# Cabinet

Agenda Item: 8

**Ward:** All

**Portfolio:** Finance

**Meeting Date:** 12 February 2018

**Report Author(s):** **Cllr Parham / Corporate Finance**

**SUBJECT:** **Treasury Management Strategy Statement and Annual Investment Strategy**

| | | | |
|---|---|---|---|
| **Report Sign off** | **Seen by:** | **Name** | **Date** |
| | Chief Executive / Deputy Chief Executive | Stuart Brown | Via CMT |
| | Legal | Donna Nolan | Via CMT |
| | Finance | Duncan Moss | |
| | Group Manager | Paul Deal | Via CMT |
| | Portfolio Holder | Cllr Parham | |
| | Ward Member(s) | ALL | N/A |

| | |
|---|---|
| **Summary:** | Approval is sought for the Treasury Management and Annual Investment Strategy for the forthcoming financial year 2018/19. |
| **Recommendation:** | **Cabinet are recommended to agree and recommend to Full Council:**<br>**1. The strategy as laid out in the report;**<br>**2. The prudential guidelines as laid out in the report;**<br>**3. To approve MRP policy included in this report.** |
| **Direct and/or indirect impact on service delivery to our customers and communities** | The Treasury Management and Annual Investment Strategy impacts on all service delivery indirectly through the capital programme. |
| **Contribution to Corporate Priorities:** | This paper directly links to the Corporate Plan 2017-20 and its two main priorities. |
| **Legal Implications:** | In addition the Council is required by Regulation to have regard to the Prudential Code when exercising powers under the Local Government Act 2003. |
| **Financial Implications:** | Capital programme and the interest income achievable |

| | |
|---|---|
| **Impact on Service Plans:** | Effective Treasury Management provides support to the range of business and service level objectives that together help to deliver individual service plans and the overall Corporate Plan. |
| **Value for Money:** | All the Council's operations are subject to scrutiny under Value for Money. This is currently tested by Grant Thornton, our External Auditors but from April 2018 this will change to Ernst & Young. |
| **Equalities Implications:** | The implications are reviewed with the service plans and business case for the capital expenditure. |
| **Risk Assessment and Adverse Impact on Corporate Actions:** | The Strategy attempts to minimise the risks wherever possible. |
| **Scrutiny Recommendation** | N/a |

## 1. BACKGROUND

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

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

1.3. CIPFA defines treasury management as:

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

1.4. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training. Training at Mendip has been undertaken by proxy when treasury management reports are presented and discussed at public meetings. Further training will be arranged as

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

1.5. The council recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. However, 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.

1.6. The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors and ensures that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

## 2. REPORTING REQUIREMENTS

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

a) **Treasury Management Strategy Statement and Annual Investment Strategy** (this report) covers:
- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

**b) A mid-year treasury management report**
This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

**c) An annual treasury report**
This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

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

## 3. CAPITAL STRATEGY

3.1. In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:

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

3.2. The aim of this report is to ensure that all elected members fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

3.3. The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

## 4. PRUDENTIAL INDICATORS 2018/19 – 2020/21

4.1. Within the prudential indicators there are a number of key indicators to ensure that the council operates its activities within well-defined limits.

4.2. The council's capital expenditure plans are the key driver of treasury management activity. These are provided in full within the Medium Term Resource Strategy which will is also on the agenda for this meeting. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. These are set out below:

**Cabinet are recommended to agree and recommend to Full Council the following indicators:**

**4.3. Capital expenditure**

This prudential indicator is a summary of the council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle.

| Capital Expenditure | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| Corporate Services | 0 | 17,578 | 532 | 0 | 0 |
| Law & Governance | 29 | 67 | 1,482 | 0 | 14 |
| Neighbourhood Services | 320 | 208 | 585 | 253 | 220 |
| Community Health | 0 | 15 | 15 | 0 | 0 |
| Planning & Growth | 285 | 69 | 0 | 0 | 0 |
| Housing | 628 | 843 | 1,151 | 951 | 951 |
| 5 Councils | 210 | 0 | 10 | 0 | 0 |
| **Total** | **1,473** | **18,780** | **3,774** | **1,204** | **1,185** |

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

| Financing of Capital Expenditure | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| **Capital Expenditure** | **1,473** | **18,780** | **3,774** | **1,204** | **1,185** |
| Financed by: | | | | | |
| Capital Receipts | 240 | 79 | 461 | 261 | 261 |
| Capital Grants | 875 | 764 | 701 | 701 | 701 |
| Direct Revenue Contribution | 884 | 53 | 25 | 25 | 25 |
| **Total Financing** | **1,999** | **896** | **1,187** | **987** | **987** |
| **Borrowing Requirement** | **(526)** | **17,885** | **2,587** | **217** | **198** |

It should be noted that no further commercial investment has been included as at the time of writing, there are no investments arrangements sufficiently advance to warrant inclusion.

