Appendix 12:
Durham County Council Annual Treasury Management Strategy 2018/19

Summary

In accordance with statutory guidance and the Council's Financial Procedure rules, this report presents the proposed Treasury Management Strategy for 2018/19, the Annual Investment Strategy, Prudential Indicators, Minimum Revenue Provision Policy and Treasury Management Policy Statement and Practices (Annex 1).

A glossary of terms is provided at the end of the report.

Background

Treasury management is defined as 'the management of the local authority's investments and cash flows, its banking, money market and capital market transactions, the effective control of the risks associated with those activities and the pursuit of optimum performance consistent with those risks'.

The Council operates 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 this cash flow is adequately planned, with surplus monies being invested in low risk counterparties, providing adequate liquidity initially before considering optimising investment return.

The second main function of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending requirements. The management of longer term cash may involve arranging long or short term loans, utilising longer term cash flow surpluses and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

Reporting Requirements

The Council adopts the latest CIPFA Code of Practice on Treasury Management (the Code) which is regarded as best practice in ensuring adequate monitoring of the Council's capital expenditure plans and its Prudential Indicators (PIs). This requires Members to approve the following reports, as a minimum:

1. An annual Treasury Management Strategy in advance of the year (i.e. this report) which includes:

    - Capital financing plans (including Prudential Indicators)
    - Annual Investment Strategy 2018/19
    - Minimum Revenue Provision Policy
    - Treasury Management Policy Statement and Practices

2. A mid-year Treasury Management Review - this updates Members on the progress of the capital position, amending prudential indicators as necessary, and reports on any policies requiring revision (2017/18 mid-year review reported to the County Council on 6 December 2017).

3. A Treasury Management Outturn Report following the end of the year describing the actual activity for the year in comparison to the annual Treasury Management Strategy (2016/17 Outturn reported to the County Council on 20 September 2017).

Annual Treasury Management Strategy 2018/19

This report covers the following issues in respect of 2018/19:

i. Current treasury position
ii. Capital financing plans (including Prudential and Treasury Indicators)
iii. Borrowing strategy
iv. Municipal Bond Agency
v. Policy on borrowing in advance of need
vi. Debt rescheduling
vii. Annual Investment Strategy
viii. Minimum Revenue Provision (MRP) Policy
ix. Training
x. Policy on use of external advisers

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

i. Current Treasury Position

The table below shows the Council's position as at 31 December 2017, with comparators for 31 March 2017 and a forecast position for 31 March 2018:

	31-Mar-17 (£m)	Average Rate (%)	31-Dec-17 (£m)	Average Rate (%)	31-Mar-18 (£m)	Average Rate (%)
Borrowing	255.633	3.96	280.620	3.89	280.613	3.89
Investments	174.630	0.53	185.248	0.57	160.000	0.57
Net Debt	81.003		95.372		120.613	

It is anticipated that borrowing will increase by March 2018 and investment levels reduce slightly, thus increasing net debt.

ii. Capital Financing Plans

The Council's capital expenditure plans are the key driver of treasury management activity. The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources. This capital expenditure can be paid for immediately by applying capital resources such as capital receipts, capital grants and revenue resources, however if these resources are insufficient, any residual capital expenditure will increase the Council's borrowing need.

The following Prudential Indicators provide an overview and assist members in reviewing plans and performance.

Prudential Indicator 1 – Estimate of Capital Expenditure
This prudential indicator is a summary of the Council's capital expenditure plans; those agreed previously and those forming part of this budget cycle.

The table below summarises the annual capital expenditure plans and how the expenditure is due to be financed. Any shortfall of resources results in a funding need i.e. borrowing:

Capital Expenditure	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Capital Expenditure	**107.141**	**111.383**	**112.734**	**116.358**	**17.824**
Other LTL	2.968	8.691	7.339	6.584	8.148
Financed by:					
Capital receipts	7.739	17.591	22.439	10.000	0
Capital grants and contributions	47.150	51.858	35.867	38.066	0
Revenue and reserves	20.397	4.864	14.446	33.516	0
Net financing need for the year	**34.823**	**45.761**	**47.321**	**41.360**	**25.972**

Prudential Indicator 2 – Estimate of Capital Financing Requirement (CFR)
The CFR is the total historic outstanding capital expenditure which has yet to be paid for. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life.

