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Treasury Management, Investment, Borrowing and MRP strategies 2019/20 (Including Prudential Indicators)

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Office of the Police and Crime Commissioner Report

Title: Treasury Management, Investment, Borrowing and MRP strategies 2019/20 & Prudential Indicators

Report of the Joint Chief Finance Officer

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1. Purpose of the Report

1.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the CIPFA TM Code) and the Prudential Code require Local Authorities (including PCCs) to determine the Treasury Management Strategy Statement (TMSS) on an annual basis.

These codes were originally issued in 2002, revised in 2009, 2011 and again in 2017. The TMSS presented here complies to the 2017 codes and accompanying guidance notes. The TMSS also incorporates the Investment Strategy which is a requirement of the Ministry of Housing, Communities and Local Government's Investment (MHCLG) Investment Guidance 2018.

This report proposes a strategy for the financial year 2019/20.

Treasury Management in Local Government continues to be a highly important activity. The Police and Crime Commissioner ("The Commissioner") adopts the CIPFA definition of Treasury Management which is as follows:

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

2. Recommendations

2.1. The Commissioner is asked to:

- Approve the Strategy for Treasury Management as set out at paragraph 4 for 2019/20.
- Approve the Prudential Indicators Specific to Treasury Management for 2019/20 as described in paragraph 5.
- Approve the Minimum Revenue Provision Policy Statement for 2019/20 as set out in paragraph 6.
- Approve the Investment Strategy for 2019/20 as set out in paragraph 4.6
- Note that the detailed Treasury Management Practices (TMPs) have been reviewed and updated as required by the Code of Practice and will be published alongside the TMSS on the Commissioner's website.
- Delegate to the Joint Chief Finance Officer any non-material amendments arising from scrutiny of the strategy by the Joint Audit Committee.

2.2. The Joint Audit Committee are asked to review the Treasury Management Strategy Statement and Treasury Management Practices to be satisfied that controls are satisfactory and provide advice as appropriate to the Commissioner.

3. Background

3.1. The Commissioner is required to approve an annual Treasury Management Strategy Statement in accordance with the CIPFA Code of Practice on Treasury Management, which also incorporates an Investment Strategy as required by the Local Government Act 2003 and which is prepared in accordance with the Ministry of Housing, Communities and Local Government's Investment Guidance 2018. Together, these cover the financing and investment strategy for the forthcoming financial year.

3.2. The Treasury Management Strategy has been prepared in line with the model guidance produced by Arlingclose Ltd, who provide specialist treasury management advice to the Commissioner. It should however be noted that all treasury management decisions and activity are the responsibility of the Commissioner and any such references to the use of these advisors should be viewed in this context.

3.3. The current contract to provide specialist treasury advice expires on 31/03/2019 and a process to re-tender the contract is currently underway.

4. Treasury Management Strategy 2019/20

4.1. General Principles

4.1.1. Treasury management activities involving, as they do, the investment of large sums of money and the generation of potentially significant interest earnings have inherent risks. The Commissioner regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks. The main risks to the Commissioner's treasury activities are outlined below:

- Credit and Counterparty Risk (Security of Investments)
- Liquidity Risk (Inadequate cash resources)
- Market or Interest Rate Risk (Fluctuations in interest rate levels)
- Re-financing risks (Impact of debt maturing in future years)
- Legal & Regulatory Risk.
- Fraud, error and corruption Risk

4.1.2. Details of the control measures the Commissioner has put in place to manage these risks are contained within the separate Treasury Management Practices (TMPs).

4.1.3. The Commissioner acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management. However, the high profile near failure of major banks in 2008 highlighted that this objective must be sought within a context of effective management of counter-party risk. Accordingly, the Commissioner will continue to search for optimum returns on investments, but at all times the **security** of the sums invested will be paramount. This is a cornerstone of the CIPFA Code of Treasury Management Practice which emphasises "**Security, Liquidity, Yield** in order of importance at all times". The security of the sums invested is managed by tight controls over the schedules of approved counter-parties, which are continually reviewed to take account of changing circumstances, and by the setting of limits on individual and categories of investments as set out at **Appendix A**.

