are considered firmly to the downside.

European banks are considering their approach to Brexit, with some looking to create new UK subsidiaries to ensure they can continue trading here. The credit strength of these new banks remains unknown, although the chance of parental support is assumed to be very high if ever needed. The uncertainty caused by protracted negotiations between the UK and EU is weighing on the creditworthiness of both UK and European banks with substantial operations in both jurisdictions.

At 1.5%, annual GDP growth continues to remain below trend. Looking ahead, the BoE, in its November Inflation Report, expects GDP growth to average around 1.75% over the forecast horizon, providing the UK's exit from the EU is relatively smooth.

4

ANNUAL TREASURY MANAGEMENT INVESTMENT STRATEGY 2019/20

At any point in time the council holds surplus funds, which represent income received in advance of expenditure in addition to balances and reserves held. In the past 12 months, the council's investment balance has ranged between £31m and £86.5 million. Both the CIPFA Code and the CLG Guidance require councils to invest their funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. Guidance prescribes that the following issues should be considered when setting and approving the Strategy.

4.1 Investment criteria and limits

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.

	Overall Limit[1]	**In-house Limit**	**Tradition Limit**	**Time Limit**
Banks and other organisations whose lowest published long-term credit rating from Fitch, Moody's and Standard and Poor's is:				
AAA	***£30m***	£30m	£0m	5 years
AA+	***£25m***	£25m	£0m	5 years
AA	***£22m***	£22m	£0m	4 years
AA-	***£20m***	£16m	£4m	3 years
A+	***£18m***	£14m	£4m	2 years
A	***£16m***	£12m	£4m	13 months
A-	***£13m***	£9m	£4m	6 months
The council's bank accounts	***Net £9m***	Net £9m	£0m	Overnight
UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than **£0.4bn**	***£10m***	£6m	£4m	6 months
UK building societies whose lowest long-term rating is BBB and societies without credit ratings, that have an asset size of more than **£1bn**	***£10m***	£6m	£4m	2 years
Money market funds[2] and similar pooled vehicles whose lowest published credit rating is AAA	***£15m***	£15m	£0m	1 year
UK Central Government	***no limit***	unlimited	unlimited	no limit
UK Local Authorities[3]	***£15m***	£10m	£5m	25 years
Pooled Investment funds	***£5m per Fund Type***	*£5m per Fund type*	£0m	N/A

[1] limits shown are per organisation
[2] as defined in the Local Authorities (Capital Finance and Accounting) Regulations 2003
[3] as defined in the Local Government Act 2003

The maximum that could be lent to any one organisation (other than the UK Government) will be £30 million. This will limit the potential loss in the case of a single bank. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

There is no intention to restrict investments to banks and building society deposits, and investments may be made with any public or private sector organisation that meets the credit rating criteria above.

Long-term investments

The maximum duration of the investment will depend upon its lowest published long-term credit rating, time limits are included within the table above.

Long-term investments will be limited to 50% of the counter-party limit (except the UK Government), therefore the combined value of short-term and long-term investments with any organisation will not exceed the limits for investments in the table above.

4.2 Current bank account

Members will be aware that the current banking contract is held with Barclays Bank. Balances held within these accounts are excluded from investment award criteria and do not count towards investment totals.

4.3 Building Societies

UK building societies without credit ratings will be considered to be of "high credit quality", but subject to a lower cash limit and shorter time limit than rated societies. They provide the council with the opportunity to spread financial risk across a broader range and number of financial institutions which allows individual counter-party risk to be set at lower levels.

It is proposed that no investments will be made with building societies that hold a long-term credit rating lower than BBB or equivalent and with asset value less than £0.4bn, due to the increased likelihood of default implied by this rating.

4.4 Money Market Funds

Money market funds are pooled investment vehicles consisting of instruments similar to those used by the council such as cash deposits. They are highly liquid and have the added advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the council.

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.

4.5 Pooled Funds

Pooled funds are investments from many individual investors aggregated for the purpose of investment and managed by professionals. Funds can vary in asset class from equities, property, bonds or a mixed portfolio with varying levels of each.

