APPENDIX A

PENDLE BOROUGH COUNCIL

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2018/19

INDEX

1 INTRODUCTION

1.1 Background

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

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, when it is prudent and economic, any debt previously drawn may be restructured to meet Council risk or cost objectives.

CIPFA defines treasury management as:

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

1.2 **Reporting requirements**

The Council approves the overall policy and strategy within which the treasury management activity takes place. Within this framework, the approach followed at Pendle is one in which update reports are then presented to the Executive (at mid-year and at year-end). An overview of the process is provided below:

Prudential and treasury indicators and treasury strategy (this report) - The first and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update members with the progress of the capital position, amending prudential indicators where required (subject to Council approval), and whether any policies require revision. This report has traditionally been submitted to the Executive, normally in the October cycle of meetings but following the change in governance structure, will going forward be presented to the Policy & Resources Committee.

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. This report will be submitted to the Policy & Resources Committee in the July/August cycle of meetings.

Scrutiny (in year monitoring)
This role will continue to be undertaken by the Accounts and Audit Committee who receive quarterly updates on treasury management activity during the year.

Capital Strategy
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

The Council approved the Capital Strategy for the period 2018/21 at a meeting on 22nd February 2018.

The aim of the Capital Strategy is to provide for a balanced, sustainable capital programme over the medium term planning period ensuring that limited resources are applied in the most effective, efficient and economical way to contribute to the achievement of the Council's Strategic Plan.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

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

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

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training needs will be discussed with members of the Accounts and Audit Committee during the year. The training needs of treasury management officers are periodically reviewed as part of the Council's annual Performance Management Review (appraisal) process.

1.5 Treasury Management Consultants

The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2018/19 – 2020/21

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

2.1 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. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Private Sector Housing	2,420	3,096	760	660
Asset Renewal	468	937	270	250
Area Committees	297	276	170	170
Resource Procurement	1,670	903	400	0
Other general schemes	6,685	2,471	270	140
Total	**11,540**	**7,683**	**1,870**	**1,220**

Other long-term liabilities. The above financing need excludes other long-term liabilities, such as leasing arrangements, which already include borrowing instruments.

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 £000	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Total Expenditure	**11,540**	**7,683**	**1,870**	**1,220**
Financed by:				
Capital receipts	1,219	2,185	1,170	570
Capital grants	1,118	1,021	700	650
Revenue/Other	529	56	-	-
Net financing need for the year	**8,674**	**4,421**	**-**	**-**

2.2 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 indebtedness and so its 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 indebtedness 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. 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. The Council currently has no such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£000	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement					
Total CFR	**15,406**	**23,648**	**27,483**	**26,725**	**25,959**
Movement in CFR		**8,242**	**3,835**	**(758)**	**(766)**

Movement in CFR represented by					
Net financing need for the year (above)		8,674	4,421	-	-
Less MRP and other financing movements		(432)	(586)	(758)	(766)
Movement in CFR		**8,242**	**3,835**	**(758)**	**(766)**

3 BORROWING

The capital expenditure plans set out in Section 2 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 and the Council's capital strategy. 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.

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2017, with forward projections is 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.

£m	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt					
Debt at 1 April	15,359	16,359	23,659	27,159	26,159
Expected change in Debt	1,000	7,000	3,500	(1,000)	(1,000)
Other long-term liabilities (OLTL)	134	127	120	112	104
Expected change in OLTL	(7)	(7)	(8)	(8)	(8)
Actual gross debt at 31 March	**16,486**	**23,479**	**27,271**	**26,263**	**25,255**
The Capital Financing Requirement	**15,406**	**23,648**	**27,483**	**26,725**	**25,959**
Under / (over) borrowing	**(1,080)**	**169**	**212**	**462**	**704**

Within the prudential indicators, there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.

The Financial Services Manager reports that the Council expects to comply 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 report.

3.2 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 and the ability to fund under-borrowing by other cash resources.

Operational boundary £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt	26	28	28	28
Other long term liabilities	0.5	0.5	0.5	0.5
Total	**26.5**	**28.5**	**28.5**	**28.5**

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.