### 4.4. Affordability prudential indicators

The following provide an indication of the impact of the capital investment plans on the council's overall finances.

**Ratio of financing costs to net revenue stream**

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

| | 2016/17 Actuals | 2017/18 Estimate | 2018/19 Estimate | 2019/20 Estimate | 2020/21 Estimate |
|---|---|---|---|---|---|
| Ratio of Financing Costs to Net Revenue Stream (%) | **0.59** | **1.46** | **2.52** | **3.77** | **3.67** |

The estimates of financing costs include current commitments and the proposals in the associated MTRS report.

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

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life, and so charges the economic consumption of capital assets as they are used.

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

| Capital Financing Requirement (CFR) | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| Brought forward | 2,417 | 1,410 | 19,133 | 21,611 | 21,504 |
| Borrowing requirement | (526) | 17,885 | 2,598 | 228 | 209 |
| Less MRP and other financing movements | (480) | (162) | (120) | (335) | (362) |
| **CFR Carried Forward** | **1,410** | **19,133** | **21,611** | **21,504** | **21,350** |
| | | | | | |
| **Net movement in CFR** | **(1,006)** | **17,723** | **2,478** | **(107)** | **(153)** |

### 4.6. Borrowing

The capital expenditure plans set out in Section 5.3 above provide details of the service activity of the council. The treasury management function ensures that the council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

### 4.7. Current portfolio position

The council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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

| Borrowing | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| Borrowing | 162 | 16,334 | 16,314 | 16,294 | 16,275 |
| Other long term liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total debt** | 162 | 16,334 | 16,314 | 16,294 | 16,275 |
| | | | | | |
| CFR (at year end) | 1,410 | 19,133 | 21,611 | 21,504 | 21,350 |
| **Under / (Over) Borrowing** | **1,249** | **2,799** | **5,297** | **5,210** | **5,076** |

The council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the council's reserves, balances and cash flow has been used as a temporary measure.

The Corporate Financial Advisor reports that the council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### 4.8. Borrowing strategy

The prudent policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years as investment returns are low and counterparty risk is still an issue that needs to be considered. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Corporate Finance Advisor will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the Full Council during the Mid-Year or Outturn Report.

### 4.9. Treasury Indicators: limits to borrowing activity

The operational boundary.

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

| Operational Boundary for External Debt | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| Borrowing | 38,000 | 80,000 | 80,000 | 80,000 | 80,000 |
| Other long term liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total debt at year end** | **38,000** | **80,000** | **80,000** | **80,000** | **80,000** |

The authorised limit for external debt.

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

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the

total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

| Authorised Limits for External Debt | 2016/17 Actuals £'000 | 2017/18 Estimate £'000 | 2018/19 Estimate £'000 | 2019/20 Estimate £'000 | 2020/21 Estimate £'000 |
|---|---|---|---|---|---|
| Borrowing | 40,000 | 100,000 | 100,000 | 100,000 | 100,000 |
| Other long term liabilities | 0 | 0 | 0 | 0 | 0 |
| **Total** | **40,000** | **100,000** | **100,000** | **100,000** | **100,000** |

### 4.10. Prospects for interest rates

The council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. The following table gives their central view.

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

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

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

A summary of the economic climate is included within **Appendix 1**.

### 4.11. Policy on borrowing in advance of need

The benefit for the council to borrow in advance is that it is able to fix the interest rate at a point in time ahead of the actual need to make a payment. In a period of rising interest rates, this could be very beneficial. If however rates at the point in time the cash is required are lower, then the advanced borrowing agreement is not invoked.