The council currently has invested £5m with the CCLA Local Authorities Property Fund, £4m in the Investec Diversified Income Fund and £1m in the UBS Multi Asset Income Fund. Giving a combined investment in pooled funds of £10m.

Pooled fund investments will be limited to £5m in any one Fund Type to limit exposure, provide further diversification, protect against changes in interest rates and limit exposure to Bail-in legislation.

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. The council's treasury advisers, Arlingclose Ltd are entirely comfortable with Pooled Funds as a long-term term investment on a 5-year rolling horizon.

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.

4.6 Credit Ratings

The council uses long-term credit ratings from the three main rating agencies Fitch Ratings Ltd, Moody's Investors Service Inc and Standard & Poor's Financial Services LLC to assess the risk of investment default. The lowest available credit rating will be used to determine credit quality.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The council's credit rating criteria are set to ensure that it is unlikely that the council will hold speculative grade investments, despite the possibility of repeated downgrades.

Credit ratings are obtained and monitored by the council's treasury advisers on at least a monthly basis, 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 rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it is likely to fall below the above criteria, then no further investments will be made in 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.

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 considered.

4.7 Other Information on the Security of Investments

Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, asset size, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the above criteria.

4.8 Investment Instruments

Investments may be made using any of the following instruments:

- interest paying bank accounts
- fixed term deposits
- call or notice deposits (where the council can demand repayment)
- callable deposits (where the bank can make early repayment) – subject to an overall limit of £25 million
- certificates of deposit
- property funds
- pooled investment funds
- treasury bills and gilts issued by the UK Government
- bonds issued by multilateral development banks (e.g. the EIB)
- shares in money market funds

4.9 Foreign Countries

Investments in foreign countries will be limited to those that hold a AAA, AA+ or AA sovereign credit rating from all three major credit rating agencies, and to a maximum of £12 million per country, this limit to be divided between the in-house team (£8m) and cash manager Tradition (£4m). There is no limit on investments in the UK whatever the sovereign credit rating.

Banks that are domiciled in one country but are owned in another country will need to meet the rating criteria and will count against the limit for both countries. Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. However, Santander UK plc (a subsidiary of Spain's Banco Santander) and Clydesdale Bank plc (a subsidiary of National Australia Bank) will be classed as UK banks due to their substantial UK franchises and the arms-length nature of the parent-subsidiary relationships.

Sovereign credit rating criteria and foreign country limits will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations (e.g. the European Union).

4.10 Liquidity Management

The council uses a series of control spreadsheets to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated 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.

4.11 Benchmarks to be Adopted

Both treasury teams will be benchmarked during the financial year to monitor the performance of both the manager and the types of investment being used. The benchmarks to be used are;

- Tradition UK Ltd — 7 Day Notice Rate
- In-House team — Information from Treasury Advisers

4.12 Planned Investment Strategy for 2019/20

The council's current investment strategy allows surplus cash balances to be managed by two treasury teams each having distinct and separate controls and flexibilities. This allows the council to spread risk by not only investing in different financial products, but also utilising experienced external cash managers within the marketplace, who do not have the constraints and limitations of managing the council's daily cash-flows. The treasury teams are;

- Tradition UK Ltd
- In-house Treasury Team

The council's annual cash-flow forecast will be used to divide surplus funds into three categories;

- ***Short-term*** – cash required to meet known cash outflows in the next month, plus a contingency to cover unexpected cash flows over the same period.
- ***Medium-term*** – cash required to manage the annual seasonal cash flow cycle, including amounts to cover forecast shortages, planned uses of reserves, and a longer-term contingency.
- ***Long-term*** – cash not required to meet cash flows and used primarily to generate investment income.

Short-term funds are required to meet cash flows occurring in the next month or so, and the preservation of capital and liquidity is therefore of paramount importance. Generating investment returns is of limited concern here, although it should not be ignored. Instant access AAA-rated money market funds and bank deposit accounts will be the main methods used to manage short-term cash. This will primarily be the responsibility of the council's in-house team.