4.1.4. The strategy also takes into account the impact of treasury management activities on the Commissioner's revenue budget. Forecasts of cash balances, interest receipts and financing costs are regularly re-modelled. The revenue budget for 2019/20 and forecasts for future years have been updated in light of the latest available information as part of the financial planning process.

4.2. External Guidance

4.2.1. The guidance under which this strategy is put forward comes from a variety of different places. Principally, however, the requirement to produce an annual Treasury Management Strategy is set out in the CIPFA Code of Practice on Treasury Management published in 2011 and recently updated in 2017. There is, in addition, a further requirement arising from the Local Government Act 2003 (Section 15) and the 2018 Ministry of Housing, Communities and Local Government's Investment Guidance, to produce an investment strategy as part of the wider Treasury Strategy. This is set out below at paragraph 4.6. Finally, the Commissioner's current treasury advisor's Arlingclose Ltd have provided some advice about possible future trends in interest rates and advice on best practice in relation to the format of the TMSS.

4.3. Treasury Management Cash Flow Forecast

4.3.1. Treasury Management activity is driven by the complex interaction of expenditure and income flows, but the core drivers within the Commissioner's balance sheet are the underlying need to borrow to finance its capital programme, as measured by the capital financing requirement (CFR), which is explored in detail in section 4.5 of this report, and the level of reserves and balances. In addition, day-to-day fluctuations in cash-flows due to the timing of grant and council tax receipts and out-going payments to employees and suppliers have an impact on treasury activities and accordingly are modelled in detail. The Commissioner's level of debt and investments is linked to the above elements, but market conditions, interest rate expectations and credit risk considerations all influence the Commissioner's strategy in determining exact borrowing and lending activity.

4.3.2. The estimated treasury position at 31st March 2019 and for the following financial years are summarised below:

Estimated Treasury Position	Estimate 2019/20 £m	Estimate 2020/21 £m	Estimate 2021/22 £m	Estimate 2022/23 £m
External Borrowing	0.00	0.00	0.00	0.00
Interest Payments	0.00	0.00	0.00	0.00
Investments (average)	15.185	9.816	7.376	4.563
Interest Receipts	0.120	0.165	0.140	0.115

4.3.3. The figures in the table above are based on the approval of the proposed revenue budget and capital programme presented to the Commissioner elsewhere on this agenda and are based on the interest rate assumptions as outlined in paragraph 4.4.3 below.

4.3.4. The Commissioner's underlying need to borrow, as measured by the Capital Financing Requirement (CFR), is estimated to be £17.5m at the start of the 2019/20 financial year. This includes £4.7m which is the capital value of the PFI contract as required by changes to proper accounting practices introduced in The Code of Practice on Local Authority Accounting 2009. The capital programme paper elsewhere on this agenda (see item 10b) indicates that the Commissioner will need to borrow to deliver the agreed capital programme, specifically to provide a fit for purpose territorial policing HQ in the west of the county. This investment is still indicative and would be subject to a full business case decision process. However, under current market conditions, where short term interest receipts are forecast to remain low in the immediate future, and there are continuing general uncertainties over the credit worthiness of financial institutions, it is assumed that the most prudent borrowing strategy for the present is to meet the capital funding requirement from within internal resources. This has the effect of reducing the cash balances available for investment. Advice will continue to be sought from our treasury advisors as to the most opportune time and interest rate to undertake external borrowing.

4.3.5. The estimate for interest receipts in 2019/20 is £165k (latest forecast for 2018/19 is £135k). The low level of receipts reflects the historically low level of investment returns currently available where the Bank of England base rate stands at 0.75%.

4.4. Treasury Management Interest Rate Forecast

4.4.1. The uncertain political situation surrounding Brexit has produced the prospect of divergent paths for UK monetary policy. The on-going economic and political uncertainty relating to Brexit has prompted Arlingclose to both change their central forecast and widen the possible range of interest rate paths to incorporate the different Brexit outcomes. These range from an immediate no-deal Brexit to remaining in the European union.

4.4.2. Due to the short time for a Brexit withdrawal deal to be agreed and the possibility of an extended period of uncertainty the central forecast is the bank base rate to remain unchanged until December 2019 before rising twice thereafter

4.4.3. The main forward projections of interest rates provided by Arlingclose are shown in the table below. It should be noted that these forecasts are based on information as at January 2019. The quarterly treasury activities reports will contain updated information in respect of interest rate forecasts.