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

	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
CFR	**431.641**	**462.001**	**492.152**	**514.853**	**520.724**
Movement in CFR	**21.234**	**30.360**	**30.151**	**22.701**	**5.871**
Net financing need for the year	34.823	45.761	47.321	41.360	25.972
Less MRP/ VRP and other financing movements	-13.589	-15.401	-17.170	-18.659	-20.101
Movement in CFR	**21.234**	**30.360**	**30.151**	**22.701**	**5.871**

Prudential Indicator 3 - Operational Boundary
This is the limit beyond which external borrowing 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 borrowing.

Operational boundary	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m
Debt	411.000	440.000	462.000	468.000
Other long term liabilities	52.000	53.000	53.000	53.000
Total	463.000	493.000	515.000	521.000

Prudential Indicator 4 - Authorised Limit
This represents a control on the maximum level of borrowing and is a statutory limit determined under section 3 (1) of the Local Government Act 2003.

This represents a limit beyond which external borrowing is prohibited, and this limit needs to be set or revised by full Council. It reflects the level of external borrowing which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

Authorised limit	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m
Debt	461.000	490.000	512.000	518.000
Other long term liabilities	55.000	56.000	56.000	56.000
Total	516.000	546.000	568.000	574.000

Prudential Indicator 5 – Gross Debt and the Capital Financing Requirement

The objective is to keep external debt within sustainable and prudent limits and ensure that in the medium term, debt is only used for a capital purpose. This is undertaken by a comparison of the gross debt with the CFR. To ensure that, over the medium term, gross borrowing will only be for a capital purpose, borrowing should not, except in the short-term, exceed the CFR for the previous year plus the cumulative increases in CFR for the current year and next two financial years. The Council has complied with this requirement as shown in the following table, which shows gross borrowing is less than the CFR:

	Position at 31 Mar 2017 (£ million)	Estimated Position at 31 Mar 2018 (£ million)
Gross Borrowing*	303.511	331.653
CFR as at 31 March (previous year):	410.407	431.641
Add: Increase in CFR current year	21.234	30.360
Add: Increase in CFR + 1 year	30.360	30.151
Add: Increase in CFR + 2 year	30.151	22.701
Equals: CFR comparator for gross borrowing	492.152	514.853

*includes PFI and finance lease liabilities on balance sheet

Current Portfolio Position
The Council's treasury portfolio position as at 31 March 2017 and projections up to 2020/21 are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (CFR), highlighting any over or under borrowing.

	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Debt at 1 April	245.623	255.633	280.613	295.597	308.579
Expected change in debt	10.010	24.980	14.984	12.982	14.924
Other long-term liabilities	49.304	47.878	51.040	51.863	51.248
Expected change in other long-term liabilities	-1.426	3.162	0.823	-0.615	0.239
Gross debt at 31 March	**303.511**	**331.653**	**347.460**	**359.827**	**374.990**
CFR	**431.641**	**462.001**	**492.152**	**514.853**	**520.724**
Under borrowing	**128.130**	**130.348**	**144.692**	**155.026**	**145.734**

The Corporate Director of Resources confirms that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Affordability Prudential Indicators

The previous indicators cover overall capital and control of borrowing, but further indicators are used to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances.

Prudential Indicator 6 - Actual and estimates of the ratio of financing costs to net revenue stream
This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2016/17 Actual	2017/18 Budget	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	%	%	%	%	%
Ratio of financing costs to net revenue stream	5.46	6.89	7.74	8.38	8.75

The estimates of financing costs include current commitments and the proposals in this budget report.

