

REPORT

SUBJECT: Treasury Policy and Strategy Report 2020/21
DIRECTORATE: Resources
MEETING: Council
DATE: 5th March 2020

DIVISION/WARDS AFFECTED: Countywide

1. PURPOSE:

- 1.1 Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks.
- 1.2 The purpose of this report is to agree the 2020/21 Treasury policy and Strategy for officers to follow. This is to ensure that an appropriate level of care is taken of the Authority's funds and that a prudent budget is set to cover these activities.

2. RECOMMENDATIONS:

- 2.1 That Council approves the following reports endorsed by Audit Committee on the 13th February 2020:
 - a) the proposed Treasury Management and Minimum Revenue Provision Policy Statement for 2020/21 (Appendix 1); and
 - b) the proposed Treasury Management Strategy 2020/21 (Appendix 2) including the Investment & Borrowing Strategies, be approved together with the Treasury Limits as required by section 3 of the Local Government Act 2003.
- 2.2 To approve the Prudential Indicators supplied in Appendix 3 and that will be used in the performance monitoring of the treasury function during 2020/21.
- 2.3 That Council agrees that Audit Committee should continue to review the Council's treasury activities on behalf of the Council by receiving & scrutinising the mid-year report and year-end report and also scrutinising the Treasury Policy & Strategy before passing to Council for approval.

3. KEY ISSUES:

Background

- 3.1 The Treasury Strategy proposals and recommendations were presented to Audit Committee on the 13th February 2020. Audit Committee debated its content and

provided the following feedback, to assist with Strategy development ultimately volunteered to Council.

- 3.2 A member noted the pleasing return on investments in strategic pooled funds, where we have invested a total of £3m, which to date is providing an income return above 4%.
- 3.3 Some clarification was provided on the figures included in table 1 and table 2 of Appendix 2 to this report, alongside the associated liability benchmark graph. Clarification was provided regarding the capital financing requirement and the borrowing required to be taken in the longer term. It was explained that the graph attempts to show gap between required borrowing for capital purposes and the actual borrowing the Authority has drawn to date, to allow assessment of the borrowing requirement over the long term and to consider the best strategy for meeting this.
- 3.4 Clarification was provided on the historic level of short and long term borrowing rates. It was explained that although shorter term borrowing is currently more attractive than long term, that historically this would not have been the case. Further clarification was also sought around the use of “Oral loan agreements” as highlighted in Annex D of Appendix 2 to this report. It was explained that the Authority does not enter into any such arrangements and the term in Annex D purely reflects the definition of such agreements as per the revised Welsh Government investment guidance.

Treasury Management Policy Statement and Treasury Management Strategy

- 3.5 As stated in the treasury management policy statement, the Council adopts the key recommendations of CIPFA’s Code of Practice for Treasury Management in the Public Services (the “Code”) (as revised in 2017) which is designed to provide effective control of the risks of treasury management activities, prioritising security and liquidity of investments above yield. It includes the requirement for a number of treasury management indicators.
- 3.6 The Audit Committee in its role as the Council’s delegated body must receive as a minimum a semi-annual report and an annual report after its close on treasury management activities. This condition continues to be met by existing practices
- 3.7 Similarly, the Treasury management strategy is traditionally considered by Audit Committee and volunteered to full Council for approval. The Code now requires that full Council also approve annually an Investment Strategy. It is proposed to include the Investment strategy within the Treasury strategy and for Audit Committee to continue to review proposals and endorse or otherwise the Strategy for approval by full Council. Appendix 2 contains the Councils detailed proposed investment strategy.
- 3.8 Overall responsibility for treasury management remains with the Full Council. In effect, that body delegates the execution and administration of treasury management decisions to the Director of Finance (S151 officer) or deputy who will act in accordance with the treasury management policy statement (Appendix 1) and treasury management practices and CIPFA’s Standard of Professional Practice on treasury management.

- 3.9 The Council also adheres to the Prudential Code for Capital Finance in Local Authorities (as revised in 2017) which outlines requirements for the manner in which capital spending plans are to be considered and approved. Authorities are required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds. The Prudential Code further requires the Council to set a number of prudential indicators, which are included as part of the capital budget considerations. They are summarised in Annex C and provided in full in Appendix 3.
- 3.10 The revised Prudential Code and Treasury Management Code were issued in 2017. The LA (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2018 came into force in March 2018. The Welsh Government Guidance on Local Government Investments has been revised in 2019 and comes into force for the 2020/21 financial year. Changes required by these codes are incorporated into the 2020/21 Treasury Strategy and sits alongside the Authority's Capital Strategy which was approved by Council on 19th September 2019.
- 3.11 The PWLB increased its lending rates, which are set by reference to UK gilts, by 1% in October 2019. Due to the economic backdrop in the UK and worldwide, in the previous year gilt interest rates had fallen by almost as much, possibly increasing the demand for PWLB borrowing by Local authorities during that year. The treasury team will look at alternative options for borrowing as the need arises.

Other Considerations influencing the strategy

- 3.12 The section on External context within the treasury strategy in Appendix 2, Section 2 explains the backdrop which has been considered when setting the limits for borrowing & investing. These include:
- The effect of the Brexit process on Sterling, GDP, Inflation the Bank of England base rate and UK growth & the likelihood that European banks may create UK subsidiaries to trade in the UK.
 - Growth in Europe remains soft and in the US, the Federal Reserve began easing monetary policy in 2019 so an upward impact on UK interest rates and growth are not expected during the coming year.
 - Achieving a balanced budget continues to be a challenge for the council, so the Authority continued with its investments in strategic pooled funds, investing a total of £3m, to increase returns whilst maintaining a prudent level of security. The income return to date has been above 4%.
- 3.13 The limits proposed in the 2020/21 treasury strategy have not changed significantly from the 2019/20 strategy which means that most of our investments will be limited to £2 million per counterparty – see table 3 'Approved Investment counterparties & Limits' in Appendix 2. The counterparty rating limits and investment maturities in this table are ultimate limits and are further informed by bespoke periodic advice from our treasury advisers as to sustainability and financial robustness of specific counterparties.

Annual Minimum Revenue Provision (MRP) Policy Statement

3.14 The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent. In addition there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is attached in Appendix 1.

3.15 The Welsh Government issued revised MRP guidance in 2018. This is taken into account by the MRP Statement and Policy.

4. OPTIONS APPRAISAL:

4.1 The strategy looks to codify the parameters within which the Council can operate for its treasury and investment activities and as such the strategy itself does not require an option appraisal. However, in-year treasury decisions will continually assess options to manage treasury risks but also to ensure that investment returns and borrowing costs are optimised.

5. EVALUATION CRITERIA:

5.1 As noted in recommendation 2.3 of the report it is proposed that Audit Committee continues to review the Council's treasury activities on behalf of the Council by receiving & scrutinising the mid-year report and year-end report. As well as also scrutinising the Treasury Policy & Strategy before passing to Council for approval.

5.2 Treasury activity is also reported and monitored via revenue budget monitoring reports during the financial year.

6 REASONS:

6.1 The Authority is required to produce a treasury management policy and strategy and an annual investment strategy in order to comply with the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code").

6.2 The Authority is required to produce an MRP policy statement in order to comply with the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, last amended in 2018.

7. RESOURCE IMPLICATIONS:

7.1 In summary, the Treasury Policy and Strategy remains very similar to previous years, such that the Council remains a net borrower, and utilises internal resources to reduce net borrowing costs, known as internal borrowing.

7.2 In order to keep the Authority's borrowing costs lower, the external borrowing total is split fairly equally between long and short term recurrent borrowing. The short term borrowing achieves a reduction in cost but causes an increase in interest rate risk. Although interest rates could rise, it is not expected that short term rates over the MTFP window will exceed current long term rates. The Treasury team continues to optimise its loans and investments to reduce the net cost of borrowing/investing

while ensuring that security and liquidity levels are maintained at a suitable level and the various risks are properly managed.

- 7.3 The levels of Treasury debt and investments at the 31st December 2019 are provided in Annex B.
- 7.4 The medium-term treasury budgets contained within the 2020/21 revenue budget proposals to be presented to Council shortly, were constructed in accordance with the strategy documents appended to this report. Consequently there are no additional resource implications directly arising from this report.