1. 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.
2. The Council is asked to approve the following authorised limit:

Authorised limit £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt	28	30	30	30
Other long term liabilities	0.5	0.5	0.5	0.5
Total	**28.5**	**30.5**	**30.5**	**30.5**

3.3 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 our central view.

	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%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

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%. At its February 2018 meeting, there was no change in Bank Rate but the forward guidance changed significantly to warn of "earlier, and greater than anticipated" rate of increases in Bank compared to their previous forward guidance. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in May and November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets.

There was a sharp rise in bond yields after the US Presidential election in November 2016 and yields have risen further more recently as a result of an agreement to a big increase in the government deficit aimed at stimulating economic growth and the Fed. taking the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature. We have also seen a sharp selloff in equities and bonds in February 2018 that has given further impetus to a rise in bond yields.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019.

These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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.

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

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

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without a fully agreed and stable coalition government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

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

- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

Investment and borrowing rates

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2017-18 and increased sharply after the result of the general election in June 2017, after the September MPC meeting, (when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases), and again in January and February 2018.

- Increases have been sharper in periods up to 10 years than in longer maturities. The policy of delaying new borrowing by running down spare cash balances has served well over the last few years. However, this was reviewed and reversed in the past 2 years to avoid incurring higher borrowing costs in the future when the Council may be unable to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

3.4 Borrowing strategy

At the end of 2016/17, the Council was in an over-borrowed position having borrowed in advance of capital spending given the low rates on offer from the PWLB. As can be seen from the table in 3.1 this position is due to unwind in the near-term.

Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Financial Services Manager 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.

Based on current plans it is expected that net additional borrowing of £3.5m will be undertaken in 2018/19. However, should the borrowing in 2017/18 be less than expected this will most likely be carried forward to 2018/19 and lead to an increased borrowing requirement in the year. For example, the Council purchased property interests relating to Number 1 Market Street and the ACE Centre during 2017/18 amounting to c£5.8 and thus far has only borrowed £3m for these transactions.

The position will be maintained under review with any decisions reported to the Executive and/or the Accounts and Audit Committee as appropriate.

3.5 Policy on borrowing in advance of need

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.

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.

3.6 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 Policy & Resources Committee and the Accounts and Audit Committee at the earliest meeting following its action.

3.7 Municipal Bond Agency

It is possible that the Municipal Bond Agency will be offering loans to local authorities in the future. The Agency hopes that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority may make use of this new source of borrowing as and when appropriate.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the MHCLG's Guidance on Local Government Investments ("the Guidance") and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 ("the CIPFA TM Code"). The Council's investment priorities will be security first, portfolio liquidity second, and 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 achieve this consideration 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 5.4 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 Creditworthiness policy

The primary principle governing the Council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

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

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

The 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 & Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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. The Council will therefore use designated counterparties within the following durational bands:

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

The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

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

- Designated UK Banks meeting credit rating criteria (defined by reference to Fitch ratings);
- UK Building Societies (currently only Nationwide, Coventry and Leeds Building Societies but this could change subject to other institutions meeting our minimum credit rating criteria):
- Principal Local Authorities;
- UK Government (Debt Management Office and Treasury Bills/Gilts);
- Money Market Funds (to-date only the CCLA Public Sector Deposit Fund has been used but this could vary subject to any review in 2018/19);
- Designated Non-UK Banks meeting minimum credit rating criteria (defined by reference to Fitch ratings) – to-date only Svenska Handelsbanken has been used.

Typically, the minimum credit ratings criteria the Council uses (per Fitch) will be a:

- Short-term rating F1
- Long-term rating A-
- Viability rating BB+ (where this continues)
- Support Rating 5

If a rating downgrade results in the counter-party falling below the minimum criteria then it will be removed from our 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.

Time and monetary limits applying to investments. The proposed criteria for specified and non-specified investments are shown in Appendix 5.4 for approval. Due care will be taken to consider the country, group and sector exposure of the Council's investments.

4.3 Country limits

With the exception of the UK, the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA (*from Fitch or equivalent). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.4. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Sector Limits

In addition to the limits outlined above the Council also applies the following operational limits as part of treasury management activity:

- Investments in any one sector (i.e. Banks, Building Societies, Money Market Funds, Local Govt) should not exceed 75% of the funds under investment with the exception of Principal Local Authorities;
- There should be no fewer than four counterparties in use at any point in time.