By way of an example, the funding of the waste vehicles has been approved but payment will now not be made until the 2019. The council could therefore fix the rate at the current interest rate and if the rates increase it will have saved. However, it will incur debt financing costs in advance of any return on the investment and will therefore have to have sufficient financial cover. A balance needs to be stuck.

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

Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 100% of the expected increase in borrowing need (CFR) over the three year planning period; and
- The authority would not look to borrow more than 18 months in advance of need.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

### 4.12. Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

All rescheduling will be reported to the Full Council during the Mid-Year or Outturn Report.

## 5. MINIMUM REVENUE PROVISION (MRP) POLICY STATEMENT

5.1. The council is required to pay off an element of the accumulated Capital Financing Requirement through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

The Ministry of Housing, Communities and Local Government (MHCLG) regulations have been issued which require Full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

**Cabinet are recommended to agree and recommend to Full Council the following *following MRP Statement:***

**“The Council will continue to make Minimum Revenue Provision at least equal to an annual 4% reducing balance method on all capital expenditure covered by government supported borrowing approvals.**

**Minimum Revenue Provision for the capital expenditure within the proposed Annual Service Capital Programme will be based on the nominal life of the asset delivered.**

**For the capital expenditure within the proposed Commercial Investment Capital Programme, Provision will be based upon one the following options:**

- **a) Where the asset is to be retained, Minimum Revenue Provision will be set aside based on the nominal life of the asset delivered (the default position);**
- **b) Where the asset is to be sold to repay the debt, a separate provision will be created for any reduction in the valuation of the asset (assessed annually) being recovered over the remaining life of associated debt financing the investment.**

**If in subsequent years the value increases, the Provision could be revised to ensure the amount set aside is appropriate. Any excess provision set aside could then be released enabling the council to invest further or reduce the overall capital financing costs thereby assisting the Revenue Budget”**

## 6. COMMERCIAL INVESTMENT PROGRAMME

6.1. Since the recession in 2008 and the drop in interest rates there has been further pressure on the council’s revenue budget. While investment returns on cash investments fell, the rental income from prime investment property portfolios remained strong.

6.2. The council has broad powers under either under Section 1 of the Local Government Act 2003 or under the General Power of Competence in Section 1 of the Localism Act 2011 to invest directly in land and commercial property, either for the purposes of any of its functions (which includes powers to acquire, sell and develop land for the benefit or improvement of the area), or for its treasury management purposes (to deliver a sound return under its investment strategy).

6.3. As such, to help cover the budget shortfall the Council faces, and the continued low return on cash investments, the Council is pursuing other sources of income including the investment in properties by purchasing high calibre property. This strategy adds flexibility to enable the Council to maximise its investment returns through a ‘mixed portfolio’ approach.

6.4. To facilitate this commercial investment, the Council has reviewed its borrowing capacity and increase the Operational Boundary to £80m. In order to maximise the return that can be achieved from this funding, it is key that all options are open including investment in land, assets, and organisations to ensure that a mixed portfolio is achieved that provides a balance between risk and reward.

6.5. However, a strong degree of governance also needs to be in place to safeguard public funds and this will be achieved through the Phoenix Board, a cross party Member Board chaired by the Leader. It will provide oversight on the performance of the organisation in delivering the Transformation Programme; and will be responsible for the supporting policy framework. It will advise on and make decisions on emerging opportunities for transformational activity, including, but not limited to, new commercial partnerships; decisions on borrowing within the £80million approval of Full Council and investment decisions.

6.6. When considering investment property acquisitions, the council should look to ensure a positive commercial return (i.e. that the yield exceeds the cost of the debt financing or the interest available via Specified Investments) and that the associated long-term operating lease has strong covenants included to protect the council's interests. However, with the corporate objectives of economic development and health and wellbeing, the Phoenix Board will also have the discretion to buy assets that provide a community benefit if the overriding benefit of the purchase was to meet these strategic priorities.

6.7. The Phoenix Board will also have discretion to loan funds to third parties on a commercial basis subject to a detailed business case and risk analysis. This includes, but is not limited to, the Council's Arm's Length Trading company Shape Housing and its subsidiary companies. When considering this option, the business case should include an external credit assessment, such as Dun and Bradstreet, Creditsafe or Company Watch and specific advice from the Council's Corporate Financial Advisor. Also wherever possible, the debt should be secured against assets. The type of security will depend on what assets the borrower has and the value of those assets and whether the borrower has given security over the same asset to another party.