The Council's indicative treasury budgets for the next 4 years are:

| Subjective Classification | Indicative Base Budget 2020/21 | Indicative Base Budget 2021/22 | Indicative Base Budget 2022/23 | Indicative Base Budget 2023/24 |
|---|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Interest and Investment Income | (251,639) | (249,809) | (251,541) | (253,032) |
| Interest Payable and Similar Charges | 4,019,724 | 4,049,335 | 4,156,636 | 4,075,909 |
| Charges required under Regulation (MRP) | 6,455,882 | 6,195,975 | 6,332,859 | 6,765,008 |
| Related Evidence based pressures & Disinvestments | (205,000) | 219,000 | 331,000 | 90,000 |
| Total Treasury Budgets | 10,018,967 | 10,214,501 | 10,568,954 | 10,677,885 |

- 7.5 However there are some key future financial risks on medium-term treasury budgets concerning:
- The capital medium term financial plan for 2020/21 has been shared with members as part of the capital budget setting process which won't conclude until February/March. Should additions be required funded from borrowing, then Treasury figures and consequences on capital financing requirement and external borrowing requirement would need to be recast.
 - The risks associated with rising interest rates are indicated in the Treasury Strategy by the Interest rate risk indicator & limit. This figure is a full 12 month impact on all of the Authority's variable rate loans and loans maturing in the following 12 months, being impacted by a 1% rise in interest rates irrespective of their maturity date. A 1% rise is not considered likely as the Bank of England Base Rate has been 0.5% since March 2009 falling to 0.25% briefly & then rising to 0.75% in August 2018. Further rises have been debated since then but are only expected to be small and gradual if they occur at all. The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. A 1% increase from the current level over the MTFP window would be very unexpected. The limit for this Interest rate Indicator has been set at £825,000, higher than the forecast for this indicator over the next 2 years. It should be noted that this indicator could only be reduced by less borrowing which would be difficult to implement or fixing external borrowing costs by taking out more expensive longer term loans. The anticipated future net borrowing costs for the Authority based on

anticipated borrowing levels and at forecast rates is incorporated into the 2020/21 Revenue MTFP.

- The Authority continues to make plans to assess the capital receipts which can be obtained from selling property assets. Without these receipts being available to fund capital expenditure, new capital programs will have to be funded by additional borrowing.

8. WELLBEING OF FUTURE GENERATIONS IMPLICATIONS (INCORPORATING EQUALITIES, SUSTAINABILITY, SAFEGUARDING AND CORPORATE PARENTING):

- 8.1 There is no Wellbeing of Future Generations implications arising directly from this report. This comprises a strategy document that will guide treasury activities during 2020/21.

9. CONSULTEES:

Senior Leadership Team
Cabinet

10. BACKGROUND PAPERS:

Appendix 1 – Treasury Management & Minimum Revenue Provision (MRP) Policy Statement 2020/21

Appendix 2 – Treasury Management Strategy Statement 2020/21 including the Investment & Borrowing Strategies

Appendix 3 – Prudential Indicators 2020/21

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TREASURY MANAGEMENT POLICY STATEMENT AND MINIMUM REVENUE PROVISION POLICY STATEMENTS 2020/21

1 TREASURY MANAGEMENT POLICY STATEMENT

- 1.1 The Council is required by law to have regard to CIPFA's Treasury Management in the Public Services: Code of Practice 2017 (The Code)...
- 1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-
 - A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
 - Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 1.3 The revised code allows the Audit Committee to approve the treasury strategy providing the Authority produces a capital strategy, while being clear that overall responsibility remains with full council. Full Council is required to approve the investment strategy which is currently included in the same document as the treasury policy and treasury strategy so the combined document will continue to be approved by full Council in the current year.
- 1.4 The Council delegates responsibility for the implementation, monitoring and scrutiny of its treasury management policy, strategy and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Director of Finance (S151 officer), who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
- 1.5 As a minimum, the Audit Committee will receive reports on its treasury management policies, practices and activities including, an annual strategy and plan in advance of the year, and a semi-annual report, mid year and an annual report after its close.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

- 2.1 The Council defines its treasury management activities as:

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

- 2.3 This Council 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 performance measurement techniques, within the context of effective risk management.”

As CIPFA states the policy statement should also include the Council's high level policies for borrowing and investments:

- 2.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk, refinancing risk and budgetary risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- 2.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations.

3. Approach to Risk Management

- 3.1 This section identifies the risks that the Council faces as a result of it undertaking treasury management activities.

Liquidity risk
Credit (or counterparty) risk
Interest rate risk
Inflation rate risk
Exchange rate risk
Market risk
Refinancing risk
Procedural risk
Legal and regulatory risk

The Council manages these down to an acceptable level within the regulatory framework through the consideration and application of its treasury strategy and appropriate monitoring against agreed treasury & prudential indicators and limits.

4. MRP Policy Statement 2020/21

- 4.1 Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The Welsh Government's Guidance on Minimum Revenue Provision most recently issued in 2018 places a duty on local authorities to make a prudent provision for debt redemption. Local authorities are required to “have regard” to such Guidance under section 21(1A) of the Local Government Act 2003.

- 4.2 In line with WG guidance, this annual MRP Statement will be submitted to Council before the start of the 2020/21 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.
- 4.3 Authorities are permitted discretion in terms of the charge levied, albeit within certain parameters. A “prudent” period of time for debt repayment is defined as being one which reflects the period over which the associated capital expenditure provides benefits or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 4.4 MRP options recommended in the Guidance include:
- Option 1: Regulatory Method
 - Option 2: CFR Method
 - Option 3: Asset Life Method
 - Option 4: Depreciation Method

Note: This does not preclude other prudent methods.

MRP in 2020/21:

- 4.5 Options 1 and 2 can only be used for supported Non-HRA capital expenditure funded from borrowing (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government). Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses).
- 4.6 **MRP on Supported Borrowing funded Expenditure**
- The Authority's policy is to apply Option 3, the Asset life method in respect of supported capital expenditure funded from borrowing. The charge will be 2% per annum, equivalent to equal installments over a 50 year life.
- 4.7 **MRP on Unsupported Borrowing funded Expenditure**
- The Authority's policy is to apply Option 3, the Asset life method in respect of unsupported capital expenditure funded from borrowing. The MRP is calculated on an annuity basis within the asset life method, whereby the MRP element increases over time to reflect a consistent charge over life of the assets taking into account the real value of money. The first MRP charge will be in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

These lives may be reduced if it is prudent to do so because the resultant income stream or useful life to the Authority is shorter.

4.8 MRP in respect of leases and PFI

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the CIPFA Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

- 4.9 For capital expenditure loans to third parties that are repaid in annual or more frequent instalments of principal, the Council may make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead. In years where there is no principal repayment, MRP will be charged in accordance with the MRP policy for the assets funded by the loan, including where appropriate, delaying MRP until the year after the assets become operational. While this is not one of the options in the WG Guidance, it is thought to be a prudent approach since it ensures that the capital expenditure incurred in the loan is fully funded over the life of the assets.

- 4.10 The 2020/21 budget proposals reflect these positions.

Treasury Management Strategy Statement 2020/21

Introduction

Treasury management is the management of the Authority's cash flows, borrowing and investments, and the associated risks. The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of financial risk are therefore central to the Authority's prudent financial management.

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2017 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. In addition, the Welsh Government (WG) issued revised Guidance on Local Authority Investments in November 2019 that requires the Authority to approve an investment strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

Revised strategy: In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance, or a material loss in the fair value of a non-financial investment identified as part of the year end accounts preparation and audit process.

External Context

Economic background: The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2020/21.

UK Consumer Price Inflation (CPI) for September registered 1.7% year on year, unchanged from the previous month. Core inflation, which excludes the more volatile components, rose to 1.7% from 1.5% in August. The most recent labour market data for the three months to August 2019 showed the unemployment rate ticked back up to 3.9% while the employment rate was 75.9%, just below recent record-breaking highs. The headline 3-month average annual growth rate for pay was 3.8% in August as wages continue to rise steadily. In real terms, after adjusting for inflation, pay growth increased 1.9%.

GDP growth rose by 0.3% in the third quarter of 2019 from -0.2% in the previous three months with the annual rate falling further below its trend rate to 1.0% from 1.2%. Services and construction added positively to growth, by 0.6% and 0.4% respectively, while production was flat and agriculture recorded a fall of 0.2%. Looking ahead, the Bank of England's Monetary Policy Report (formerly the Quarterly Inflation Report) forecasts economic growth to pick up during 2020 as Brexit-related uncertainties dissipate and provide a boost to business investment helping GDP reach 1.6% in Q4 2020, 1.8% in Q4 2021 and 2.1% in Q4 2022.