Treasury Management Indicators

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

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

The Council is asked to approve the following treasury indicators and limits:

	2018/19	2019/20	2020/21
Interest rate Exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	30%	30%	30%
Maturity Structure of fixed interest rate borrowing 2018/19			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years and above		0%	100%

Maturity Structure of variable interest rate borrowing 2018/19		
	Lower	**Upper**
Under 12 months	0%	10%
12 months to 2 years	0%	20%
2 years to 5 years	0%	30%
5 years to 10 years	0%	40%
10 years to 20 years	0%	50%
20 years to 30 years	0%	70%
30 years to 40 years	0%	70%
40 years and above	0%	70%

iii. Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the CFR), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk remains an issue which needs to be considered.

Against this background and the risks within economic forecasts, caution will be adopted with the 2018/19 treasury operations. The Corporate Director Resources will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances. Any decisions will be reported to the appropriate decision making body at the next available opportunity.

iv. **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). The Council may make use of this new source of borrowing as and when appropriate.

v. Policy on Borrowing in Advance of Need

The Council will not borrow more than, or in advance of, its needs, purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be made within approved CFR estimates and following careful consideration, in order to demonstrate value for money and ensure the security of such funds.

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

vi. Debt Rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be opportunities to generate savings by switching from long term debt to short term debt. Advantages of debt rescheduling would include:

- generating cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;

- enhancing the balance of the portfolio (amend the maturity profile and/ or the balance of volatility).

However, these savings will need to be considered in light of the current treasury position and the cost of debt repayments (i.e. premiums).

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 relevant Committee, at the earliest meeting following its action.

vii. Annual Investment Strategy 2018/19

The Council has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the latest CIPFA Code of Practice on Treasury Management in Public Services and Cross Sectoral Guidance Notes ("the CIPFA TM Code").

In accordance with the above guidance from the CLG 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.

As with previous practice, ratings will not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisers to maintain a monitor on market pricing (e.g. "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 which are identified for use in the financial year are listed in Annex 2 under the 'specified' and 'non-specified' investments categories.

Investment Risk Benchmarking

The following benchmarks are simple guides to maximum risk, so they may be breached from time to time depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported with supporting reasons in the mid-year or annual report.

Security - the Council's maximum security risk benchmark for the current portfolio, when compared to the historic default tables, is:

- 0.08% historic risk of default when compared to the whole portfolio.

Liquidity - the Council seeks to maintain:

- Bank overdraft - £250,000
- Adequate liquid short term deposits available with a week's notice
- Weighted average life benchmark is expected to be 6 months, with a maximum of 9 months

Yield – the local measure of yield benchmark*:*

- Investments – internal returns above the 7 day LIBID rate

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

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

Maximum principal sums invested > 365 days			
£m	**2018/19**	**2019/20**	**2020/21**
Principal sums invested > 365 days	£75m	£75m	£75m

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 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 Corporate Director of Resources will maintain a counterparty list in compliance with the following criteria, will revise the criteria, and submit to full Council for approval as necessary. This criteria provides an overall pool of counterparties considered to be high quality which the Council may use, rather than defining what types of investment instruments are to be used.

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

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

All credit ratings will be monitored regularly. The Council is alerted to changes to ratings of all three agencies (Fitch, Moody's and Standard and Poors) through its use of Link's creditworthiness service.

If a downgrade results in the counterparty/ investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

In addition to the use of credit ratings, the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

Sole reliance will not be placed on the use of the service provided by Link. The Council will also use market data and market information, information on sovereign support for banks and the credit ratings of that supporting government.

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

- Banks 1 – good credit quality. The Council will only use banks which are:
  i. UK banks and/ or
  ii. Non UK banks domiciled in a country which has a minimum sovereign long term rating of AA-

  and have, as a minimum, the following credit ratings (where rated):

	Fitch	**Moody's**	**Standard & Poors**
Short Term	F1	P1	A-1
Long Term	A-	A3	A-

  (n.b. viability, financial strength and support ratings have been removed and will not be considered in choosing counterparties).