Base Rate Estimates	2018/19	2019/20	2020/21	2021/22	2022/23
Quarter 1	0.50%	0.75%	1.00%	1.25%	1.25%
Quarter 2	0.75%	0.75%	1.25%	1.25%	1.25%
Quarter 3	0.75%	0.75%	1.25%	1.25%	1.25%
Quarter 4	0.75%	1.00%	1.25%	1.25%	1.25%

4.5. Borrowing Strategy

4.5.1. Long Term Borrowing

The Commissioner's underlying need to borrow for capital purposes is measured by reference to the Capital Financing Requirement (CFR), which is one of the Prudential Indicators and represents the cumulative capital expenditure of the Commissioner that has **not** been financed from other sources such as capital receipts, capital grants, revenue contributions or reserves. To ensure that this expenditure will ultimately be financed, authorities are required to make a provision from their revenue accounts each year for the repayment of debt. This sum known as the Minimum Revenue Provision (MRP) is intended to cover the principal repayments of any loan over the expected life of a capital asset. The CFR together with Usable Reserves, are the core drivers of the Commissioner's Treasury Management activities.

Actual borrowing may be greater or less than the CFR, but in order to comply with the Prudential Code, the Commissioner must ensure that in the medium term, net debt will only be for capital purposes. Therefore the Commissioner must ensure that except in the short term, net debt does not exceed the

CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. In compliance with this requirement the Commissioner does not currently intend to borrow in advance of spending need.

The table below shows the Commissioner's projected capital financing requirement for 2019/20 and beyond.

Capital Financing	2017/18 Actual £m	2018/19 Forecast £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Balance B/fwd	18.40	17.98	17.55	17.06	16.56	16.03
Plus Capital Expenditure financed from borrowing	0.00	0.00	0.00	0.00	0.00	3.40
Less MRP for Debt Redemption	-0.42	-0.43	-0.49	-0.50	-0.53	-0.55
Balance C/Fwd	**17.98**	**17.55**	**17.06**	**16.56**	**16.03**	**18.88**

The above table shows only capital expenditure that is required to be financed from borrowing. The full capital programme and associated financing is reported in summary within the capital programme and capital programme elsewhere on the agenda (see item 10b).

The Commissioner is not expected to have any external borrowing at the start of 2019/20. Given that the CFR is forecast to be £17.5m this effectively means that the Commissioner will be funding over £12.8m of capital spend from internal resources (CFR £17.5m less £4.7m in relation to PFI).

Currently, there is a significant differential between investment rates at 1.00% and the rate at which long term finance can be procured, which despite standing at historically low levels, will still cost over 3.00+% pa. Consequently, at this juncture, undertaking long term borrowing is likely to have a prohibitively high short term cost to the revenue account. However, such funding decisions may commit the Commissioner to costs for many years into the future and it is therefore critical that a long term view is taken regarding the timing of such transactions. It should also be recognised that by funding internally, there is an exposure to interest rate risk at the point that actual borrowing is undertaken. Accordingly, the Commissioner, in conjunction with its treasury advisor (currently Arlingclose Ltd), will continue to monitor market conditions and interest rate prospects on an on-going basis, in the context of the Commissioner's capital expenditure plans, with a view to minimising borrowing costs over the medium to long term.

4.5.2. Short Term Borrowing

Short term loans will be used to manage day to day movements in cash balances, or over a short term period to enable aggregation of existing deposits into longer and more sustainable investment sums. Short term borrowing would probably be from another Local Authority.

4.6. Investment Strategy

4.6.1. Local Authorities (which include the Commissioner) invest their money for three broad purposes:

- because they have surplus cash as a result of their 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 Local Government Act 2003, Section 15(1)(a) requires the Commissioner to approve an investment strategy which must also meets the requirement in the statutory investment guidance issued by the Ministry of Housing, Communities and Local Government in January 2018. The Commissioner does not currently have, and does not intend to invest in, service investments or commercial investments so the detail below focuses on a Treasury Management Investment Strategy.