The Bank of England maintained Bank Rate to 0.75% in November following a 7-2 vote by the Monetary Policy Committee. Despite keeping rates on hold, MPC members did confirm that if Brexit uncertainty drags on or global growth fails to recover, they are prepared to cut interest rates as required. Moreover, the downward revisions to some of the growth projections in the Monetary Policy Report suggest the Committee may now be less convinced of the need to increase rates even if there is a Brexit deal.

Growth in Europe remains soft, driven by a weakening German economy which saw GDP fall -0.1% in Q2 and is expected to slip into a technical recession in Q3. Euro zone inflation was 0.8% year on year in September, well below the European Central Bank's target of 'below, but close to 2%' and leading to the central bank holding its main interest rate at 0% while cutting the deposit facility rate to -0.5%. In addition to maintaining interest rates at ultra-low levels, the ECB announced it would recommence its quantitative easing programme from November.

In the US, the Federal Reserve began easing monetary policy again in 2019 as a pre-emptive strike against slowing global and US economic growth on the back of the ongoing trade war with China. At its last meeting the Fed cut rates to the range of 1.50-1.75% and financial markets expect further loosening of monetary policy in 2020. US GDP growth slowed to 1.9% annualised in Q3 from 2.0% in Q2.

Credit outlook: Credit conditions for larger UK banks have remained relatively benign over the past year. The UK's departure from the European Union was delayed three times in 2019 and while there remains some concern over a global economic slowdown, this has yet to manifest in any credit issues for banks. Meanwhile, the post financial crisis banking reform is now largely complete, with the new ringfenced banks embedded in the market.

Challenger banks hit the news headlines in 2019 with Metro Bank and TSB Bank both suffering adverse publicity and falling customer numbers.

Looking forward, the potential for a "no-deal" Brexit and/or a global recession remain the major risks facing banks and building societies in 2020/21 and a cautious approach to bank deposits remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that Bank Rate will remain at 0.75% until the end of 2022. The risks to this forecast are deemed to be mostly weighted to the downside, due to the continuing need for clarity on Brexit process despite the improved stability provided by the December 2019 election result and also due to the continuing global economic slowdown. The Bank of England, having previously indicated interest rates may need to rise if a Brexit agreement was reached, stated in its November Monetary Policy Report and its Bank Rate decision (7-2 vote to hold rates) that the MPC now believe this is less likely even with a deal being days away at the time of writing.

Gilt yields have risen but remain at low levels and only some very modest upward movement from current levels are expected based on Arlingclose's interest rate projections. The central case is for 10-year and 20-year gilt yields to rise to around 1.00% and 1.40% respectively over the time horizon, with broadly balanced risks to both the upside and downside. However, short-term volatility arising from both economic and political events over the period is a near certainty.

A more detailed economic and interest rate forecast provided by Arlingclose is attached at Annex A.

For the purpose of setting the budget, it has been assumed that treasury management investments will return an average rate of 1.2% during 2020/2021. This includes £3m of strategic pooled funds returning 4.5%, the balance being short term investments returning 0.7%. ; It has also been assumed - that new long-term loans will be borrowed at an average rate of 2.5% / 2.8% for 10 and 30 year PWLB loans & 0.9% for short term loans mainly from other Local Authorities.

Local Context

On 31st December 2019, the Authority held £178.4m of borrowing, £2.4m of other debt and £20.4m of treasury investments. This is set out in further detail at **Annex B**. Forecast changes to the Capital Financing Requirement and how this affects these sums over time are shown in the balance sheet analysis

in Table 1 below which concludes with the total amount of external new (or replacement) loans required by each year end when compared to 31st March 2019.

Table 1: Balance sheet summary and forecast

| | 31.3.19 Actual £m | 31.3.20 Estimate £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m | 31.3.23 Forecast £m | 31.3.24 Forecast £m |
|--|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| General Fund CFR | 151.2 | 160.4 | 162.2 | 164.1 | 178.3 | 179.3 |
| Commercial Investments CFR | 35.1 | 50.7 | 51.4 | 49.3 | 47.2 | 44.3 |
| Total CFR | 186.3 | 211.1 | 213.6 | 213.4 | 225.4 | 223.6 |
| Less: Other debt liabilities * | -2.4 | -2.4 | -2.4 | -2.4 | -2.4 | -2.4 |
| Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |
| Less: Existing external borrowing reducing as matures ** | -178.4 | -122.7 | -87.0 | -79.1 | -77.3 | -73.5 |
| Internal borrowing requirement | 5.5 | 86.0 | 123.1 | 130.9 | 144.7 | 146.8 |
| Less: Usable reserves | -17.3 | -21.0 | -26.8 | -27.4 | -27.2 | -27.2 |
| Less: Working capital | -8.7 | -8.7 | -8.7 | -8.7 | -8.7 | -8.7 |
| Cumulative New External borrowing requirement/ (Investments) - Including Replacement of borrowing at 31/3/2019 maturing | -20.5 | 56.3 | 87.5 | 94.8 | 108.8 | 110.9 |
| Anticipated gross borrowing levels *** | 178.4 | 194.0 | 189.6 | 188.8 | 201.1 | 199.3 |

* leases and PFI liabilities that form part of the Authority's total debt

** shows only loans to which the Authority is committed and excludes optional refinancing

*** Based on £15m of investments being held but excluding other debt liabilities

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority is expected to need to borrow in the region of £111m over the forecast period above due to maturing debt and due to the rising CFR. The Authority has an increasing CFR due to its borrowing funded capital programme, including 21st Century Schools Band B and the completion of the £50m of Property Investments (which whilst increasing CFR is expected to be afforded by additional income).

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. By comparing Anticipated gross borrowing levels to Loans CFR, table 1 shows that the Authority expects to comply with this recommendation during 2020/21.

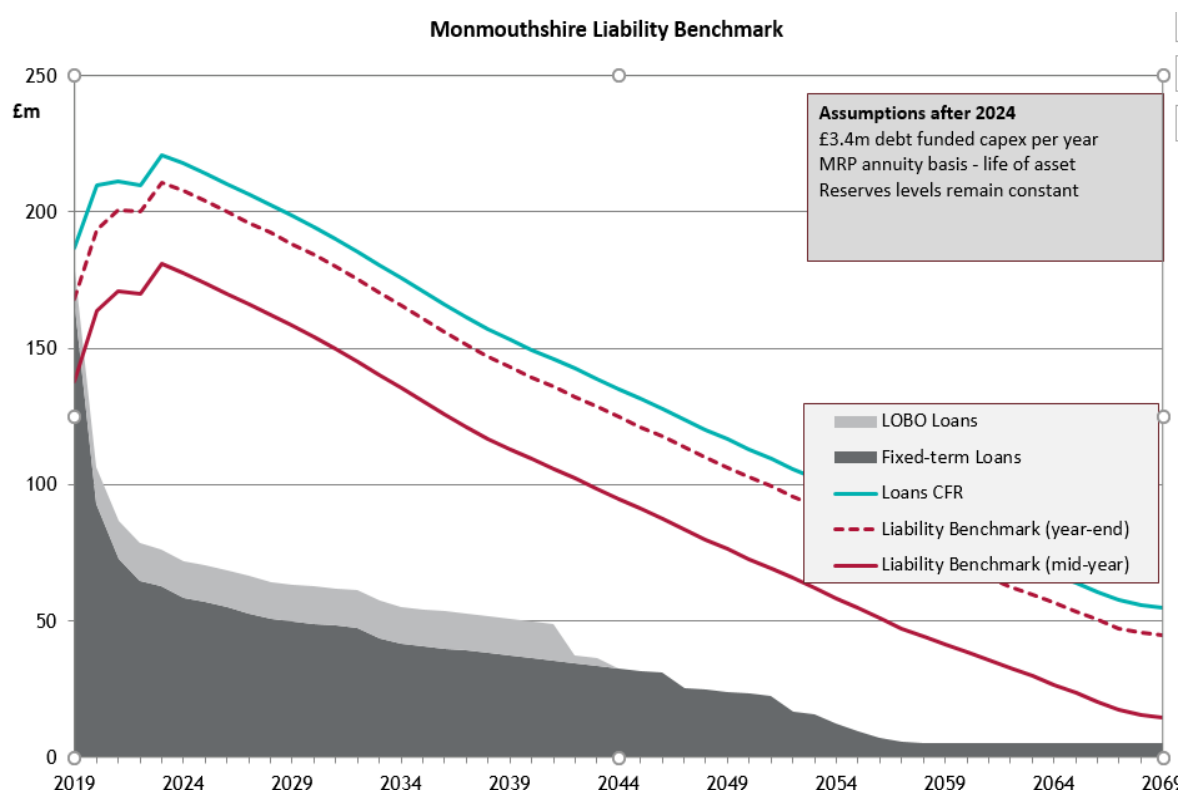
Liability benchmark: This is the lowest level of external borrowing required to fund the capital programme. This assumes the same forecasts as table 1 above, but that cash and investment balances are kept at an average of £15m to comply with the minimum of £10m required of a professional investor under

Mifid II (Markets in Financial Instruments Directive II). This minimum level of borrowing is expected to rise by £5.3m from 1st April 2020 to 31st March 2024.