- Banks 2 – Part nationalised UK banks - Royal Bank of Scotland. This bank can be included if it continues to be part nationalised or meets the ratings in Banks 1 above.
- Banks 3 – The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case, balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation. The Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.
- Building societies. The Council will use societies which:
  i. Meet the ratings for banks outlined above;
  ii. Have assets in excess of £1bn;
  iii. or meet both criteria.

- Money market funds
- Ultra-Short Dated Bond Funds
- UK Government (including gilts and the DMADF)
- Local authorities, parish councils etc.

Use of additional information other than credit ratings

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties available for use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties.

This additional market information, for example credit default swaps and negative rating watches/ outlooks, will be applied to compare the relative security of differing investment counterparties. The relative value of investments will be reviewed in relation to the counterparty size to ensure an appropriate ratio.

Time and Monetary Limits applying to Investments

The time and monetary limits for institutions on the Council's counterparty list, covering specified and non-specified investments, are as follows:

	Long Term Rating	Money Limit	Time Limit
Banks	AA-	£50m	2 years
Banks	A	£35m	1 year
Banks	A-	£25m	6 months
Banks – part-nationalised	N/A	£60m	2 years
Banks– Council's banker	A-	£25m	3 months
DMADF/ Treasury Bills	AAA	unlimited	6 months
Local Authorities	N/A	£10m each	5 years
	Fund Rating	Money Limit	Time Limit
Money Market Funds	AAA	£100m total	liquid
Money Market Funds CNAV	AAA	£20m each	liquid
Money Market Funds LVNAV	AAA	£20m each	liquid
Money Market Funds VNAV	AAA	£20m each	liquid
Ultra-Short Dated Bond Funds	AAA	£10m each	liquid
Property Funds	N/A	£50m total (£25m each)	Unlimited

viii. MRP Policy Statement

The CIPFA Prudential Code for Capital Finance in Local Authorities requires the full Council to agree an annual policy for the Minimum Revenue Provision (MRP).

The MRP is the amount that is set aside each year to provide for the repayment of debt. The regulations require the authority to determine an amount of MRP which it considers to be prudent. The broad aim of a prudent provision is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Revenue Support Grant (RSG), reasonably commensurate with the support provided through the RSG. The guidance provides recommended options for the calculation of a prudent provision but local authorities have significant discretion in determining the level of MRP which they consider to be prudent.

A review of the Council's MRP policy is being undertaken by Link Asset Services and recommendations arising from this will be reported in the Mid-Year Treasury Management Review.

It is proposed that the Council adopt an annual MRP policy in line with the following principles:

- Existing assets pre 1 April 2008 – MRP will be charged at 2.5% per annum.
- Capital expenditure post 1 April 2008 – for all assets financed by unsupported borrowing, MRP will be charged over the estimated life of the assets.
- Finance leases/ PFI – the MRP charge will be equal to the principal element of the rental or charge that goes to write down the balance sheet liability created from such arrangements.

ix. 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 and training will be arranged as required.
- The training needs of treasury management officers are periodically reviewed.

x. Policy on use of external advisers

Link Asset Services (formerly Capita Asset Services) are the Council's treasury management advisers and whilst they provide professional support to the internal treasury management team, under current market rules and the CIPFA Code of Practice, the final decision on treasury matters remains with the Council. This service is subject to regular review.
The range of services provided by the advisers currently includes:

- technical support on treasury matters and capital finance issues;
- economic and interest rate analysis;

- debt services which includes advice on the timing of borrowing;
- debt rescheduling advice surrounding the existing portfolio;
- generic investment advice on interest rates, timing and investment instruments;
- credit ratings/ market information service comprising the three main credit rating agencies.

Annex 1: Treasury Management Policy Statement and Practices

Treasury Management Policy Statement

This organisation defines its treasury management activities as: 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.

This organisation 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.

This organisation 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.

Treasury Management Practices

TMP1 Risk management

General statement

This organisation regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that robust due diligence procedures cover all external investment.