Medium-term funds which may be required in the next one to twelve months will be managed concentrating on security, with less importance attached to liquidity but a slightly higher emphasis on yield. Most of investments in this period will be in the form of fixed term deposits with banks and building societies. A wide spread of counterparties and maturity dates will be maintained to maximise the diversification of credit and interest rate risks. Deposits with lower credit quality names will be made for shorter periods only, while deposits with higher quality names can be made for longer durations. It is anticipated that the council's in-house team will also administer these funds.

Any cash that is not required to meet any liquidity need can be invested for the ***longer-term*** with a greater emphasis on achieving returns that will support spending on council services. Security remains important, as any losses from defaults will impact on the total return, but liquidity is of lesser concern, although it should still be possible to sell investments, with due notice, if large cash commitments arise unexpectedly. The council currently employs an external fund manager that has both the skills and resources to manage the risks inherent in a portfolio of long-term investments. This allows the council to diversify its investment portfolio and obtain maximum returns from the different types of surplus cash. It is assumed that the majority of longer-term cash-flow balances will be invested by the council's cash fund manager, i.e. Tradition or in products which offer longer-term returns such as property funds.

Members should note that 'counter-party' risk is still the council's largest areas of risk which needs to be addressed, and it will continue to be managed in various ways; with credit ratings; and limits on individual institutions, groups and countries.

It is proposed that all counter-parties which the council invests funds with, should have at least a minimum credit rating or be considered as having "high credit quality" by having an asset base greater than £0.5bn, and if the investment increases in risk, because of either the size or length of the deposit, then a counter-party with a higher rating should be used.

In addition, maximum investment limits with individual counter-parties will continue to be applied, including the continuation of 'group' limits for those counter-parties with subsidiaries. This reduces the council's overall exposure to the one group.

It is also proposed that the council should continue to be given the flexibility to invest with financial institutions who are not solely based within the UK, as this does widen the number of available counter-parties with whom the council can invest and diversify investments away from just the UK. However, to mitigate any potential risks from overseas institutions it is proposed that investments are only placed in those countries with the highest credit rating and continue to operate within a system of 'country' limits to reduce the council's overall exposure to any one country.

With short-term interest rates currently much lower than long-term rates, due consideration may also be given to using surplus funds to make early repayments of long-term borrowing. In addition to the savings on the interest rate differential, this strategy will also reduce the council's exposure to credit risk and interest rate risk. However, before any such decisions are made then the council will also quantify and assess early termination penalties chargeable by lenders to determine whether the potential course of action represents good value for the council tax payers.

5 BORROWING STRATEGY

5.1 Introduction

The council's main objectives when borrowing is to achieve a low but certain cost of finance while retaining flexibility should plans change in future. These objectives are often conflicting, and the council therefore seeks to strike a balance between cheaper short-term loans (currently available at around 0.75%) and long-term fixed rate loans where the future cost is known but higher (currently 2.0 to 3.0%).

As shown in paragraph 3.1 above, the council currently holds £148.3 million of long-term loans, all of which are from the PWLB.

5.2 Borrowing Requirement

Following a review of the council's existing approved capital programme together with the incorporation of the proposed new schemes, it is anticipated that the total **borrowing requirement for the period of the MTFP totals £63.7m**.

5.3 Sources of Borrowing

The approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- Other Local Authorities and Pension Funds
- UK Municipal Bond Agency plc
- Funds administered by the West of England Combined Authority including
    - Revolving Infrastructure Fund
    - Local Growth Fund
    - Economic Development Fund
- any institution approved for investments above
- any other bank or building society on the Financial Services Authority list

5.4 Resources to finance Borrowing costs

The increase in borrowing costs in respect of the North Somerset council funded elements will be charged to the council's revenue budget in accordance with proper accounting practice and will be funded by a combination of growth included within the Medium Term Financial Plan and contributions from services budgets via their invest-to-save proposals.