4.6.2. The CIPFA Code requires funds to be invested prudently, and to have regard for:

- **Security** – protecting the capital sum invested from loss; and
- **Liquidity** – ensuring the funds invested are available for expenditure when needed

*The updated investment guidance emphasises "**Security, Liquidity, Yield** in order of importance at all times".*

The generation of **yield** is distinct from these prudential objectives. Once proper levels of security and liquidity are determined, it is then reasonable to consider what yield can be obtained consistent with these priorities. The objective when investing surpluses is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the aim would be to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

In the past the treasury management investment strategy has operated criteria based on credit ratings to determine the size and duration of investments it is willing to place with particular counterparties. The credit worthiness of counterparties is reviewed on an ongoing basis in conjunction with the Commissioner's treasury advisors (Arlingclose Ltd).

The Commissioner holds significant balances of invested funds, representing income received in advance of expenditure plus balances and reserves held. During 2018/19, the Commissioner's investment balance has ranged between £9.2m and £35.1m. The larger sum was due to the receipt in July 2018 of £20.4m pension top up grant from the Home Office, which is drawn down steadily over the remainder of the year. Balances in 2019/20 are forecast to slowly reduce as expenditure on large capital schemes continues. It is anticipated that, at the peak, when the pensions grant is received in July, balances for investment could approach £32m.

Credit Rating - Investment decisions are made by reference to the lowest published long-term credit rating from credit agencies such as, Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. In addition to credit ratings, the Commissioner and its advisors,(currently Arlingclose Ltd), select countries and financial institutions after analysis and ongoing monitoring of:

- Economic fundamentals (e.g., net debt as a % of GDP)
- Credit default swap prices
- Sovereign support mechanisms
- Share prices
- Corporate developments, news, articles, market sentiment and momentum
- Subjective overlay – or, put more simply, common sense.

The investment strategy for 2015/16 was opened up slightly to include some additional classes of investment to allow more flexibility and diversification. The strategy for 2019/20 remains the same. The decision to enter into a new class of investment is delegated to the Joint Chief Finance Officer. The strategy allows for investments in pooled funds such as money market funds or property funds. Following Brexit information and advice will be sought regarding the use of property funds to further diversify the Commissioners' portfolio, provide a longer-term investment and increase yield whilst maintaining security. A full explanation of each class of asset is provided in **Appendix A** together with a schedule of the limits that will be applied.

The Treasury Management Strategy is designed to be a dynamic framework which is responsive to prevailing conditions with the aim of safeguarding the Commissioner's resources. Accordingly, the Commissioner and his advisors will continuously monitor corporate developments and market sentiment with regards to counterparties and will amend the approved counterparty list and lending criteria where necessary. Whilst credit ratings are central to the counterparty risk evaluation process, other factors such as the prevailing economic climate are taken into consideration when determining investment strategy. It is proposed to continue the policy, adopted in 2017/18 that the Joint Chief Finance Officer, subject to consultation with the Commissioner, be granted delegated authority to amend or extend the list of approved counterparties should market conditions allow.

The Joint Audit Committee will be updated on any changes to policy. The performance of the Commissioner's treasury advisors and quality of advice provided is evaluated prior to the annual renewal of the contract. Meetings with the advisors to discuss treasury management issues are held on a regular basis.

4.6.3. The use of Financial Instruments for the Management of Risks

Currently, Local Authorities (including PCC's) legal power to use derivative instruments remains unclear. The General Power of Competence enshrined in the Localism Act is not sufficiently explicit.

In the absence of any explicit legal power to do so, The Commissioner has **no** plans to use derivatives during 2019/20. Should this position change, the Commissioner may seek to develop a detailed and robust risk management framework governing the use of derivatives, but this change in strategy will require explicit approval.

4.6.4. Liquidity of investments

The investment strategy must lay down the principles which are to be used in determining the amount of funds which can prudently be committed for more than one year i.e. what MHCLG's defines as a long term investment.

The Financial Services team uses a cash flow forecasting spreadsheet to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Commissioner being forced to borrow on unfavourable terms to meet his financial commitments. For the Commissioner, the total of investments over one year in duration are limited to £5m with a maximum duration of three years. This policy balances the desire to maximise investment returns, with the need to maintain the liquidity of funds.