Table 2: Liability benchmark

| | 31.3.19 Actual £m | 31.3.20 Estimate £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m | 31.3.23 Forecast £m | 31.3.24 Forecast £m |
|--|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |
| Less: Usable reserves | -17.3 | -21.0 | -26.8 | -27.4 | -27.2 | -27.2 |
| Less: Working capital | -8.7 | -8.7 | -8.7 | -8.7 | -8.7 | -8.7 |
| Plus: Forecast investments | 20.4 | 15.0 | 15.0 | 15.0 | 15.0 | 15.0 |
| Liability Benchmark (Minimum level of gross borrowing needed) | 178.3 | 194.0 | 189.6 | 188.8 | 201.1 | 199.3 |

Following on from the medium-term forecasts in Table 2 above, the long-term liability benchmark, below assumes capital expenditure funded by borrowing is as the draft 2020/21 capital MTFP and thereafter £3.4m per year, minimum revenue provision on new capital expenditure is based on asset life as in the MTFP or 25 years and, income, expenditure and reserves held are not increasing or decreasing beyond the MTFP window. This is shown in the chart below:



Our underlying need to borrow is shown by the top blue line. However, due to the use of reserves and working capital, the Authority is expected to need total external borrowing between the full red lower line and the dotted line above it. As our existing loans portfolio will reduce as loans mature as shown by the grey areas, new loans will therefore be required to fill the gap between the grey area and the red lines over the long term. The Authority intends to maintain about a 50% level or £63m of short term loans which will partly fill this gap, but will still need to take out long term loans, mainly to fund the rest of the Commercial investment program and also the 21C schools band B program, both built into the Draft Capital MTFP.

Borrowing Strategy

As shown in Annex B, at the 31st December 2019, the Authority held £174.3 million of loans, a decrease of £4.0 million compared to 31st March 2019 as part of its strategy for funding previous years' capital programmes. The Liability Benchmark in table 2 shows that the Authority expects to borrow up to £189.6m by the end of 2020/21.

Objectives: The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority's long-term plans change is a secondary objective.

Strategy: Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. A roughly equal balance of long and short term debt is, at the time of writing, taken as the right balance to maintain sufficient long term stability.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2020/21 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it now a relatively more expensive option. Before taking out PWLB loans to cover its future borrowing needs, the Authority will look at other sources including banks, pension funds and local authorities, and will investigate the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

Sources of borrowing: The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds (except the Greater Gwent Pension Fund)
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

- CSC Foundry

Other sources of debt finance: In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback
- the MIMs (Mutual Investment Model) being developed by Welsh Government

Municipal Bonds Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will be required to provide bond investors with a guarantee to refund their investment in the event that the agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

LOBOs: The Authority holds £13.6m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOs have options during 2020/21, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans: These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the interest rate exposure limits in the treasury management indicators below.

Debt rescheduling: The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

Treasury Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. From the 1st April 2019 to 31st December 2019, the Authority's treasury investment balances ranged from £10 to £41 million, with an average of £25.1 million. The Authority is committed to holding a minimum of £10m as mentioned above due to the Mifid II regulation. The treasury team aim to keep balances above £20m to a minimum. This is sometimes difficult to avoid if borrowing is taken out to coincide with a specific project or to take advantage of a good rates. When balances do go above £20m, longer term investments are sort to minimise the impact on the bottom line.

Loans to organisations providing local public services and purchases of investment property are not normally considered to be treasury investments, and these are therefore covered separately in Annex D.

Objectives: Both the CIPFA Code and the WG Guidance require the Authority to invest its treasury funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than

one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative interest rates: If the UK enters into a recession in 2020/21, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority aims to continue during 2020/21 with the diversification practiced in 2019/20 into higher yielding asset classes such as pooled funds. This continues to take advantage of the £10m that is available for longer-term investment due to the Mifid II regulations. The remainder of the Authority's surplus cash remains invested in short-term unsecured bank deposits, certificates of deposit, with other Local Authorities, the Debt Management Office and money market funds.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost with the income appearing as a credit in the Surplus or Deficit on Provision of Services (SDPS). The newer pooled fund investments will be held on balance sheet at Fair Value. The movements in Fair Value will go through Other Comprehensive Income (OCI) and be held in the Financial Instruments Revaluation Reserve (FIRR) until the investments are sold. Dividends from these funds will be credited to the SDPS.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 3 below, subject to the cash limits (per counterparty) and the time limits shown. Any formal recommendations received from the Authority's treasury advisors which reduces or increases the restrictions on certain counterparties in terms of eligibility, limits or duration of Investments will supersede the limits set below. . Any Investments with a credit rating of less than A-, or one which has a maturity of more than one year unless it is with another Local Authority, are classed in the WG Guidance as "Non Specified" so explicit approval must be obtained from the S151 Officer or Deputy or more senior line manager and also the Authority's treasury advisors, before being made. See Annex D for further information.

Table 3: Approved investment counterparties and limits

This table must be read in conjunction with the notes below

| Counterparty / Instrument | Instrument Limit of Portfolio | Counterparty Limit of Portfolio | Country Limit | Other Limits | Maturity Limit |
|---|-------------------------------|--|---------------|--------------|----------------|
| UK Central Government including Debt Mgt deposit facility, Gilts and T Bills. | 100% | 100% | N/A | N/A | 50 Years |
| Any investment with UK Local Authorities * (irrespective of credit rating) | 75% | The higher of £2m or 10% of total investments (at the time of deposit) | N/A | NA | 2 Years |

| | | | | | |
|--|--|---|--|---|---|
| <p>'Unsecured' investments with Banks, Building Societies, Other Organisations and Securities whose lowest published rating from Fitch, Moody's and S&P's is (A-)</p> <p>As above but (A)</p> <p>As above but (A+)</p> | <p>75% of total investments at the time of deposit</p> <p>For Non-UK 50% of total investment at the time of deposit</p> | <p>Upper limit of £2m.</p> <p>An additional £1m can be held in the Authority's bank current account to cover the total of credit balances</p> | <p>£4m per foreign country with a credit rating of AA+ or above</p> | <p>Limit for negotiable instruments held in Brokers nominee accounts: the lower of 50% or £10m per Broker</p> | <p>6 months</p> <p>13 months</p> <p>2 years</p> |
| <p>Secured Investments with Banks, Building Societies, Other Organisations and Securities, (including Repo's) whose lowest published rating from Fitch, Moody's and S&P's is (A-)</p> <p>As above but (A) or (A+)</p> | <p>75% of total investments at the time of deposit (both secured and unsecured)</p> <p>For Non-UK 50% of total investments at the time of deposit (both secured and unsecured)</p> | <p>£4m per counterparty (both secured and unsecured)</p> | <p>£4m per foreign country with a credit rating of AA+ or above for all investment types</p> | <p>N/A</p> | <p>13 months</p> <p>2 years</p> |
| <p>Deposits with unrated UK Building Societies which have been assessed by our Treasury advisers as comparable with the Building Societies that have an A- credit rating or higher</p> | <p>25% of total investments</p> | <p>£1m per Counterparty</p> | <p>UK only</p> | <p>N/A</p> | <p>6 months</p> |
| <p>Money Market Funds with a Constant Net Asset Value (CNAV) or Low Volatility NAV if assessed by our Treasury advisers as being of high credit worthiness</p> | <p>50% of total investments at the time of deposit increased to 75% if total investments is £10m or less</p> | <p>The lower of £2m and 10% of investments rounded up to next £0.5m; not exceeding 0.50% of MMF size or 2% for Government MMFs</p> | <p>N/A</p> | <p>N/A</p> | <p>N/A</p> |
| <p>Pooled funds & Real Estate Investment Trusts (REITS) without credit</p> | <p>£6m total investment at the time of</p> | <p>£2m per fund</p> | <p>N/A</p> | <p>N/A</p> | <p>N/A</p> |

| | | | | | |
|--|--|----------------|-----|-----|---------|
| ratings which are not classed as capital expenditure - if assessed by our Treasury advisers as a suitable investment for a L. A. and as being managed in a way which is consistent with the objectives of the fund | deposit | | | | |
| Investments with UK Registered Providers (e.g. Housing Associations) where the lowest published credit rating is A- or higher | £4m of total investments at the time of deposit. | £2m per issuer | N/A | N/A | 5 years |

* unless advised against lending by our Treasury Advisors

Credit rating: Investment limits are set by reference to the lowest published long-term credit rating from a selection of external rating agencies. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Banks unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

Banks secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is generally a lower risk of insolvency, although they are not zero risk. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1,000,000 per company as part of a diversified pool in order to spread the risk widely.