5.5 Debt Instruments

Loans will be arranged by one of the following debt instruments:

- fixed term loans at fixed or variable rates of interest
- lender's option borrower's option (LOBO) loans, subject to a maximum of £10m
- municipal bonds

As an alternative to borrowing loans, the council may also finance capital expenditure and incur long-term liabilities by means of:

- leases
- Private Finance Initiative
- sale and leaseback
- Revolving Infrastructure Grants

5.6 Planned Borrowing Strategy for 2019/20

Section 1 of the Local Government Act 2003 gives the power for local authorities to borrow for the purposes of their functions or for the prudent management of their financial affairs. The timing of any borrowing is not tied rigidly to the need for cash to pay for expenditure that was going to be financed by borrowing but there needs to be a reasonable link. An authority would need to show a need to borrow the cash in the reasonable future.

It is proposed that the council will consider PWLB borrowing as the primary source of finance for 'unsupported' capital projects and the UK Municipal Bonds Agency plc as the second source, with decisions being made to ensure the best value for the taxpayer.

The proposed strategy will be to consider anticipated future life of the asset being financed in order to align it to the capital repayment chargeable to the revenue budget, but the current maturity profile of the council will also be considered to ensure that no more than £15m will be repayable in any one financial year in relation to long term borrowing and no more than £40m in relation to short term borrowing. In addition, it is projected that the length of the borrowing will also follow the current yield curve which is showing that the longer rates have lower rates, therefore representing best value to taxpayers.

Although the council's current long-term PWLB borrowing is held within fixed rate loans, variable rate borrowing will also be considered around this time to hedge against interest rate risk within the investment portfolio.

It will be necessary to review borrowing rates throughout the financial year to determine the optimum time to borrow so that the lowest rates can be achieved.

Restructuring debt

Whilst in an environment of low interest rates the opportunity to repay PWLB borrowing using cash balances and realise any net gains is limited due to the size of the premiums repayable on early repayment and the loss of income from those cash balances. Previous calculations indicate the premium resulting from the early repayment of the council's portfolio could be between £10m to £35m depending on options.

For the same reasons above the early repayment of the councils share of the Ex-Avon loan debt would result in additional costs over and above the current interest payments. However, the transfer of this debt into North Somerset Council control is being discussed.

6 OTHER TREASURY MANAGEMENT MATTERS

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

6.1 Financial Derivatives

Financial Derivatives: councils 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 (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over councils' 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 considered 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.

6.2 Markets in Financial Instruments Directive

Markets in Financial Instruments Directive: The council has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but without the greater regulatory protections afforded to individuals and small companies. Given the size and range of the council's treasury management activities, the Section 151 Officer believes this to be the most appropriate status.

6.3 Financial Implications

The budget for investment income in 2019/20 is £0.9 million, based on an average investment portfolio of £90 million at an interest rate of 1.08%. The budget for debt interest paid in 2019/20 is £6.3 million, based on an average debt portfolio of £165 million at an average interest rate of 4.18%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

6.4 Other options considered

The CLG Investment Guidance and the CIPFA Code of Practice do not prescribe any particular treasury management strategy for local authorities to adopt. The Interim Head of Finance believes 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
Adopt a narrower definition of "high credit quality" and/or shorter time limits	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Adopt a wider definition of "high credit quality" and/or longer time limits	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

7 NON-TREASURY MANAGEMENT INVESTMENT STRATEGY

The council invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as treasury management investments),
- to support local public services by lending to or buying shares in other organisations (service investments), and
- to earn investment income (known as commercial investments where this is the main purpose).

This non-treasury management investment strategy is a new strategy for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Treasury Management Investments

The council typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure and collects local taxes on behalf of other local bodies and central government. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with guidance from the Chartered Institute of Public Finance and Accountancy. The balance of treasury management investments is expected to fluctuate between £30m and £110m during the 2019/20 financial year.

Contribution: The contribution that these investments make to the objectives of the council is to support effective treasury management activities.

Further details: Full details of the council's policies and its plan for 2019/20 for treasury management investments are covered elsewhere in the treasury management strategy above.