Under current market conditions there is still little opportunity to generate significant additional investment income by investing in longer time periods over one year. However, as always, investment plans should be flexible enough to respond to changing market conditions during the year. The estimate of investment income for 2019/20 amounts to £165k (£135k 2018/19) and actual investment performance will be reported regularly to the Commissioner and will be provided to members of the Joint Audit Committee as background information to provide guidance and support when undertaking scrutiny of Treasury Management procedures.

4.7. Treasury Management and Risk

4.7.1. The Commissioner's approach to risk is to seek optimum returns on invested sums, taking into account at all times the paramount security of the investment. The CIPFA Code of Practice and Treasury Management Practices (as set out below in para. 4.8) sets out in some detail defined treasury risks and how those risks are managed on a day to day basis.

4.8. Treasury Management Practices

4.8.1. The CIPFA Code of Practice on Treasury Management recommends the adoption of detailed Treasury Management Practices (TMPs). As outlined in section 1.1 above, the Treasury Management Code and Prudential Code were updated and additional guidance notes have now been received. The TMP's have been updated. The guidance from CIPFA recommends that TMPs should cover the following areas:

- Risk Management
- Performance Management
- Decision Making and Analysis
- Approved Instruments
- Organisation, Segregation of duties and dealing arrangements
- Reporting and Management Information requirements
- Budgeting, Accounting and Audit
- Cash and cashflow management
- Money laundering
- Training & Qualifications
- Use of external service providers
- Corporate Governance

Treasury Management is a specialised and potentially risky activity, which is currently managed on a day-to-day basis by the Financial Services Team under authorisation from the Joint Chief Finance Officer as part of a shared service arrangement for the provision of financial services. The training needs of treasury management staff to ensure that they have appropriate skills and expertise to effectively undertake treasury management responsibilities is addressed on an ongoing basis.

Specific guidance on the content of TMPs is contained within CIPFA's revised code of Practice for Treasury Management. Accordingly, the TMPs have been reviewed in detail and where necessary minor amendments have been made to bring the TMPs into line with The Code.

5. Treasury Management Prudential Indicators

5.1. The key objectives of The Code are to ensure, within a clear framework, that Capital investment plans are **affordable, prudent and sustainable** (or to highlight, in exceptional cases, that there is a danger this will not be achieved so that the Commissioner can take remedial action). To demonstrate that Authorities have fulfilled these objectives, the Prudential Code sets out the Indicators that must be used. The indicators required by The Code are designed purely to support local decision making and are specifically not designed to represent comparative performance indicators.

5.2. The treasury management Indicators are not targets to be aimed at, but are instead limits within which the treasury management policies of the Commissioner are deemed prudent. These cover three aspects:

5.2.1. **Maturity Structure of Borrowing** - It is recommended that upper and lower limits for the maturity structure of borrowings are calculated as follows:

Period of Maturity	Upper Limit %	Lower Limit %
Under 12 months	100.00	0
12 months and within 24 months	100.00	0
24 months and within 5 years	100.00	0
5 years and within 10years	100.00	0
10 years and above	100.00	0

The PCC currently has no external debt. This table will be updated once actual borrowing is undertaken.

This indicator is primarily applicable to organisations, which have undertaken significant levels of borrowing to finance their capital programmes in which case it is prudent to spread the profile of repayments to safeguard against fluctuations of interest payments arising from having to refinance a large proportion of the debt portfolio at any point in time. During 2012/13 the Commissioner repaid all outstanding external borrowing and as a result there is currently no requirement to apply stringent limits to the maturity profile of existing debt.

5.2.2. **Principal sums invested for periods longer than a year –** The purpose of this indicator is to contain the Commissioner's exposure to the possibility of loss that might arise as a result of having to borrow short term at higher rates or losses by seeking early repayment of its investments.

Price Risk Indicator	2019/20	2020/21	2021/22
Limit on principal invested beyond one year	£3m	£2m	£1m

5.2.3. **Exposure to interest rate changes** - The 2017 code encourages Authorities to define their own 'Liability Benchmark' which will provide a basis for developing a strategy for managing interest rate risk. On the basis that Arlingclose are not forecasting significant interest rate movements in the short term and that the Commissioner has no plans to make any long term external borrowing decisions over the next financial year, because of the 'cost of carry', development of a liability benchmark at this point would not provide added value. However, the Commissioner will actively develop indicators to manage interest rate risk in due course once there is more clarity over borrowing intentions.