The responsible officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the organisation's objectives in this respect, all in accordance with the procedures set out in TMP6 *Reporting requirements and management information arrangements*.

In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedule to this document.

[1] credit and counterparty risk management
This organisation regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in TMP4 *Approved instruments, methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

[2] liquidity risk management
This organisation will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with whom funds may be deposited, and will limit its treasury management investment activities to the instruments, methods and techniques referred to in *TMP4 Approved instruments, methods and techniques* and listed in the schedule to this document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing or derivative arrangements.

[3] interest rate risk management
This organisation will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with TMP6 Reporting requirements and management information arrangements.
It will achieve this by the prudent use of its approved instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.
It will ensure that any hedging tools such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

[4] exchange rate risk management
It will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

[5] inflation risk management
The organisation will keep under review the sensitivity of its treasury assets and liabilities to inflation, and will seek to manage the risk accordingly in the context of the whole organisation’s inflation exposures.

[6] refinancing risk management
This organisation will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the organisation as can reasonably be achieved in the light of market conditions prevailing at the time.
It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid overreliance on any one source of funding if this might jeopardise achievement of the above.

[7] legal and regulatory risk management
This organisation will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under TMP1[1] *credit and counterparty risk management*, it will ensure that there is evidence of counterparties’ powers, authority and compliance in respect of the transactions they may effect with the organisation, particularly with regard to duty of care and fees charged.

This organisation recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the organisation.

[8] fraud, error and corruption, and contingency management

This organisation will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

[9] price risk management

This organisation will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 Performance measurement

This organisation is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of ongoing analysis of the value it adds in support of the organisation's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements.

TMP3 Decision making and analysis

This organisation will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

TMP4 Approved instruments, methods and techniques

This organisation will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in the schedule to this document, and within the limits and parameters defined in TMP1 *Risk management*.

Where this organisation intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. The organisation will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

TMP5 Organisation, clarity and segregation of responsibilities, and dealing arrangements

This organisation considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when this organisation intends, as a result of lack of resources or other circumstances, to depart from these principles, the responsible officer will ensure that the reasons are properly reported in accordance with TMP6 Reporting requirements and management information arrangements, and the implications properly considered and evaluated.

The responsible officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The responsible officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out. The present arrangements are detailed in the schedule to this document.

The responsible officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

The delegations to the responsible officer in respect of treasury management are set out in the schedule to this document. The responsible officer will fulfil all such responsibilities in accordance with the organisation’s policy statement and TMPs and, if a CIPFA member, the *Standard of Professional Practice on Treasury Management*.

TMP6 Reporting requirements and management information arrangements

This organisation will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.
As a minimum:

The organisation (i.e. full Council) will receive:

- an annual report on the strategy and plan to be pursued in the coming year
- a mid-year review
- an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the organisation’s treasury management policy statement and TMPs.

The committee/board/council will receive regular monitoring reports on treasury management activities and risks.

The body responsible for scrutiny, such an audit or scrutiny committee, will have responsibility for the scrutiny of treasury management policies and practices.

TMP7 Budgeting, accounting and audit arrangements

The responsible officer will prepare, and this organisation will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with TMP1 *Risk management*, TMP2 *Performance measurement*, and TMP4 *Approved instruments, methods and techniques*. The responsible officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with TMP6 *Reporting requirements and management information arrangements*.

This organisation will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP8 Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of this organisation will be under the control of the responsible officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the responsible officer will ensure that these are adequate for the purposes of monitoring compliance with TMP1[1] *liquidity risk management*.

TMP9 Money laundering

This organisation is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained.

TMP10 Training and qualifications

This organisation recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The responsible officer will recommend and implement the necessary arrangements.
The responsible officer will ensure that board/council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

TMP11 Use of external service providers

This organisation recognises that responsibility for treasury management decisions remains with the organisation at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also 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. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid overreliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of suc arrangements rests with the responsible officer.