Registered providers: Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing and registered social landlords, formerly known as housing associations. These bodies are tightly regulated by the Regulator of Social Housing (in England), the Scottish Housing Regulator, the Welsh Government and the Department for Communities (in Northern Ireland). As providers of public services, they retain the likelihood of receiving government support if needed.

Pooled funds: Shares or units in diversified investment vehicles consisting of the any of the above investment types, plus equity shares, property & some minority holdings. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility can be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods. Where more than one fund is managed by the same organisation, the limits per counterparty will be applied to all investments in that organisation's funds unless advice is obtained to support an adequate degree of differentiation in approach between funds to reduce correlation between those funds to a similar level as funds in different organisations.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties. Investments in REIT shares cannot be withdrawn but can be sold on the stock market to another investor.

Operational bank accounts: The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £50,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other information on the security of investments: The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support, reports in the quality financial press and analysis and advice from the Authority's treasury management adviser. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may otherwise meet the above criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other

market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned but will protect the principal sum invested.

Investment limits: The Authority's revenue reserves available to cover investment losses are forecast to be £13.5 million on 31st March 2020. In order that no more than 30% of available revenue reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) is £4.0 million for secured investments or £2.0 million for unsecured investments to banks & building societies. These levels are considered prudent (See Table 3). A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits have also been placed on investments in brokers' nominee accounts & countries. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Liquidity management: The Authority is a net borrower and does not have an overdraft set up due to the high cost to do so. The treasury team maintain an excel cashflow model which calculates the net cashflow movements expected per year based on the capital medium term financial plan and informs the timing and amount of any longer term investment and borrowing decisions. The team also uses a detailed excel cash flow forecasting spreadsheet for the current financial year to determine the optimum size and timing for new short term loans and investments to ensure sufficient liquid cash is available to make any payments required. The aim of short term liquidity management is to borrow only when the need arises and therefore to minimise net borrowing costs. The amount of investments, with duration over one day, held at any one time is a balance between increased returns and the time taken/ dealing costs of identifying and implementing those investments.

Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

Security: The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating / credit score of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| Credit risk indicator | Target |
|---|----------|
| Portfolio average credit rating / score | A- / 5.0 |

Interest rate exposures: This indicator is set to control the Authority's exposure to interest rate risk. The value of this indicator is the total of 'The 12 month impact of a 1% rise in interest rates on each loan' which will mature in the following 12 months offset by the 12 month impact of investments maturing in the next 12 months. The forecast levels and the Upper limit for the total impact is:

| Interest rate risk (Forecasts / Limit) | 31 st Dec 2019 £'000 | 31 st Mar 2020 £'000 | 31 st Mar 2021 £'000 | 31 st Mar 2022 £'000 | Limit £'000 |
|---|---------------------------------------|---------------------------------------|---------------------------------------|---------------------------------------|----------------|
| Forecasts / Upper limit on 12 month revenue impact | 534 | 626 | 699 | 657 | 825 |

| | | | | | |
|---|-------|-------|-------|-------|-------|
| of a 1% <u>rise</u> in interest rates | | | | | |
| Forecast / Upper limit on one-year revenue impact of a 1% <u>fall</u> in interest rates | (534) | (626) | (699) | (657) | 0 |
| Rise as a % of Council Fund balance at 31 st March 2019 | 7.5% | 8.8% | 9.8% | 9.2% | 11.6% |

Note - This is a variation on the Interest rate exposure indicator from the 2019/20 strategy as 12 months of impact is included for each maturing loan irrespective of timing, so this indicator produces a higher figure but is less likely to vary due to small variations in maturity date which are not relevant for decision making. The impact is calculated assuming each maturing loan or investment will be replaced with a like for like instrument. In reality the type, counterparty and maturity might change, but it is however a good indicator of the interest rate risk of holding shorter maturity/variable rate instruments. The comparison to Council Fund balance is provided as any overspend resulting from an increase in interest rates would as a default be funded from the Council fund, £7.1m at 31st March 2019. As loan maturities are spread over the 12 months in question, the 12 month impact of all maturing loans being replaced by ones with higher rates would not be felt in the same financial year.

Maturity structure of borrowing: This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing will be:

| Refinancing rate risk indicator | Forecast 31 st March 2020 % / £m | Lower limit | Upper limit |
|---------------------------------------|---|-------------|-------------|
| Under 12 months - LOBO loans | 8.0% / £13.6m | | |
| Under 12 months - short term loans | 36.9% / £62.7m | | |
| Under 12 months - variable rate loans | 8.0% / £13.5m | | |
| Under 12 months - maturing LT loans | 0.8% / £1.4m | | |
| Total - Under 12 months | 53.7% / £91.2m | 0.0% | 60% |
| 12 months and within 24 months | 5.2% / £8.8m | 0.0% | 20% |
| 24 months and within 5 years | 7.7% / £13.1m | 0.0% | 30% |
| 5 years and within 10 years | 7.5% / £12.8m | 0.0% | 30% |
| 10 years and within 20 years | 7.5% / £12.7m | 0.0% | 100% |
| 20 years and above | 18.4% / £31.3m | 0.0% | 100% |
| Total | 100% / £169.9m | | |

The maturity periods in the table above are measured from the first day of the financial year for existing loans, loan start dates for new loans & with matured loans removed if relevant. The maturity date of borrowing is the earliest date on which the lender can demand repayment so LOBO loans are under 12 months despite not being expected to mature until 2041/3.

Principal sums invested for periods longer than a year: The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by having to seek early repayment of long-term investments. The limits on the total of any long-term investments arranged before 31st March 2021, maturing in each of the following periods are:

| Price risk indicator | 2020/21 | 2021/22 | 2022/23 |
|---|---------|---------|---------|
| Limit on principal invested beyond year end | £6m | £6m | £2m |

the limits are measured at invested amount if different to sum received at maturity

This indicator excludes Pooled funds, which, although intended to be held for 3 - 5 years, do not have a fixed maturity.

Prudential Indicators

Prudential indicators have traditionally been included in the Treasury Strategy but are now included with the 2020/21 budget papers as an Appendix. They are included in Annex C for information.

The Actual External Debt is reported against the Operational Boundary and Authorised Limit after the end of each year in the Treasury Outturn report.

Related Matters

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

Financial Derivatives: In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

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

Government Guidance: Further matters required by the WG Guidance are included in Annex D.

Financial Implications

The budget for investment income in 2020/21 is £250,000, based on an average investment portfolio of £17 million at an interest rate of 0.7% plus £3m of strategic pooled funds at an average income return of 4.5%. The budget for debt interest paid in 2020/21 is £4.1 million excluding new debt required to fund the remainder of the Commercial Investment purchase program. This figure is based on an average debt portfolio of £174 million at an average interest rate of 2.4% made up of approximately half long and half short term and variable rate debt. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The S151 Officer and his team, having previously consulted the Audit Committee believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| Alternative | Impact on income and | Impact on risk management |
|-------------|----------------------|---------------------------|
|-------------|----------------------|---------------------------|

| | expenditure | |
|---|--|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses may be smaller |
| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain |

Annex A - Arlingclose Economic & Interest Rate Forecast November 2019

Underlying assumptions:

- The global economy is entering a period of slower growth in response to political issues, primarily the trade policy stance of the US. The UK economy has displayed a marked slowdown in growth due to both Brexit uncertainty and the downturn in global activity. In response, global and UK interest rate expectations have eased.
- Some positivity on the trade negotiations between China and the US has prompted worst case economic scenarios to be pared back. However, information is limited, and upbeat expectations have been wrong before.
- Brexit has been delayed until 31 January 2020. While the General Election has maintained economic and political uncertainty, the opinion polls suggest the Conservative position in parliament may be strengthened, which reduces the chance of Brexit being further frustrated. A key concern is the limited transitional period following a January 2020 exit date, which will maintain and create additional uncertainty over the next few years.
- UK economic growth has stalled despite Q3 2019 GDP of 0.3%. Monthly figures indicate growth waned as the quarter progressed and survey data suggest falling household and business confidence. Both main political parties have promised substantial fiscal easing, which should help support growth.
- While the potential for divergent paths for UK monetary policy remain in the event of the General Election result, the weaker external environment severely limits potential upside movement in Bank Rate, while the slowing UK economy will place pressure on the MPC to loosen monetary policy. Indeed, two MPC members voted for an immediate cut in November 2019.
- Inflation is running below target at 1.7%. While the tight labour market risks medium-term domestically-driven inflationary pressure, slower global growth should reduce the prospect of externally driven pressure, although political turmoil could push up oil prices.
- Central bank actions and geopolitical risks will continue to produce significant volatility in financial markets, including bond markets.