Investment Properties currently owned

| Name | Value (£) |
|---|---|
| Wells Film Centre | 164,000 |
| Frome Abattoir | 80,000 |
| Newhouse Park - Chepstow | 8,710,000 |
| DFS Swindon | 7,876,850 |
| **TOTAL** | **16,830,850** |

## 7. CASH INVESTMENT STRATEGY

**7.1. Investment policy**

The council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance

Notes ("the CIPFA TM Code"). The council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Investment instruments identified for use in the financial year are listed in **Appendix 2** under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the council's treasury management practices – schedules.

**7.2. Ethical Investment Policy**

Historically, the council has not included ethical criteria when determining its investment criteria. The investment environment can be very fast moving, so there is a need to ensure that any investment criteria are objective, such as credit ratings. It is difficult to gain an objective assessment of the ethical standing of a potential counterparty, particularly to a tight timescale.

Ethical considerations are difficult to evaluate subjectively, and would also need to be applied to the counterparty list after taking into account security and liquidity issues. The council's current counterparty list is, due to the high credit quality criteria used by the council, very small, and therefore does not encompass solely those organisations which promote themselves as ethical. However, none of the organisations on the counterparty list have given cause for concern regarding the ethical nature of their business.

Furthermore, the council will not knowingly invest directly in businesses whose activities and practices pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the council's mission and values. This would include avoiding direct investment in institutions with material links to:

- Human rights abuse (e.g. child labour, political oppression);
- Environmentally harmful activities (e.g. pollutions, destruction of habitat, fossil fuels);
- Socially harmful activities (e.g. tobacco, gambling).

### 7.3. Creditworthiness policy

This council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines Credit Ratings, Credit Watches And Credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the council to determine the suggested duration for investments.

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

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

- if a downgrade results in the counterparty / investment scheme no longer meeting the council's minimum criteria, its further use as a new investment will be withdrawn immediately.
- in addition to the use of credit ratings the council will be advised of information in movements in credit default swap spreads against the iTraxx[1] benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the council's lending list.

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

**Appendix 2** also shows the counterparties that the Council will use and the associated limitations.

[1] **iTraxx** (Thomson Reuters Eikon code '**ITRAXX**'; Bloomberg code 'ITRX') is the brand name for the family of credit default swap index products covering regions of Europe, Australia, Japan and non-Japan Asia.

### 7.4. Country limits

The council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch. The list of countries that qualify using this credit criteria as at the date of this report are shown in **Appendix 2**. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy

### 7.5. Investment strategy

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

Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations.

Bank Rate is forecast to stay flat at 0.50% until Quarter 4 of 2018 and not to rise above 1.25% by Quarter 1 of 2021. Bank Rate forecasts for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

- 2017/18 0.40%
- 2018/19 0.60%
- 2019/20 0.90%
- 2020/21 1.25%
- 2021/22 1.50%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.75%

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

Investment treasury indicator and limit

Total principal funds invested for greater than 365 days. These limits are set with regard to the council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The council is asked to approve the treasury indicator and limit:

| **Maximum principal sums invested > 365 days** | | | |
|---|---|---|---|
| | **2018/19** | **2019/20** | **2020/21** |
| Principal sums invested > 365 days | £5m / 10% | £5m / 10% | £5m / 10% |

## 8. RECOMMENDATION

**Cabinet are recommended to agree and recommend to Full Council:**

1. **The strategy as laid out in the report;**
2. **The prudential guidelines as laid out in the report;**
3. **To approve MRP policy included in this report.**

**Contact Officer:** **Paul Deal**
Ext No: **0300 303 8588**

**Background Papers**
Prudential Guidelines – CIPFA
CIPFA Treasury Management Code of Practice

## APPENDIX 1 – ECONOMIC BACKGROUND

**UK. Growth in 2017 has been disappointingly weak.** The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

**Inflation prospects are generally muted** and it is particularly notable that **wage inflation** has been subdued despite unemployment falling to historically very low levels in the UK (4.3%, the lowest level since 1975) and US. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the **fourth industrial revolution.**

**KEY RISKS - central bank monetary policy measures**
The key issue now is reversing the economic recovery and anti-deflation measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt (QE). This is required in order to increase capacity in the economy, and prevent unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

There is also concern over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the **low level of productivity growth**, which may be the main driver for increases in wages; and **decreasing consumer disposable income,** which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

This questions whether **an inflation target for central banks of 2%**, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy).