5.3. Setting, Revising, Monitoring and Reporting

Prudential Indicators, other than those using actual expenditure taken from audited statements of accounts must be set prior to the commencement of the financial year to which they relate. Indicators may be revised at any time, and must, in any case, be revised for the year of account when preparing indicators for the following year. The Joint Chief Finance Officer has a prescribed responsibility under The Code to ensure that relevant procedures exist for monitoring and reporting of performance against the indicators. The Prudential Indicators when initially set and whenever revised, must be approved by the body which approves the budget, i.e. The Commissioner at his Public Accountability Conference.

6. Annual MRP Statement for 2019/20

6.1. The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 (SI 2008/414) place a duty on authorities to make a prudent provision for debt redemption, this is known as the **Minimum Revenue Provision** (MRP). The Local Government Act 2003 requires the Authority to "have regard" to The Ministry of Housing, Communities and Local Government's Guidance on Minimum Revenue Provision most recently issued in 2018. This sum known as the MRP is intended to cover the principal repayments of any loan over the expected life of a capital asset.

6.2. The Ministry of Housing, Communities and Local Government's Guidance recommends that before the start of the financial year, The Commissioner approves a statement of MRP policy for the forthcoming financial year. This is now by agreement encompassed within the TMSS. The broad aim of the policy is to ensure that MRP is charged over a period that is reasonably commensurate with the period over which the capital expenditure, which gave rise to the debt, provides benefits.

The four options available for calculating MRP are set out below:

- Option 1 – Regulatory Method based on 4% of the CFR after technical adjustments.
- Option 2 – CFR Method, based on 4% of the CFR with no technical adjustments.
- Option 3 – Asset Life Method, spread over the life of the asset being financed.
- Option 4 – Depreciation Method, based on the period over which the asset being financed is depreciated.

6.3. It is proposed that The Commissioner's MRP policy for 2019/20 is unchanged from that of 2018/19 and that The Commissioner utilises option 1 for all borrowing incurred prior to the 1st April 2008 and option 3 for all borrowing undertaken from 2008/09 onwards, irrespective of whether this is against supported or unsupported expenditure. This policy establishes a link between the period over which the MRP is charged and the life of the asset for which borrowing has been undertaken. It is proposed that a fixed instalment method is used to align to the Commissioner's straight line depreciation policy.

6.4. MRP in respect of PFI and leases brought on to the balance sheet under the 2009 accounting requirements will match the annual principal repayment for the associated deferred liability. This will not result in an additional charge to the Commissioner's revenue budget as this is part of the capital repayment element of the PFI unitary charge.

6.5. There have been some additional voluntary contributions of MRP made in previous years that are available to reduce the revenue charges in later years. No such overpayments or withdrawals are planned for 2019/20.

7. Balanced Budget Requirement

7.1. The Commissioner complies with the provisions of section 32 of the Local Government Finance Act 1992 to set a balanced budget.

8. Reporting on Treasury Activities

8.1. In accordance with The Code of Practice for Treasury Management, the Commissioner will approve the Annual TMSS, receive, a quarterly summary of treasury activity, a mid-year update on the strategy and an annual report after the close of the financial year.

8.2. The Joint Audit Committee will be responsible for the scrutiny of treasury management policy and processes. The Joint Audit Committee terms of reference in relation to treasury management are:

- Review the Treasury Management policy and procedures to be satisfied that controls are satisfactory.
- Receive regular reports on activities, issues and trends to support the Committee's understanding of Treasury Management activities; the Committee is not responsible for the regular monitoring of activity.
- Review the treasury risk profile and adequacy of treasury risk management processes.
- Review assurances on Treasury Management (for example, an internal audit report, external or other reports).

8.3. The MHCLG Guidance on investments states that publication of strategies is now formally recommended, the full suite of strategy documents will be published on the Commissioner's website once approved.

Counterparty Selection Criteria and Approved Counterparties

1. Background

1.1. The lending criteria set out below are designed to ensure that, in accordance with The Code of Practice, the security of the funds invested is more important than maximising the return on investments. Following consultation with the Commissioner's treasury advisors (currently Arlingclose Ltd) there are no amendments to the criteria used in determining approved investment counterparties for 2019/20 compared to those in operation for 2018/19.