Forecast:

- Although we have maintained our Bank Rate forecast at 0.75% for the foreseeable future, there are substantial risks to this forecast, dependant on General Election outcomes and the evolution of the global economy.
- Arlingclose judges that the risks are weighted to the downside.
- Gilt yields have risen but remain low due to the soft UK and global economic outlooks. US monetary policy and UK government spending will be key influences alongside UK monetary policy.
- We expect gilt yields to remain at relatively low levels for the foreseeable future and judge the risks to be broadly balanced.

| | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 | Jun-22 | Sep-22 | Dec-22 | Average |
|----------------------------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|--------------|
| Official Bank Rate | | | | | | | | | | | | | | |
| Upside risk | 0.00 | 0.00 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.21 |
| Arlingclose Central Case | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Downside risk | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.73 |
| 3-month money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.10 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.25 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.25 |
| Arlingclose Central Case | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 | 0.75 |
| Downside risk | -0.50 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.75 | -0.73 |
| 1yr money market rate | | | | | | | | | | | | | | |
| Upside risk | 0.10 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.20 | 0.25 | 0.30 | 0.30 | 0.30 | 0.30 | 0.30 | 0.23 |
| Arlingclose Central Case | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 | 0.85 |
| Downside risk | -0.30 | -0.50 | -0.55 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.65 | -0.60 |
| 5yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.45 | 0.45 | 0.45 | 0.37 |
| Arlingclose Central Case | 0.50 | 0.50 | 0.50 | 0.55 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.60 | 0.57 |
| Downside risk | -0.35 | -0.50 | -0.50 | -0.55 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.60 | -0.56 |
| 10yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | 0.37 |
| Arlingclose Central Case | 0.75 | 0.75 | 0.80 | 0.80 | 0.85 | 0.85 | 0.90 | 0.90 | 0.95 | 0.95 | 1.00 | 1.00 | 1.00 | 0.88 |
| Downside risk | -0.40 | -0.40 | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | -0.50 | -0.50 | -0.50 | -0.45 |
| 20yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | 0.37 |
| Arlingclose Central Case | 1.20 | 1.20 | 1.25 | 1.25 | 1.25 | 1.30 | 1.30 | 1.30 | 1.35 | 1.35 | 1.35 | 1.40 | 1.40 | 1.30 |
| Downside risk | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | -0.45 |
| 50yr gilt yield | | | | | | | | | | | | | | |
| Upside risk | 0.30 | 0.30 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.35 | 0.40 | 0.40 | 0.45 | 0.45 | 0.37 |
| Arlingclose Central Case | 1.20 | 1.20 | 1.25 | 1.25 | 1.25 | 1.30 | 1.30 | 1.30 | 1.35 | 1.35 | 1.35 | 1.40 | 1.40 | 1.30 |
| Downside risk | -0.40 | -0.40 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.45 | -0.50 | -0.50 | -0.45 |

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 1.80%

PWLB Local Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Annex B - Existing Investment & Debt Portfolio Position

| | 31 st Dec 2019 Actual Portfolio £m | Average Rate % |
|--|---|-------------------|
| External borrowing: | | |
| Public Works Loan Board - Fixed rate | 75.7 | 3.6 |
| Public Works Loan Board - Variable rate | 13.5 | 0.9 |
| LOBO loans from banks | 13.6 | 4.8 |
| Welsh Government Loans | 4.6 | 0.0 |
| Local authority & other LT loans | 0.9 | 0.95 |
| Local authority & other ST loans | 66.0 | 0.87 |
| Total external borrowing | 174.3 | 2.3 |
| Other long-term liabilities: | | |
| Private Finance Initiative | 0.7 | |
| Leases | 0.1 | |
| Other | 1.6 | |
| Total other long-term liabilities | 2.4 | NA |
| Total gross external debt | 176.7 | NA |
| Treasury investments: | | |
| Banks & building societies (unsecured) | 5.8 | } |
| Government (incl. local authorities) | 5.5 | 0.7 |
| Money Market Funds | 6.8 | } |
| Strategic pooled funds | 3.0 | 4.5 |
| Total treasury investments | 21.1 | 1.2 |
| Net debt | 155.6 | NA |

Annex C - Prudential Indicators

| Capital Expenditure £m | 2018/19 actual | 2019/20 forecast | 2020/21 budget | 2021/22 budget | 2022/23 budget | 2023/24 budget |
|---|-------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| General Fund services | 39.6 | 27.6 | 27.9 | 20.3 | 19.6 | 5.9 |
| Commercial investments (£50m total pool) | 30.7 | 16.7 | 2.6 | 0.0 | 0.0 | 0.0 |
| TOTAL | 70.3 | 44.3 | 30.5 | 20.3 | 19.6 | 5.9 |

| Proportion of Financing Costs to net revenue stream | 2018/19 actual | 2019/20 forecast | 2020/21 budget | 2021/22 budget | 2022/23 budget | 2023/24 budget |
|---|-------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| Interest £m | 3.3 | 3.8 | 3.8 | 3.8 | 3.9 | 3.8 |
| MRP £m | 4.6 | 5.7 | 6.3 | 6.4 | 6.6 | 6.8 |
| Total Financing costs £m | 7.9 | 9.5 | 10.1 | 10.2 | 10.5 | 10.6 |
| Net Revenue Stream (£m) | 150.4 | 154.3 | 160.8 | 163.3 | 165.9 | 168.6 |
| Proportion of net revenue stream % | 5.2% | 6.1% | 6.3% | 6.2% | 6.3% | 6.3% |

| Capital Financing Requirement | 31.3.19 Actual £m | 31.3.20 Estimate £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m | 31.3.23 Forecast £m | 31.3.24 Forecast £m |
|---|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| Commercial Investments CFR (including solar farm) | 35.1 | 50.7 | 51.4 | 49.3 | 47.2 | 44.3 |
| Other Loans CFR | 148.8 | 158.0 | 158.8 | 160.7 | 174.8 | 175.9 |
| Total Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |
| Other Debt Liabilities CFR | 2.4 | 2.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| Total CFR | 186.3 | 211.1 | 213.6 | 213.4 | 225.4 | 223.6 |

| A comparison of Net and Gross Debt to Capital Financing Requirement (Loans CFR) | 31.3.20 19 actual | 31.3.202 0 forecast | 31.3.202 1 budget | 31.3.202 2 budget | 31.3.202 3 budget | 31.3.2024 budget |
|---|-------------------------|---------------------------|----------------------|----------------------|----------------------|---------------------|
| Net Debt | 158.0 | 182.0 | 174.8 | 170.1 | 181.4 | 178.1 |
| Gross Debt | 178.3 | 197.0 | 189.8 | 185.1 | 196.4 | 193.1 |
| Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |

| <u>Authorised & Operational Borrowing Limits</u> | 2019/20 for comparison | 2020/21 limit | 2021/22 limit | 2022/23 limit | 2023/24 limit |
|--|---------------------------|------------------|------------------|------------------|------------------|
| Authorised limit - borrowing | 248.2 | 230.0 | 225.3 | 236.6 | 233.3 |

| | | | | | |
|--|--------------|--------------|--------------|--------------|--------------|
| Authorised limit - PFI, leases & Right of use assets | 4.4 | 5.4 | 5.4 | 5.4 | 5.4 |
| Authorised limit - total external debt | 252.6 | 235.5 | 230.7 | 242.0 | 238.7 |
| | | | | | |
| Operational boundary - borrowing | 218.0 | 210.8 | 206.1 | 217.4 | 214.1 |
| Operational boundary - PFI, leases & Right of use assets | 2.9 | 3.9 | 3.9 | 3.9 | 3.9 |
| Operational boundary - total external debt | 220.9 | 214.8 | 210.0 | 221.3 | 218.0 |

nb - Authorised limit is higher than CFR as CFR is not a limit but an indicator of debt requirement

Annex D - Additional requirements of Welsh Government Investment Guidance

The Welsh Government (WG) published revised Investment Guidance in November 2019 which places additional reporting requirements that are not integral to this Authority's treasury management processes, upon local authorities. The guidance also covers investments that are not part of treasury management, for example commercial investments including property and loans and other investments in local organisations.