- a shift to a **lower inflation target of 1%** will help control inflation
- a **shift *UP* in the inflation target to 3%** could ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.

Whichever, it is clear that the central banks should **target financial market stability**.

Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that **other non-financial asset prices**, particularly house prices, have been driven up to very high levels, especially compared to income levels. Consumers may also have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up. Any sharp downturn in the

availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth.

**GLOBAL OUTLOOK. World growth** looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

**EZ.** Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the European Central Bank (ECB) eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus.

**USA.** The American economy has shown strong growth in the second half of 2017. As in the UK, unemployment fallen to the lowest level for many years, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases since December 2016 and an unwind of its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities.

**CHINA.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

**JAPAN.** GDP growth has been gradually improving during 2017 however, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

## APPENDIX 2 – TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

**Credit Ratings**
Organisations and Countries are rated on a scale from AAA to D on their ability to fulfil their financial commitments, based on previous dealings. Intermediate ratings are offered at each level between AA and CCC (e.g., BBB+, BBB and BBB−). For some borrowers, the company may also offer guidance (termed a "credit watch") as to whether it is likely to be upgraded (positive), downgraded (negative) or uncertain (neutral).

Long-term credit ratings
- **AAA:** An obligor rated 'AAA' has extremely strong capacity to meet its financial commitments. 'AAA' is the highest issuer credit rating assigned by Standard & Poor's.
- **AA:** An obligor rated 'AA' has very strong capacity to meet its financial commitments. It differs from the highest-rated obligors only to a small degree. Includes:
    - **AA+:** equivalent to Moody's Aa1 (high quality, with very low credit risk, but susceptibility to long-term risks appears somewhat greater)
    - **AA:** equivalent to Aa2
    - **AA−:** equivalent to Aa3
- **A:** An obligor rated 'A' has strong capacity to meet its financial commitments but is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligors in higher-rated categories.
    - **A+:** equivalent to A1
    - **A:** equivalent to A2
- **BBB:** An obligor rated 'BBB' has adequate capacity to meet its financial commitments. However, adverse economic conditions or changing circumstances are more likely to lead to a weakened capacity of the obligor to meet its financial commitments.

Non-Investment Grade (also known as speculative-grade)
- **BB:** An obligor rated 'BB' is less vulnerable in the near term than other lower-rated obligors. However, it faces major ongoing uncertainties and exposure to adverse business, financial, or economic conditions, which could lead to the obligor's inadequate capacity to meet its financial commitments.
- **B:** An obligor rated 'B' is more vulnerable than the obligors rated 'BB', but the obligor currently has the capacity to meet its financial commitments. Adverse business, financial, or economic conditions will likely impair the obligor's capacity or willingness to meet its financial commitments.
- **CCC:** An obligor rated 'CCC' is currently vulnerable, and is dependent upon favourable business, financial, and economic conditions to meet its financial commitments.
- **CC:** An obligor rated 'CC' is currently highly vulnerable.
- **C:** highly vulnerable, perhaps in bankruptcy or in arrears but still continuing to pay out on obligations

- **R:** An obligor rated 'R' is under regulatory supervision owing to its financial condition. During the pendency of the regulatory supervision, the regulators may have the power to favor one class of obligations over others or pay some obligations and not others.
- **SD:** has selectively defaulted on some obligations
- **D:** has defaulted on obligations and S&P believes that it will generally default on most or all obligations
- **NR:** not rated

Short-term issue credit ratings
Specific issues are rated on a scale from A-1 to D. Within the A-1 category the Organisation or Country can be designated with a plus sign (+). This indicates that the issuer's commitment to meet its obligation is very strong. Country risk and currency of repayment of the obligor to meet the issue obligation are factored into the credit analysis and reflected in the issue rating.