Service Investments: Loans

In support of the council's overall strategy which includes the MTFP, treasury management and capital strategies, loans to social enterprises and local businesses will be considered. Where regeneration and infrastructure investments in North Somerset clearly support local public services and stimulate local economic growth financing will be considered on projects that offer adequate security and returns.

The largest loan given is an amount of £0.9m to a Care Home provider made in 2008. The Care provider has subsequently made payments (including interest) on a 6-monthly schedule and the outstanding balance at the time of writing is £0.8m.

Security: The main risk when making service loans is that the borrower will be unable to repay the principal lent and/or the interest due. In order to limit this risk, and ensure that total exposure to service loans remains proportionate to the size of the council, upper limits on the outstanding loans to each category of borrower have been proposed as follows.

Table 7.1: Loans for service purposes in £ millions

Category of borrower	31/3/2018 Actual			2019/20
	Balance owing £m	Loss allowance £m	Net value in Accounts £m	Approved Limit £m
Local Charities & Registered providers	0.8	0	0.8	1.0
TOTAL	**0.8**	**0**	**0.8**	**1.0**

Accounting standards require the council to set aside loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the council's statement of accounts from 2018/19 onwards will be shown net of this loss allowance. However, the council makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment: The council assesses the risk of loss before entering into and whilst holding service loans by review of cash flow forecasts and any relevant assumptions. Ongoing monitoring may include review of the recipient's annual financial statements and/or periodic monitoring of cash flow forecasts and business plans.

<u>Commercial Investments: Property</u>

The council's draft commercial investment strategy was approved by Council in July 2017 and updated in January 2019 following advice provided by Montagu Evans. The purpose being to acquire a portfolio of investments which generate a steady income and provide capital appreciation whilst contributing to the alleviation of service pressures and contribute to regeneration.

The strategy provides guidelines to aid investment decisions and create a balanced portfolio with weightings by sector and target yields above the cost of financing. Each investment is considered by the Property Investment Board (PIB) before seeking approval from Council under its own terms of reference. As noted in the Capital Strategy there is a £100m capital budget for commercial investments and as shown in Table 7.2 below, the council remains within this limit.

Table 7.2: Property held for investment purposes in £ millions

Property	Actual	31/3/2018 Actual		31/3/2019 Estimated	
	Purchase cost £m	Gains or (losses) £m	Value in Accounts £m	Gains or (losses)* £m	Value in Accounts £m
North Worle District Centre	40.0	0	40.0		40.0
Sovereign Centre	31.0	N/A	N/A		31.0
TOTAL	**71.0**		**40.0**		**71.0**

Security: In accordance with government guidance, the council considers a property investment to be secure depending upon a comparison of its accounting valuation with either its purchase cost including taxes and transaction costs, and any associated rental income receivable or capital financing costs payable.

A fair value assessment of the council's investment property portfolio will be made prior to the end of the current financial year, in order to assess and ensure that the underlying assets provide appropriate security for capital investment. Further updates will be provided within the mid-year strategy reports.

Governance

Recommendations on commercial investments are made by the Property Investment Board (PIB) in line with the agreed strategy. Its board members include the Leader, the Executive Member for HR, Asset Management, Capital Finance and Transformation, the Chief Executive, the S151 Officer and the Monitoring Officer. Commercial investments or leased transactions are required to be approved in accordance with the council's financial regulations.

Borrowing in Advance of Need

Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed.

The council may, from time to time, borrow in advance of spending need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £274 million. The maximum periods between borrowing and expenditure is expected to be two years, although the council does not link particular loans with particular items of expenditure.

Capacity, Skills and Culture

The council's treasury management adviser is Arlingclose who currently provide advice and information on the council's investment and borrowing activities, although responsibility for final decision making remains with the council and its officers. The services received include:

- advice and guidance on relevant policies, strategies and reports,
- advice on investment decisions,
- notification of credit ratings and changes,
- other information on credit quality,
- advice on debt management decisions,
- accounting advice,
- reports on treasury performance,
- forecasts of interest rates,
- training courses.