2. Counterparty Selection Criteria

2.1. The agreed changes to the selection criteria for investment counterparties for 2015/16 included changes to the investment categories, a reduction in the maximum amount and duration lengths for investments. This was to encourage diversification and to increase the security of those funds invested. These principles apply to the 2019/20 strategy. The investment limits and duration are linked to the credit rating and type of counterparty at the time the investment is made.

2.2. The credit worthiness of counterparties is monitored on an ongoing basis in conjunction with the Commissioner's treasury management advisors Arlingclose Ltd who provide timely updates and advice on the standing of counterparties. Whilst credit ratings are central to the counterparty risk evaluation process, other factors such as the prevailing economic climate are taken into consideration when determining investment strategy and at the time when individual investment decisions are made. In the event that this ongoing monitoring results in a significant change to counterparty selection during the year, the Commissioner and the Joint Audit Committee will be advised through the quarterly activities report.

2.3. The approved investment counterparties for the 2019/20 investment strategy are summaried as follows:

Category	Description	Comments
Category 1	Banks Unsecured	Includes building societies
Category 2	Banks Secured	Includes building societies
Category 3	Government	Includes other Local Authorities
Category 4	Registered Providers	Includes providers of social housing e.g. Housing Associations
Category 5	Pooled Funds	Includes Money Market Funds and property funds

2.4. A more detailed explanation of each of these counter party groupings in provided in **Schedule B** (page 20).

3. Counterparty Groupings / Limits

3.1. The criteria for approving investment counterparties have been devised, grouped, graded and investment limits attached as detailed in **Schedule A** (page 19). The limits are based on a percentage of the potential maximum sums available for investment during the year of up to £40m. The counterparty limits for 2019/20 are the same as the limits for 2018/19. Pooled funds are in essence the same as AAA money market funds but they require 3 days notice for the return of our funds. This slight reduction in cashflow is rewarded by a slightly increased interest rate. Arlingclose suggest that these funds are used for longer term investments and the ordinary money market funds to manage cash flow.

4. Description of Credit Ratings

4.1. As outlined in paragraph 2.2 above the credit worthiness of counterparties is monitored on an ongoing basis in conjunction with the Commissioner's treasury management advisors Arlingclose Ltd. A description of each of the credit rating is provided at **Schedule C** (page 21-23).

Schedule A – Counterparty Groupings and Associated Limits

		Investment Limits				
Credit Rating	Maximum	1 Banks Unsecured	2 Banks Secured	3 Government	4 Registered Providers	5 Pooled Funds
Category Limit 2019/20	*Amount*	*£20m*	*£20m*	*Unlimited*	*£10m*	*£20m*
	Duration					
Individual Institution/Group Limits						
UK Government	Amount	N/A	N/A	£ unlimited	N/A	N/A
	Duration			50 Years		
AAA	Amount	£2m	£4m	£4m	£2m	£4m per fund (Pooled funds are generally not rated but the diversification of funds equate to AAA credit rating)
	Duration	5 years	20 years	50 years	20 years	
AA+	Amount	£2m	£4m	£4m	£2m	
	Duration	5 years	10 years	25 years	10 years	
AA	Amount	£2m	£4m	£4m	£2m	
	Duration	4 years	5 years	15 years	10 years	
AA-	Amount	£2m	£4m	£4m	£2m	
	Duration	3 years	4 years	10 years	10 years	
A+	Amount	£2m	£4m	£2m	£2m	
	Duration	2 years	3 years	5 years	5 years	
A	Amount	£2m	£4m	£2m	£2m	
	Duration	13 months	2 years	5 Years	5 years	
A-	Amount	£2m	£4m	£2m	£2m	
	Duration	6 months	13 months	5 years	5 years	
None	Amount	N/A	N/A	£2m	£2m	
	Duration			25 years	5 years	

Note, individual, group and category limits for 2019/20 are based on the potential maximum available for investment during the year of up to £40m. It should also be noted that as outlined in paragraph 2.2 above, counterparty credit rating is not the only factor taken into consideration at the time of placing investments.

The maximum of all investments with outstanding maturities greater than one year will be £5m.