- **A-1:** obligor's capacity to meet its financial commitment on the obligation is strong
- **A-2:** is susceptible to adverse economic conditions however the obligor's capacity to meet its financial commitment on the obligation is satisfactory
- **A-3:** adverse economic conditions are likely to weaken the obligor's capacity to meet its financial commitment on the obligation
- **B:** has significant speculative characteristics. The obligor currently has the capacity to meet its financial obligation but faces major ongoing uncertainties that could impact its financial commitment on the obligation
- **C:** currently vulnerable to non-payment and is dependent upon favourable business, financial and economic conditions for the obligor to meet its financial commitment on the obligation
- **D:** is in payment default. Obligation not made on due date and grace period may not have expired. The rating is also used upon the filing of a bankruptcy petition.

**Specified Investments**:
All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum ‘high’ quality criteria where applicable.

**Non-Specified Investments**:
These are any investments which do not meet the specified investment criteria. A maximum of £80m will be held in aggregate in non-specified investment.

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| | Maximum % of total investments per institution | Minimum credit criteria / colour band | Maximum maturity period |
|---|---|---|---|
| DMADF – UK Government | 100% | N/A | 6 months |
| UK Government gilts | 100% | UK sovereign rating | 12 months |
| UK Government Treasury bills | 100% | UK sovereign rating | 12 months |
| Bonds issued by multilateral development banks | 100% | AAA | 6 months |
| Money Market Funds CNAV | 100% | AAA | Liquid |
| Money Market Funds LVAV | 100% | AAA | Liquid |
| Money Market Funds VNAV | 100% | AAA | Liquid |
| Ultra-Short Dated Fond Funds with a credit score of 1.25 | 100% | AAA | Liquid |
| Ultra-Short Dated Fond Funds with a credit score of 1.5 | 100% | AAA | Liquid |
| Local authorities | 100% | N/A | 12 months |
| Term deposits with banks and building societies | 100% | Blue<br>Orange<br>Red<br>Green | 12 months<br>12 months<br>6 months<br>100 days |
| CDs or corporate bonds with banks and building societies | 100% | Blue<br>Orange<br>Red<br>Green | 12 months<br>12 months<br>6 months<br>100 days |
| Gilt funds | 100% | UK sovereign rating | 36 Months |

**Treasury indicators for debt**

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

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

| Interest rate exposures – UPPER Limit | 2017/18 | 2018/19 | 2019/20 |
|---|---|---|---|
| Limits on fixed interest rates based on net debt | 100% | 100% | 100% |
| Limits on variable interest rates based on net debt | 100% | 100% | 100% |

| Maturity structure of Fixed / Variable interest rate borrowing 2018/19 | | |
|---|---|---|
| | **Lower** | **Upper** |
| Under 12 months | 0% | 100% |
| 12 months to 2 years | 0% | 100% |
| 2 years to 5 years | 0% | 100% |
| 5 years to 10 years | 0% | 100% |
| 10 years to 20 years | 0% | 100% |
| 20 years to 30 years | 0% | 100% |
| 30 years to 40 years | 0% | 100% |
| 40 years to 50 years | 0% | 100% |

**Approved Counterparties for Investments**

| | Colour (and long term rating where applicable) | Greater of Money / % Limit | Time Limit |
|---|---|---|---|
| Banks | yellow | £5m | 5 years |
| Banks | purple | £5m | 2 years |
| Banks | orange | £5m | 1 year |
| Banks – part nationalised | blue | £5m | 1 year |
| Banks | red | £5m | 6 months |
| Banks | green | £5m | 100 days |
| Banks | No colour | Not to be used | |
| Limit 3 category – Council's banker (not meeting Banks 1) | blue | £5m | 1 day |
| Other institutions limit | - | Not to be used | |
| DMADF | AAA | unlimited | 6 months |
| Local authorities | n/a | £5m | 1 year |
| | **Fund rating** | **Greater of Money / % Limit** | **Time Limit** |
| Money market funds CNAV | AAA | £5m | liquid |
| Money market funds LVNAV | AAA | £5m | liquid |
| Money market funds VNAV | AAA | £5m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.25 | Dark pink / AAA | £5m | liquid |
| Ultra-Short Dated Bond Funds with a credit score of 1.50 | Light pink / AAA | £5m | liquid |