The needs of the council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, ACCA, the Association of Corporate Treasurers and other appropriate organisations.

Commercial deals

Where council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The council currently employs Arlingclose Limited as treasury management advisers and Montagu Evans as property consultants. This approach is more cost effective than employing such staff directly and ensures that the council has access to knowledge and skills commensurate with its risk appetite.

Investment Indicators

The council has set the following quantitative indicators to allow elected members and the public to assess the council's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the council's total exposure to potential investment losses.

Table 7.4: Total investment exposure in £millions

Total investment exposure	**Actual Held as at 31/03/18 £m**	**Forecast Held as at 31/03/19 £m**	**Forecast Held as at 31/03/20 £m**
Treasury management investments	66.0	60.0	60.0
Service investments: Loans	0.8	0.8	0.8
Commercial investments: Property	40.0	71.0	100.0
TOTAL EXPOSURE	**106.8**	**131.9**	**160.8**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the council does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the council's investments are funded by usable reserves and income received in advance of expenditure.

Table 7.5: Investments funded by borrowing in £millions

Investments funded by borrowing	**Actual Held as at 31/03/18 £m**	**Forecast Held as at 31/03/19 £m**	**Forecast Held as at 31/03/20 £m**
Commercial investments: Property – unsupported borrowing	40.0	40.0	69.0
Commercial investments: Property – finance lease	0	31.0	31.0
TOTAL FUNDED BY BORROWING & FINANCE LEASE	40.0	71.0	100.0

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 7.6: Investment rate of return (net of all costs)

Investments net rate of return	**Actual 2017/18 %**	**Forecast 2018/19 %**	**Forecast 2019/20 %**
Treasury management investments	1.12	1.16	1.16
Service investments: Loans	2.75	3.00	3.00
Service investments: Shares	0.00	0.00	0.00
Commercial investments: Property	0.00	1.34	1.53
ALL INVESTMENTS	**1.12**	**1.08**	**1.06**

Prudential Indicators for 2019/20

1.1 INTRODUCTION

Having adopted both the CIPFA Treasury Management in the Public Services Code of Practice, and also the Prudential Code for Capital Finance in Local Authorities, the council is required follow the elements within the Guidance and set 'indicators' which demonstrate that it follows good practice and has implemented and operates within appropriate systems of control before making capital financing and treasury management decisions.

1.2 PRUDENTIAL INDICATORS: '<u>PRUDENTIAL' CODE</u>

The prudential code was updated in 2017 following consultation with local authorities to improve the transparency of investment decisions. Changes to the code include the requirement to produce a Capital Strategy and the inclusion of prudential indicators within the report to allow the reader to understand overall debt levels in conjunction with the capital programme and investment decisions and how this will be repaid.

Treasury management is concerned with keeping sufficient but not excessive cash available to meet the council's spending needs, while managing the risks involved. Surplus cash is invested until required, while a shortage of cash will be met by borrowing, to avoid excessive credit balances or overdrafts in the bank current account. The council is typically cash rich in the short-term as revenue income is received before it is spent, but cash poor in the long-term as capital expenditure is incurred before being financed.

Due to decisions taken in the past, the council currently has £199m borrowing at an average interest rate of 4.18% and £106m treasury investments at an average rate of 1.07%.

1.2.1 Capital Expenditure

The first indicator details the Capital Expenditure to be incurred by the council. The proposed programmes for 2018/19 and 2019/20 are shown along with the revised programme for 2018/19 and the actual spend for 2017/18.

Capital Expenditure				
	Actual 2017/18 £m	**Revised 2018/19 £m**	**Estimate 2019/20 £m**	**Estimate 2020/21 £m**
Council Total	78.49	59.25	85.65	42.21

1.2.2 Capital Financing Requirement

Projected levels of the council's total outstanding debt (which comprises borrowing and leases) are compared with the capital financing requirement.

The capital financing requirement measures the council's underlying need to borrow for a capital purpose for the authority for the current and future years, together with the actual capital financing requirement as at 31st March 2018 included within the statutory accounts.