The Authority has taken regard of the recommendations within the WG investment guidance revised in 2019 (for implementation 2020/21) and incorporated them where relevant into the above Treasury Management Strategy Statement (TMSS). There are however some specific areas of the WG investment guidance which are not explicitly outlined in the above TMSS and these are covered further as follows:

Climate change: The Authority's investment decisions consider long-term climate risks to support a low carbon economy in line with its declaration of a Climate Emergency in 2019. The Authority's aim is to make the county of Monmouthshire zero carbon by 2030 and will revise the Corporate Plan, Well-being Plan, Local Development Plan and other relevant plans and policies in support of this. It will call on the Welsh Government and the UK Government to provide the necessary powers, resources and technical support to successfully meet the 2030 target.

Financial and Non-financial Investments: The Authority's investments contribute to its service delivery objectives and/or promote wellbeing as follows:

- treasury management investments support effective treasury management activities,
- loans & other investments in local organisations provide financial support to those organisations to enable them to deliver local public services that would otherwise be provided directly by the Authority, and
- commercial investments provide a net financial surplus that is reinvested into local public services.

More information about the categories of investments can be see below in Table C1

Table C1: Types of Investments and Limits

| Type | Specified | Other Loans | Other Non-specified | Financial / Non-financial |
|--|--|---|---|---------------------------|
| Treasury management | Investments with Government, Local Authority, Bank & Building Soc Deposits, CDs, MMFs, Bonds etc * | NA | Investments which are long term or with counterparty not of high credit quality - £6m Limit. Strategic pooled funds and REITS - £6m Limit * | Financial |
| Assistance to local organisations/relevant to Council functions | Loans to other Local Authorities, Joint ventures with LA's and LA wholly owned subsidiaries ** | Loans to local enterprises, charities, 3 rd party companies, part non-LA Joint ventures ** | Shares in local enterprises, charities, 3 rd party co's, part non-LA JVs including seed funding to SRS | Financial |

| | | | | |
|---|----|--|---|----------------------|
| | | | Ltd **** | |
| Commercial financial investments | NA | Loans to part non-LA Joint ventures and 3 rd party entities *** | Shares in part non-LA Joint ventures and 3 rd party entities *** | Financial |
| Commercial Property investments | NA | NA | This includes the Solar Farm, Castlegate & Newport Leisure park *** | Non-financial |
| Long standing Property Investments | NA | NA | This includes the county farms portfolio, shops & industrial units | Non-financial |

* The Limits on these investments are detailed in table 3 & in the Price risk indicator in the Main report

** Rather than include an explicit limit on these type of investments, a business case will be made for each individual investment and capacity made available in an existing budget or a new budget approved by Council for any possible losses.

***Rather than include an explicit limit for these type of investments, approval is required by the Investment committee and Council prior to any such investments. To date £4.5m has been approved and spent on the Solar Farm and an additional £50m was approved in May 2018, of which £31m has been invested to date.

Specified investments: The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement unless the counterparty is a local authority,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of [A-] or higher.

Other Loans: The WG Guidance defines a loan as a written or oral agreement where the authority temporarily transfers cash to a third party, joint venture, subsidiary or associate who agrees a return according to the terms and conditions of receiving the loan. For the purpose of applying the WG guidance within this strategy document, where such arrangements are treasury investments, also meeting the definition of a Specified Investment they are classed as Specified investments not loans see Table C1.

A local authority may choose to make loans & other investments in local enterprises, local charities, wholly owned companies and joint ventures where relevant to Council functions and to promote local economic growth.

Valuation of Loans and Receivables: The Authority uses an allowed 'expected credit loss' model for loans and receivables as set out in *International Financial Reporting Standard 9 Financial Instruments* as adopted by proper practices to measure the credit risk of its loan portfolio. Appropriate consideration is given to state aid rules and competition law. The Authority has appropriate credit control arrangements to recover overdue repayments in place.

Loans may also be made for commercial purposes. Whilst these assets will be valued as above, the limits and assessment of security will be addressed as in the Commercial investments section below.

Other Non-specified investments: Any financial investment not meeting the definition of a specified investment or a Loan is classed as 'Other non-specified'. This category applies to investments over one year and with counterparties not of high credit quality. It also applies to units in pooled funds and shares in companies. Limits on non-specified investments are also shown in table C1; the Authority confirms that its current non-specified investments remain within these limits.

Commercial investments: This category covers financial and non-financial investments held primarily or partially to generate a profit. It includes investment property & also loans made for commercial purposes. Security is determined by comparing each asset's purchase price to its fair value using the model in International Accounting Standard 40: Investment Property as adapted by proper practices. The Authority's current Investment Property portfolio is divided into long held Investment Properties such as County Farms and the three more recently acquired commercial Investment Properties. With regard to this latter group, at 31st March 2019, the Authority's newly acquired investment property portfolio was held in the Authority's accounts at a book value of £35.6m. This is more than the capital cost of acquisition and enhancement to date of £35.2m and is considered to provide security for the capital investment made. A full report to Audit committee on these investments is due in the coming months, which will also outline the income which has been received into the revenue account since purchase.

The total of the Authorities usable reserves is £13.1m. This represents 37% of the value of the Authorities Commercial Investment Properties acquired to date. Due to the due diligence process undertaken before Commercial Investments are entered into and the forecast income over the lifetime of the assets, these investments are considered to be prudent by the Authority.

Liquidity: The Authority's liquidity management has been detailed in the main Treasury report with regard to treasury activities. Before supporting local entities or placing a commercial investment the impact on liquidity is fully addressed, most commonly by taking out loans of an appropriate maturity to ensure funds are available for the life of the activity. £40,000 of seed funding was placed with SRS Ltd in 2011/12 with the intention of it remaining there for the long term to support that entity.

Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Authority will follow its Investment strategy for Commercial assets which ensures that any borrowed capital will be repaid with annual income earned from the investment or that an exit strategy identified during the due diligence will be followed.

Yield (net profit): The Authority utilises its profit generating investment activity to achieve a balanced revenue budget. Table C2 below details the proportion of treasury & commercial income to total revenue income and therefore its contribution to meeting the costs of delivery of the Authorities primary functions. Revenue monitoring is carried out for the whole Authority on a quarterly basis. Any Authority wide shortfall, including shortfalls resulting from lower than budgeted returns from Investments, will be addressed as part of that process to bring the Authority's outturn position back on track.

Table C2: Proportionality of Investment income to total revenue income

| | 2019/20 Forecast £m | 2019/20 Forecast £m |
|---|------------------------|------------------------|
| Total revenue income | 147.3 | 147.3 |
| Budgeted Profit from treasury investments | 0.2 | |
| Budgeted Profit from the 3 newer Commercial Investments | | 0.7 |
| Proportion | 0.14% | 0.47% |

Investment advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and has used Alder King as advisers for the last 2 Commercial investment Property Acquisitions. The quality of these services is controlled by the Internal Estates team and also the Investment Committee appointed to oversee the Commercial Investments.

Borrowing in advance of need: Welsh Government guidance is that local authorities must not borrow more than or in advance of their needs purely in order to profit from the investment of the extra sums borrowed. The Authority, after having regard to the provisions in this guidance has entered into its commercial investments utilising Local Authority investment powers, which allow for the prudent management of its financial affairs where carried out reasonably and in accordance with an authority's primary function to serve the public. Returns from commercial investments help to ensure there are sufficient funds to continue to provide public services.

Capacity and skills: The Section 151 officer is responsible for ensuring that those elected members and statutory officers involved in the investment decision making process have appropriate capacity, skills and information to enable them to:

1. take informed decisions as to whether to enter into a specific investment;
2. assess individual investments in the context of the strategic objectives and risk profile of the local authority; and
3. understand how the quantum of these decisions have changed the overall risk exposure of the local authority.

The Audit Committee has a delegated responsibility to scrutinise the treasury management activity of the Authority, which ensures that elected members have the necessary opportunity to assess whether officers are operating within the boundaries of both the prudential framework and the internal boundaries approved within the TMSS. The Audit Committee is provided with training by the Authority's Treasury Management advisers periodically and have been presented with a questionnaire to assess further training requirements.