TMP12 Corporate governance

This organisation is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

This organisation has adopted and has implemented the key principles of the Code. This, together with the other arrangements detailed in the schedule to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the responsible officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.

Annex 2: Investment Instruments identified for use in 2018/19

Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered to be low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments, which would not be defined as capital expenditure, with:

- The UK Government – e.g. the Debt Management Account deposit facility, UK treasury bills or gilts with less than one year to maturity.
- Term deposits with a body that is considered of a high credit quality e.g. UK banks and building societies.
- Global bonds of less than one year's duration
- A local authority, parish council or community council.
- Certificates of Deposit.
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency.

Non-Specified Investments

These are investments which do not meet the specified criteria as outlined above. The Council is therefore required to examine non-specified investments in more detail. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below.

Non specified investments would include any sterling investments in the following:

- Gilt edged securities with a maturity of greater than one year.
  These are Government bonds and so provide the highest security of interest and the repayment of principal on maturity.
- The Council's own banker if it fails to meet the basic credit criteria.
  In this instance balances will be minimised as far as is possible.
- Equity shareholding in businesses of not more than £30 million in total, and £15 million in any one company.
  This will be after undertaking significant due diligence checks only. It will facilitate a more balanced approach to investing by diversifying the investment portfolio and reducing concentration risk.
- Local businesses, in order to encourage regeneration and economic development in the area.
  Any new investments will only be agreed after significant due diligence checks have been carried out.
- Property funds of not more than £50 million in total and £25 million in an individual fund.

Glossary of Terms

Authorised Limit
This is the upper limit on the level of gross external indebtedness, which must not be breached without council approval. It reflects the level of borrowing, which while not desired, could be afforded but may not be sustainable. Any breach must be reported to the executive decision-making body, indicating the reason for the breach and the corrective action undertaken or required to be taken.

Capital Financing Requirement (CFR)
The capital financing requirement (CFR) replaced the ‘credit ceiling’ measure of the Local Government and Housing Act 1989. It measures an authority’s underlying need to borrow or finance by other long-term liabilities for a capital purpose.

It represents the amount of capital expenditure that has not yet been resourced absolutely, whether at the point of spend (by capital receipts, capital grants/contributions or from revenue income), or over the longer term (by prudent minimum revenue provision (MRP) or voluntary application of capital receipts for debt repayment etc). Alternatively it means, capital expenditure incurred but not yet paid for.

Constant Net Asset Value Money Market Fund (CNAV)
Are funds where the underlying securities are all priced on an amortised cost basis (i.e at the level they were originally purchased at), thus allowing funds to maintain a unit price of £1. Going forward this category will only relate to funds which invest in government securities.

Credit Default Swaps (CDS)
A credit default swap (CDS) is an agreement that the seller of the CDS will compensate the buyer in the event of loan default. In the event of default the buyer of the CDS receives compensation (usually the face value of the loan), and the seller of the CDS takes possession of the defaulted loan.

CDS pricing can be used to gauge the riskiness of corporate and sovereign borrowers.

Credit ratings
A credit rating evaluates the credit worthiness of an issuer of debt, specifically, debt issued by a business enterprise such as a corporation or a government. It is an evaluation made by a credit rating agency of the debt issuer’s likelihood of default.

Credit ratings are determined by credit ratings agencies. The credit rating represents their evaluation of qualitative and quantitative information for a company or government; including non-public information obtained by the credit rating agencies analysts.

Debt Management Account Deposit Facility (DMADF)
The Debt Management Office provides the DMADF as part of its cash management operations and in the context of a wider series of measures designed to support local authorities' cash management.

The DMADF currently offers fixed term deposits. All deposits taken will be placed in, and interest paid from, the Debt Management Account. All deposits will also be guaranteed by HM Government and thus have the equivalent of a sovereign triple A credit rating.

Financing Costs
An aggregation of interest charges, interest payable under finance leases and other long-term liabilities and MRP, net of interest and investment income.