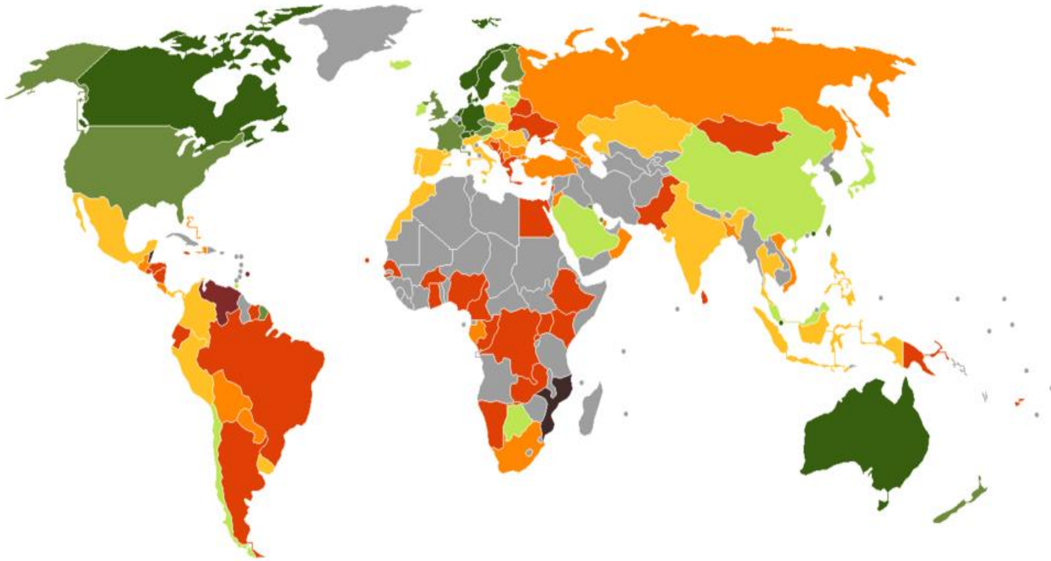
Key:

- Yellow — 5 years
- Dark pink — 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink — 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple — 2 years
- Blue — 1 year (only applies to nationalised or semi nationalised UK Banks)

- Orange	1 year
- Red	6 months
- Green	100 days
- No colour	Not to be used

Approved Countries for Investments

This list is based on those countries which have sovereign ratings of AA- or higher (we show the lowest rating from Fitch, Moody's and S&P) and also, (except - at the time of writing - for Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.



An illustrative example of World Countries Credit Ratings by Standard & Poor's Foreign Rating – it may not be accurate at the time of approving this strategy.

| AAA | AA+ | AA | AA- |
|---|---|---|---|
| • Australia<br>• Canada<br>• Denmark<br>• Germany<br>• Luxembourg<br>• Netherlands<br>• Norway<br>• Singapore<br>• Sweden<br>• Switzerland | • Finland<br>• Hong Kong<br>• U.S.A. | • Abu Dhabi (UAE)<br>• France<br>• U.K. | • Belgium<br>• Qatar |

This table is as at 15th January 2018.

# APPENDIX 3 – TREASURY MANAGEMENT SCHEME OF DELEGATION

**TREASURY MANAGEMENT SCHEME OF DELEGATION**

**(i) Full Council**
- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

**(ii) Cabinet**
- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

**(iii) Audit Committee**
- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

**(iv) The S151 (responsible) officer is responsible for:**
- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.
- preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe
- ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
- ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
- ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
- ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources
- ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

- provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees
- ensuring that members are adequately informed and understand the risk exposures taken on by an authority
- ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above
- creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following:
    - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;
    - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;
    - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;
    - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;
    - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

## APPENDIX 4 – GLOSSARY

**Bank Rate -** The official Bank Rate paid on commercial bank reserves, i.e. reserves placed by commercial banks with the Bank of England as part of the Bank's operations to reduce volatility in short term interest rates in the money markets.

**Borrowing / Investment Portfolio** - A list of loans or investments held by the Council.

**Borrowing Requirement/Financing Need** - The amount that the Council needs to borrow to finance capital expenditure and manage debt.

**Call Account –** A bank deposit account where funds can be withdrawn at any time.

**Capital Financing Requirement (CFR) -** The Capital Financing Requirement reflects the Council's underlying need to borrow for capital purposes. Thus, if new capital expenditure is incurred and not financed from sources other than by borrowing, the CFR will increase by the amount of that expenditure. Borrowing, up to the value of the CFR, may be either from internal cash balances or externally, such as from the PWLB.