Schedule B – Explanation of Counterparty Groupings

Class of Investment
Category 1 - Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.
Category 2 - Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.
Category 3 - Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.
Category 4 - Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.
Category 5 - Pooled Funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Schedule C – Description of Credit Ratings – Long Term Rating

Rating Agency	Fitch	Moody’s	Standard & Poor’s
Long Term Rating	This category of ratings applies to investments over 12 months. The grading is in the range AAA, AA, A, etc, down to DDD. • AAA Highest credit quality ‘AAA’ ratings denote the lowest expectation of credit risk.They are assigned only in case of exceptionally strong capacity for timely payment of financial commitments. This capacity is highly unlikely to be affected by foreseeable events. • AA Very high credit quality ‘AA’ ratings denote a very low expectation of credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events. • A High credit quality ‘A’ ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings. **The Commissioner will confine investments to those institutions with a minimum rating of A-.**	This category of ratings applies to investments over 12 months. The grading is in the range Aaa, Aa, A, etc, down to C. Moody's appends numerical modifiers 1, 2, and 3 to each generic rating classification from Aa to Caa. The modifier 1 indicates that the obligation ranks in the higher end of its generic rating category; the modifier 2 indicates a mid-range ranking; and the modifier 3 indicates a ranking in the lower end of that generic rating category. • Aaa Obligations rated Aaa are judged to be of the highest quality, with the lowest level of credit risk. • Aa Obligations rated Aa are judged to be of high quality and are subject to very low credit risk. • A Obligations rated A are considered upper-medium grade and are subject to low credit risk. **The Commissioner will confine investments to those institutions with a minimum rating of A1.**	This category of ratings applies to investments over 12 months. The grading is in the range AAA, AA, A, etc, down to D. The ratings from 'AA' to 'CCC' may be modified by the addition of a plus (+) or minus (-) sign to show relative standing within the major rating categories. • AAA: An obligation rated 'AAA' has the highest rating assigned by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is extremely strong. • AA: An obligation rated 'AA' differs from the highest-rated obligations only to a small degree. The obligor's capacity to meet its financial commitment on the obligation is very strong. • A: An obligation rated 'A' is somewhat more susceptible to the adverse effects of changes in circumstances and economic conditions than obligations in higher-rated categories. However, the obligor's capacity to meet its financial commitment on the obligation is still strong. **The Commissioner will confine investments to those institutions with a minimum rating of A-.**

Schedule C – Description of Credit Ratings – Short Term Rating

Rating Agency	Fitch	Moody's	Standard & Poor's
Short Term Rating	This category of ratings generally applies to investments of up to 12 months. The grading is in the range F1, F2, F3, B, C, D. • F1 Highest credit quality Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added "+" to denote an exceptionally strong credit feature. **The Commissioner will confine investments to those institutions with a minimum rating of F1.**	This category of ratings generally applies to investments of up to 12 months. The grading is in the range P1, P2, P3, NP (not prime). • P1 Issuers (or supporting institutions) rated Prime-1 have a superior ability to repay short-term debt obligations. **The Commissioner will confine investments to those institutions with a minimum rating of P1.**	This category of ratings generally applies to investments of up to 12 months. The grading is in the range A1,A2, A3, B1, B2, B3, C, D. • A1 A short-term obligation rated 'A-1' is rated in the highest category by Standard & Poor's. The obligor's capacity to meet its financial commitment on the obligation is strong. Within this category, certain obligations are designated with a plus sign (+). This indicates that the obligor's capacity to meet its financial commitment on these obligations is extremely strong. **The Commissioner will confine investments to those institutions with a minimum rating of A1.**

Schedule C – Description of Credit Ratings – Support Rating

Rating Agency	Fitch	Moody's	Standard & Poor's
Support Rating (Fitch)	This category of assessment does not rate the quality of the banking institution, but represents the analyst's view of whether the bank would receive State or other support should this be necessary. The gradings are in the range 1 – 5, although as set out above, the strategy is to restrict such investments to grades 1 - 3: • 1) A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. • 2) A bank for which, in the Analyst's opinion, there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to support the bank in question. • 3) A bank for which, in the Analyst's opinion, there is a moderate probability of external support, because of uncertainties about the ability or propensity of the potential provider of support to do so.	Not applicable	Not applicable