Figure 1: Prudential Indicator: Gross Debt and the Capital Financing Requirement in £m

	Actual as at 31/3/18 £m	Forecast as at 31/3/19 £m	Forecast as at 31/3/20 £m	Forecast as at 31/3/21 £m	Forecast as at 31/3/22 £m
Debt (incl. leases)	164	207	238	280	288
Capital Financing Requirement	174	216	243	280	288

Statutory guidance is that debt should remain below the capital financing requirement, except in the short-term. As can be seen from the table above, the council expects to comply with this in the medium term.

In accordance with best professional practice, North Somerset Council does not associate borrowing with particular items or types of expenditure, and has at any point in time, a number of cash-flows, and manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction is made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the council and not simply those arising from capital spending.

In contrast, the capital financing requirement reflects the council's underlying need to borrow for a capital purpose. The capital financing requirement indicators shown above reflect the totality of the capital expenditure contained within the proposed capital programme for 2018/19.

1.2.3 Affordable borrowing limit

The council is legally obliged to set an affordable borrowing limit (also termed the authorised limit for external debt) each year In line with statutory guidance, a lower "operational boundary" is also set as a warning level should debt approach the limit.

The **authorised limit** is the 'affordable borrowing limit' which the council is required to set in section 3 of the Local Government Act 2003 and cannot be exceeded without acting ultra vires. The authorised limit is set at a higher level than the operational boundary to provide headroom for unexpected borrowing requirements.

The **boundary** should be the council's best estimate of the most likely, prudent, maximum levels of debt to be held during the years in question. The boundary can be exceeded in the short-term should the council need to undertake temporary borrowing, or debt rescheduling, but should not be exceeded for new long-term borrowing proposals.

Figure 2: Prudential Indicators: Authorised limit and operational boundary for external debt

	2018/19 limit £m	2019/20 limit £m	2020/21 limit £m	2021/22 limit £m
Authorised limit – borrowing	184	219	269	278
Authorised limit – leases	55	55	55	55
Authorised limit – total external debt	**239**	**274**	**324**	**333**

Operational boundary – borrowing	178	211	258	267
Operational boundary – leases	50	50	50	50
Operational boundary – total external debt	**228**	**261**	**308**	**317**

It is estimated that the current forecast level of long term borrowing for 2018/19 will be £207m (PWLB £156m, Ex Avon loan Debt £13.4m and leases £37.6m).

1.2.4 Ratio of Financing Costs to Net Revenue Stream

Although capital expenditure is not charged directly to the revenue budget, interest payable on loans and MRP and loans fund repayments are charged to revenue, offset by any investment income receivable. The net annual charge is known as financing costs; this is compared to the net revenue stream i.e. the amount funded from Council Tax, business rates and general government grants.

Figure 3: Prudential Indicator: Proportion of financing costs to net revenue stream

	Actual 2017/18	**Forecast 2018/19**	**Forecast 2019/20**	**Forecast 2020/21**	**Forecast 2021/22**
Financing costs (£m)	£13.22m	£11.88m	£12.89m	£14.78m	£15.86m
Proportion of net revenue stream (%)	8.54%	7.75%	8.46%	9.79%	10.31%

1.3 TREASURY MANAGEMENT INDICATORS: ‘TREASURY CODE’

The council is asked to approve the following indicators:

1.3.1 Interest rate exposures

The treasury management team has an active strategy for assessing interest rate exposure that feeds into the setting of the annual budget, and which is used to update the budget quarterly during the year. This allows any adverse changes to be accommodated. The analysis will also inform whether new borrowing is taken out at fixed or variable interest rates.

1.3.2 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:

Maturity Structure of Borrowing	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	30%	0%
24 months and within five years	40%	0%
5 years and within 10 years	50%	0%
10 years and above	100%	0%

This indicator applies to the financial years 2019/20-2021/22. 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.