4.5 Investment strategy

In-house funds. 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 2018 and not to rise above 1.25% by quarter 1 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 about three months during each financial year are as follows:

	Now
2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%

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 – No principal funds will be invested for periods greater than 364/365 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.

For its cash flow generated balances, the Council will seek to utilise its instant access 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.

4.6 Investment risk benchmarking

This Council uses an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID.

4.7 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

5 APPENDICES

5.1 Prudential and treasury indicators and MRP statement

5.2 Interest rate forecasts

5.3 Treasury management practice 1 – credit and counterparty risk management

5.4 Approved countries for investments

5.5 Treasury management scheme of delegation

5.6 The treasury management role of the section 151 officer

5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2018/19 – 2020/21 AND MRP STATEMENT

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans. On the 22nd February 2018 Council approved a set of prudential indicators for 2018/19 including capital expenditure for the next three years.

5.1.2 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

MHCLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Based on CFR** – MRP will be based on the CFR (option 2) but adopting a charge of 2.5% per annum on a straight-line basis rather than 4% as assumed in the guidance on a reducing balance; under the latter the debt is never fully repaid unlike the former which results in the debt being cleared within 40 years. **If agreed this represents a change in current MRP policy.**

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (option 3 per CLG regulations) using the annuity method under which annual payments gradually increase during the life of the asset. Option 3 must be applied for any expenditure capitalised under a Capitalised Direction.

Repayments included in finance leases (if any) will be applied as MRP.

Exceptions to the above MRP Policy

In late 2016, the Council agreed to advance a loan of £1.1m to Pendle Leisure Trust to be repaid over a 12-year term. The principal element of repayments by the Trust constitutes capital receipts. The intention is to set these receipts aside in lieu of MRP to provide for the loan repayment by the Council.

Any borrowing to finance housing projects using the Brownfield Regeneration fund will also be excluded from the requirement for an MRP charge. If such borrowing is undertaken, the intention is to repay this borrowing from the capital receipts generated by the sale of properties over a period of up to 5 years. In similar fashion to the scenario outlined above, any capital expenditure incurred under these projects will increase the CFR. However, as it is intended to repay any associated borrowing from receipts over a 5-year term it is felt there is no need to set aside provision to repay the debt liability in the interim period, and hence there will be no MRP set aside in these circumstances. This position will also be subject to review.

A similar approach may be taken on other ‘regeneration’ type schemes where it is the intention to repay any debt financing from subsequent disposal proceeds over a ‘short’ period (usually up to 5 years).

To limit the potential exposure under this approach, debt on which MRP will initially not be provided will be capped at a maximum of £5m subject to the associated MRP liability (were it required) not exceeding an annual equivalent of £200k.

5.1.3 Maturity structure of borrowing

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.

The Council is asked to approve the following treasury indicators and limits. Note, that in practice the Council does not ordinarily expose itself to variable interest rate borrowing:

Maturity structure of fixed interest rate borrowing 2018/19		
	Lower	**Upper**
Under 12 months	0%	20%
12 months to 2 years	0%	30%
2 years to 5 years	0%	40%
5 years to 10 years	0%	60%
10 years and above	0%	100%
Maturity structure of variable interest rate borrowing 2018/19		
	Lower	Upper
Under 12 months	0%	25%
12 months to 2 years	0%	25%
2 years to 5 years	0%	25%
5 years to 10 years	0%	0%
Over 10 years	0%	0%

5.1.4. Control of interest rate exposure

Please see paragraphs 3.3, 3.4 and 4.5.