**CIPFA Code of Practice on Treasury Management** - A code of practice issued by CIPFA detailing best practice for managing the treasury management function.

**Counterparty** - Banks, Building Societies and other financial institutions that the Council transacts with for borrowing and lending.

**Credit Default Swaps (CDS) -** A contract between two counterparties in which the buyer of the contract makes quarterly payments to the seller of the contract in exchange for a payoff if there is a credit event (e.g. default) of the reference entity (i.e. the third party on whom the contract is based). The contract essentially provides a means of insurance to the buyer of the CDS against default by a borrower. The "spread" (effectively the premium paid by the CDS buyer) provides an indication of the perceived risk of a default occurring.

**Credit Ratings** - A scoring system used by credit rating agencies such as Fitch, Moody's and Standard and Poor's to indicate the creditworthiness and other factors of a Governments, banks, building societies and other financial institutions.

**Creditworthiness** - How highly rated an institution is according to its credit rating.

**Dealing** - Is the process of carrying out transactions with a counterparty, including agreeing the terms of an investment. This is usually conducted through a Money Market Broker.

**Debt Rescheduling** - Refinancing loans on different terms and rates to the original loan.

**Fitch Ratings** - A credit rating agency.

**Fund Manager** - The individual responsible for making decisions related to any portfolio of investments in accordance with the stated goals of the fund.

**Gilts** - Also known as Gilt-edged Securities. UK central Government debt. It may be dated (redeemable) or undated. Undated gilts are perpetual debt, paying a fixed periodic coupon but having no final redemption date. Gilt yields are conventionally quoted in the UK markets on a semi-annual basis.

**Limits for External Debt** - A Prudential Indicator prescribed by the Prudential Code sets limits on the total amount of debt the Council could afford.

**Liquidity** - Access to cash that is readily available.

**Maturity** - The date when an investment is repaid or the period covered by a fixed term investment.

**Minimum Revenue Provision (MRP)** - The minimum amount, which must be charged to an authority's revenue account each year for the prudent repayment of debt.

**Money Market Funds** - Open ended collective investment fund that invests in highly-liquid short-term financial instruments (with maturities typically 90 days to less than one year).

**Moody's** - A credit rating agency.

**Non-Specified Investments** - Investments deemed to have a greater potential of risk, such as investments for longer than one year or with institutions that do not have credit ratings, like some Building Societies. Limits must be set on the amounts that may be held in such investments at any one time during

**Portfolio** - A number of different assets, liabilities, or assets and liabilities together, considered as a whole. For example, a diversified investment portfolio. An investor in such a portfolio might hold a number of different investment assets within the portfolio, with the objectives of growing the total value of the portfolio and limiting the risk of losses.

**Prudential Code for Capital Finance in Local Authorities** - The capital finance system is based on the Prudential Code developed by CIPFA. The key feature of the system is that local authorities should determine the level of their capital investment and how much they borrow to finance that investment based on their own assessment of what they can afford.

**Prudential Indicators** - The key objectives of the Prudential Code are to ensure that the capital investment plans are affordable, sustainable and prudent. As part of this framework, the
Prudential Code sets out several indicators that must be used to demonstrate this.

**Public Works Loan Board (PWLB)** - A central government agency which provides loans to local authorities and other prescribed institutions at interest rates slightly higher than those at which the Government itself can borrow.

**Revenue Expenditure Financed by Capital under Statute (REFCUS**) - Expenditure that may be classified under legislation as capital but does not result in the creation of a fixed asset on the Balance Sheet.

**Security** - Placing cash in highly rated institutions.

**Sovereign Debt Rating** - Assessment of the international rating agencies of the likelihood that a particular country will default on its loans.

**Specified Investments** - Investments that offer high security and liquidity. They must have a maturity of no longer than 364 days.

**Standard and Poor's** - A credit rating agency.

**UK Government Investments** - Debt Management Office (DMO) deposits and bonds (gilts) for which maturity date at time of purchase is less than 365 days away.

**Yield** - The rate of return on the current market value of an asset or liability, usually expressed as a percentage per annum. For example, today's yield to maturity of a bond measures the total return to an investor in the bond, reflecting both the interest income over the life of the bond and any capital gain (or loss) from today's market value to the redemption amount payable at maturity.