1.3.3 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 total principal sum invested to final maturities beyond the period end will be:

Investments longer than 365 Days	2019/20	2020/21	2021/22
Limit on principal invested beyond year end	£66m	£60m	£60m

Minimum Revenue Provision Policy for 2019/20

Introduction

When the council funds capital expenditure by long-term borrowing, the costs are charged to the council tax payer in future years, reflecting the long-term use of the assets procured. There are two elements to this cost – the interest on borrowing is charged in the year it is payable, and the principal (or capital) element is charged as a “minimum revenue provision” (MRP).

The Local Government Act 2003 requires the council to have regard to the Ministry for Housing, Communities and Local Government’s guidance on Minimum Revenue Provision (the CLG Guidance) most recently issued in 2018.

The broad aim of the CLG Guidance is to ensure that capital expenditure is financed over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the council to approve an Annual MRP Statement each year and recommends several options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

The *Local Authorities (Capital Finance and Accounting) (England) Regulations 2008* which came into force on 31st March 2008, replaced the detailed statutory rules for calculating MRP with:

> **28.** A local authority shall determine for the current financial year an amount of minimum revenue provision which it considers to be prudent.

For capital expenditure incurred before 1st April 2008 MRP will be determined by calculating the MRP using a ‘straight line’ basis to the value of the council’s Capital Financing Requirement. A straight line basis allows the council to charge the same value each year over an average life of the assets of 33 years.

For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset, starting in the year after the asset becomes operational.

For assets acquired by finance leases and for the transferred debt from Avon County Council, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

The Capital Financing Requirement measures the council’s underlying need to borrow for capital purposes and is the council’s cumulative capital expenditure not financed by other means, less the total MRP made in previous years.

MRP Charge for 2019/20

The MRP charge in 2019/20 for capital expenditure funded by previous supported borrowing allocations, will be calculated over an average life of 33 years however, this sum will be adjusted to reflect the council's decision to change its policy in previous years, and apply the new policy back to 2008.

	£000
Statutory MRP to be charged in 2019/20	2,695
Less adj for backdated change in policy	(1,795)
Total Statutory MRP to be charged in 2019/20	**900**

Prudential Borrowing Charge for 2019/20

Capital expenditure financed by unsupported borrowing and incurred during 2018/19, will not be subject to a MRP charge until 2019/20, or until the year after the asset becomes operational. The annual charge is calculated by reference to the expected life of the assets, which is a more prudent approach to repayment of debt.

	£000	£000
Voluntary MRP for expenditure 2009/10	14,506	587
Voluntary MRP for expenditure 2010/11	8,621	256
Voluntary MRP for expenditure 2011/12	10,361	421
Voluntary MRP for expenditure 2012/13	3,491	116
Voluntary MRP for expenditure 2013/14	2,034	81
Voluntary MRP for expenditure 2014/15	4,963	199
Voluntary MRP for expenditure 2015/16	4,262	150
Voluntary MRP for expenditure 2016/17	10,732	842
Voluntary MRP for expenditure 2017/18	44,736	1,285
		3,967
New expenditure financed by unsupported borrowing during 2018/19:		
- NSC funded costs	8,152	359
		359
Total Prudential MRP charged in 2019/20		**4,326**

Other Borrowing Charges for 2019/20

The council's accounts include the outstanding debt administered by Bristol City Council in respect of the former Avon County Council, and this will incur a separate MRP charge of approximately £577k in 2019/20.

In addition the council will be required to account for the repayment of debt on any leasing obligations it holds at the end of March 2019, although it should be noted that this element is a technical adjustment and will already be included within the actual leasing payments charged to the revenue budget during the year.

The overall total estimated MRP charge for inclusion within the council's capital financing budgets in 2019/20 is therefore projected to be: £4.326m + £0.900m + £0.577m = **£5.803m**.

It should be noted that these sums are **exclusive** of the increased MRP charge that will become payable as a result of any further borrowing used to finance the council's commercial investments. Should the council undertake borrowing of say £30m, then this will result in a further MRP charge of £0.75m – this will be funded from the potential increased income that will be received from the property being invested in. It is proposed that the council's revenue income and expenditure budgets will be adjusted at a later date when further information is known.