5.2 INTEREST RATE FORECASTS 2017 – 2021

PWLB rates and forecast shown below have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Link Asset Services Interest Rate View													
	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 View	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
3 Month LIBID	0.40%	0.70%	0.70%	0.90%	0.90%	0.90%	0.90%	1.20%	1.20%	1.20%	1.40%	1.40%	1.40%
6 Month LIBID	0.50%	0.80%	0.80%	1.00%	1.00%	1.00%	1.10%	1.30%	1.30%	1.40%	1.50%	1.50%	1.50%
12 Month LIBID	0.80%	1.10%	1.10%	1.20%	1.20%	1.20%	1.30%	1.40%	1.40%	1.50%	1.70%	1.70%	1.70%
5yr PWLB Rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB Rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB Rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Bank Rate													
Link Asset Services	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
Capital Economics	0.50%	0.75%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	2.00%	2.00%	2.25%	2.25%	0.00%
5yr PWLB Rate													
Link Asset Services	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
Capital Economics	1.70%	1.90%	2.10%	2.40%	2.40%	2.40%	2.40%	2.40%	2.40%	2.65%	2.65%	2.90%	0.80%
10yr PWLB Rate													
Link Asset Services	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	2.20%	2.40%	2.60%	2.80%	2.80%	2.80%	2.80%	2.80%	2.80%	3.05%	3.05%	3.30%	0.80%
25yr PWLB Rate													
Link Asset Services	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
Capital Economics	2.60%	2.90%	3.10%	3.30%	3.30%	3.30%	3.35%	3.35%	3.35%	3.60%	3.60%	3.80%	0.80%
50yr PWLB Rate													
Link Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%
Capital Economics	2.50%	2.70%	2.90%	2.90%	2.90%	3.05%	3.05%	3.15%	3.15%	3.40%	3.40%	3.65%	0.80%

5.3 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The MHCLG issued updated Investment Guidance in February 2018, which takes effect for the 2018/19 financial year. This distinguishes investments held for treasury management purposes and 'other' investments. Examples of the latter include loans to Pendle Leisure Trust, Local Councils and any joint venture entities (i.e. Pearl). This Annual Statement deals solely with treasury type investments.

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

SPECIFIED INVESTMENTS: all such investments will be sterling denominated, with maturities up to a maximum of 365 days, meeting the Council's credit quality criteria where applicable. These would include sterling investments, which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. A principal local authority.
3. Collective investment schemes (i.e. money market funds) that have been rated *AAA* by a credit rating agency.
4. A body that is considered of a high credit quality (such as a bank or building society).

Within these bodies, and in accordance with the Code, the Council has set additional criteria to set the time and amount of monies which will be invested in these bodies

The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

Sector/Investment Type	**Minimum credit criteria / colour band**	**£ limit per institution / investment**	**Maximum maturity period**
DMADF – UK Government	N/A	Unlimited	6 months
UK Government Treasury bills	UK sovereign rating	£2.5m	1-6 months
Money Market Funds (CCLA Public Sector Deposit Fund only)	AAA	£1m	Liquid
Principal Local authorities	N/A	£3m (£6m for Lancashire County Council)	364/365 days
Term deposits with UK banks and building societies	Blue Orange Red Green No Colour	Range between £2m and £5m (£5m is restricted to Lloyds Group only – as the banker to the Council)	Up to 364/365 days Up to 364/365 days Up to 6 months Up to 100 days Not for use
Certificates of Deposit (CDs) with designated UK Banks and building societies	Blue Orange Red Green No Colour	£2m	Up to 364/365 days Up to 364/365 days Up to 6 months Up to 100 days Not for use
Term deposits / instant access accounts with Non-UK Banks meeting approved credit criteria	Red Green	£2.5m £1m	Up to 6 months Up to 100 days

5.4 APPROVED COUNTRIES FOR INVESTMENTS

This list is based on those countries which have sovereign ratings of AA or higher.

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+

- Finland
- Hong Kong
- U.S.A.

AA

- Abu Dhabi (UAE)
- France
- U.K.

5.5 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full Council

- Initial approval and adoption of Treasury Management Policy Statement and subsequent revisions;
- Approval of Annual Treasury Management Strategy / Annual Investment Strategy and policy on Minimum Revenue Provision (i.e. this report) and consideration and approval of any in year changes.

(ii) Executive / Policy & Resources Committee

- Annual Treasury Management Outturn Report
- Mid-year Treasury Management Report

(iii) Accounts and Audit Committee

- Approval of / amendments to the Council's adopted treasury management practices;
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Scrutiny of treasury management performance and strategy

5.6 THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- 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 (from 2019/20);
- 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.*