Housing Revenue Account (HRA)
The HRA reflects a statutory obligation to account separately for local authority housing provision, as defined particularly in Schedule 4 of the Local Government and Housing Act 1989. It shows the major elements of housing revenue expenditure – maintenance, administration and rent rebates – and capital financing costs, and how these are met by rents, subsidy and other income.

iTraxx
The brand name for the family of credit default swap index products.

London Inter Bank Bid Rate (LIBID)
The London Interbank Bid Rate (LIBID) is a bid rate; the rate bid by banks on deposits i.e. the rate at which a bank is willing to borrow from other banks.

Low Volativity Net Asset Value Money Market Fund (LVNAV)
This type of fund is the new format being introduced in Europe. Under this process, funds may value at amortised cost any instrument with a maturity of less than 75 days, but has to use mark-to-market pricing for anything longer than this. So long as the overall NAV value does not deviate more than 20bps away from £1, then the fund can keep its unit price at £1. However, if it moves outside of this 20bps boundary, then the fund has to convert to VNAV pricing basis. This category will cover most of the MMFs currently being used.

Minimum Revenue Provision (MRP)
Statutory charge to the revenue account as an annual provision for the repayment of debt associated with expenditure incurred on capital assets.

Money Market Funds
Money market funds are mutual funds that invest in short-term money market instruments. These funds allow investors to participate in a more diverse and high-quality portfolio than if they were to invest individually.

Like other mutual funds, each investor in a money market fund is considered a shareholder of the investment pool, or a part owner of the fund. All investors in a money market fund have a claim on a pro-rata share of the fund's assets in line with the number of ‘shares' or ‘units' owned.

Net Revenue Stream
The element of a local authority’s budget to be met from government grants and local taxpayers.

Non-specified Investments
These are any investments which do not meet the Specified Investment criteria.

Operational Boundary
This is the most likely, prudent view of the level of gross external indebtedness. It encompasses all borrowing, whether for capital or cash flow purposes.

Private Finance Initiative (PFI)
Private Finance Initiative (PFI) was introduced in the 1990s by the government to finance public sector projects. The main aims are to reduce public sector borrowing, introduce more innovative ways to provide public services and utilise private sector skills and experience to increase the efficiency of the public sector.

Prudential Indicators
In order to demonstrate that local authorities have fulfilled the objectives of the Prudential Code, it sets out a basket of indicators that must be prepared and used. The required indicators have to be set, as a minimum, on a three year time frame and are designed to support and record local decision-making, rather than be a means of comparing authorities.

The purpose is to set these historic and forward looking indicators in a circular process and look at the indicators collectively rather than individually in order to determine the impact of forward plans for capital or revenue expenditure. For some projects and large commitments to capital expenditure a timeframe in excess of three years is advisable.

Public Works Loans Board (PWLB)
The Public Works Loan Board (PWLB) is a statutory body operating within the United Kingdom Debt Management Office, an Executive Agency of HM Treasury.

PWLB's function is to lend money from the National Loans Fund to local authorities and other prescribed bodies, and to collect the repayments.

Specified Investments
All such investments will be sterling denominated, with maturities up to maximum of one year, meeting the minimum 'high' quality criteria where applicable.

Ultra Short Dated Bond Funds
These fund use a range of different asset classes when investing, with a focus on money market and short dated fixed income securities and are priced on a Variable Net Asset Value (VNAV) basis. Appropriate due diligence will be done before using these types of fund.

Variable Net Asset Value Money Market Fund (VNAV)
Are funds where the underlying securities are priced on a mark-to-market basis each day. This pricing is then reflected in the unit price (ie Net Asset Value) which, therefore, means that the price will fluctuate each day. The extent of any movement will be based on the sort of securities that the fund can invest in. For example, a fund that can invest in equities or long dated bonds will show significantly greater levels of daily price volatility than a fund that only invests in very short term instruments.

Weighted Average Life
The average time that deposits are lent out for, weighted by principal amount.