Commercial deals: The investment committee is responsible for ensuring that those tasked with negotiating commercial deals have the appropriate skills and access to information to allow them to operate with regard to the principles of the prudential framework and regulatory regime within which the Authority operates.

PRUDENTIAL INDICATORS for Programme Proposals 2020/24

Local Authorities determine their own programmes for capital investment in fixed assets. The Prudential Code is the code of practice which ensures the Authority can demonstrate it has properly identified the proposed financing streams, including borrowing, for those investments and the consequences of those decisions. The key objectives of the Prudential Code are to ensure, within the Prudential Framework, that capital investment plans of the Authority are affordable, prudent and sustainable.

To demonstrate that local authorities have fulfilled these objectives, the Prudential Code, revised in December 2017 sets out the Prudential indicators that must be used, and the factors that must be taken into account. These indicators are reported below based on actual, current and planned capital budget proposals as in the proposed 2020/21 capital medium term financial plan.

Importantly, it should be noted that the proposed supported and unsupported borrowing results from the current and future capital budget proposals:

Borrowing budgeted in the capital budget proposals 2020/21 to 2023/24 is as follows:

- General Unsupported borrowing of £544,000 in 2020/21 and £1,000,000 from 2021/22 to 2023/24.
- Severn view replacement £1,833,000.
- New property investments of £2,588,000.
- City deal £311,000 in 2020/21 and £489,000 from 2021/22 to 2023/24.
- Tranche B of the Future schools initiative £1,173,000 in 2021/22 and £13,631,000 in 2022/23.
- £2,417,000 of supported borrowing from 2020/21 to 2023/24 which assists in financing the core capital programme and is funded through Revenue Support grant from the Welsh Government.

Capital Expenditure

The actual capital expenditure (excluding vehicle leasing) that was incurred in 2018/19 and the estimates of capital expenditure and financing for the current year and future years that are recommended for approval are:

| Capital Expenditure £m | 2018/19 actual | 2019/20 forecast | 2020/21 budget | 2021/22 budget | 2022/23 budget | 2023/24 budget |
|---|-------------------|---------------------|-------------------|-------------------|-------------------|-------------------|
| General Fund services | 39.6 | 27.6 | 29.2 | 20.6 | 19.9 | 6.2 |
| Commercial investments (£50m total pool) | 30.7 | 16.7 | 2.6 | 0.0 | 0.0 | 0.0 |
| TOTAL | 70.3 | 44.3 | 31.8 | 20.6 | 19.9 | 6.2 |

As stated in the Capital programme budget proposals, the medium term programme has been drafted, and a programme constructed for the next four years. There will be opportunity for the programme to be reviewed annually.

Proportion of financing costs to net revenue stream

Estimates of the ratio of financing costs (net interest and MRP) to net revenue stream for the current and future years, and the actual figures for 2018/19 are:

| Proportion of Financing Costs to net revenue stream | 2018/19 actual | 2019/20 forecast | 2020/21 budget | 2021/22 budget | 2022/23 budget | 2023/24 budget |
|---|----------------|------------------|----------------|----------------|----------------|----------------|
| Interest £m | 3.3 | 3.8 | 3.8 | 3.8 | 3.9 | 3.8 |
| MRP £m | 4.6 | 5.7 | 6.3 | 6.4 | 6.6 | 6.8 |
| Total Financing costs £m | 7.9 | 9.5 | 10.1 | 10.2 | 10.5 | 10.6 |
| Net Revenue Stream (£m) | 150.4 | 154.3 | 160.8 | 163.3 | 165.9 | 168.6 |
| Proportion of net revenue stream % | 5.2% | 6.1% | 6.3% | 6.2% | 6.3% | 6.3% |

The estimates of financing costs include current commitments and the proposals in the draft 2020/21 MTFP and are based on the actual and anticipated borrowing, net of investments.

Capital Financing Requirement

Estimates of the end of year Capital Financing Requirement (CFR) for the Authority for the current and future years and the actual Capital Financing Requirement at 31 March 2019 are:

| Capital Financing Requirement | 31.3.19 Actual £m | 31.3.20 Estimate £m | 31.3.21 Forecast £m | 31.3.22 Forecast £m | 31.3.23 Forecast £m | 31.3.24 Forecast £m |
|---|-------------------|---------------------|---------------------|---------------------|---------------------|---------------------|
| Commercial Investments CFR (including solar farm) | 35.1 | 50.7 | 51.4 | 49.3 | 47.2 | 44.3 |
| Other Loans CFR | 148.8 | 158.0 | 158.8 | 160.7 | 174.8 | 175.9 |
| Total Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |
| Other Debt Liabilities CFR | 2.4 | 2.4 | 3.4 | 3.4 | 3.4 | 3.4 |
| Total CFR | 186.3 | 211.1 | 213.6 | 213.4 | 225.4 | 223.6 |

The Capital Financing Requirement measures the authority's underlying need to borrow for capital purposes. In accordance with best professional practice, Monmouthshire County Council does not associate borrowing with particular items or types of expenditure, other than under its current policy for determining its Minimum Revenue Provision (MRP). The authority has an integrated treasury management strategy (last approved on 7th March 2019 by Council). The Council is legally obliged to "have regard" to the Treasury

Management Code and the Prudential Code “as amended or reissued from time to time” by the relevant Capital Finance Regulations so there is no requirement for the Council to explicitly adopt the CIPFA Code of Practice for Treasury Management in the Public Services from 2020/21 onwards.

The Council manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction can be drawn between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the Capital Financing Requirement reflects the authority’s underlying need to borrow for capital purposes alone.

CIPFA’s Prudential Code for Capital Finance in Local Authorities recommends that the Authority’s total gross debt including other long term liabilities should be lower than its highest forecast CFR over the next three years. This is an indicator of prudence.

Net external borrowing is gross external borrowing offset by the levels of cash and treasury investments held. This is the borrowing budgeted to finance the capital programme.

| A comparison of Net and Gross Debt to Capital Financing Requirement (Loans CFR) | 31.3.2019 actual | 31.3.2020 forecast | 31.3.2021 budget | 31.3.2022 budget | 31.3.2023 budget | 31.3.2024 budget |
|---|---------------------|-----------------------|---------------------|---------------------|---------------------|---------------------|
| Net Debt | 158.0 | 182.0 | 174.8 | 170.1 | 181.4 | 178.1 |
| Gross Debt | 178.3 | 197.0 | 189.8 | 185.1 | 196.4 | 193.1 |
| Loans CFR | 183.9 | 208.7 | 210.2 | 210.0 | 222.0 | 220.2 |

The Chief Officer – Resources (the Authority’s S151 officer) reports that the Authority’s gross external borrowing is expected to stay below the Capital Financing Requirement in 2020/21. The forecasts for later years takes into account current commitments, existing plans, and the proposals in the 2020/21 capital budget report.

Authorised Limit for External Borrowing

In respect of external debt, it is recommended that the Council approves the following Authorised Limit for its total external debt gross of investments for the next four financial years.

| <u>Authorised Limits</u> | 2019/20 for comparison | 2020/21 limit | 2021/22 limit | 2022/23 limit | 2023/24 limit |
|--|------------------------|---------------|---------------|---------------|---------------|
| Authorised limit - borrowing | 248.2 | 230.0 | 225.3 | 236.6 | 233.3 |
| Authorised limit - PFI, leases & Right of use assets | 4.4 | 5.4 | 5.4 | 5.4 | 5.4 |
| Authorised limit - total external debt | 252.6 | 235.5 | 230.7 | 242.0 | 238.7 |

The limits for borrowing and other long-term liabilities are identified separately. The Council is asked to approve these limits and to delegate authority to the Head of Finance or Deputy, to manage the Authority’s borrowing within these limits in order to achieve best

value for money for the Authority. The Authorised limit is intended to be a ceiling on borrowing levels. Any changes required to these limits will be reported to the Audit Committee or Council at the next opportunity following the required change to this ceiling.

These limits are consistent with the authority's current commitments, existing plans and draft budget proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. They are based on the estimate of the most likely, prudent but not worse case scenario, with sufficient headroom over and above this to allow for operational management including movements such as in year Cabinet or Council decisions which are in line with the Corporate Plan of the Authority or unusual cash movements.

Operational Boundary for External Debt

The Council is also asked to approve the following Operational Boundary for external debt for the same period.

| <u>Operational boundary</u> | 2019/20 for comparison | 2020/21 limit | 2021/22 limit | 2022/23 limit | 2023/24 limit |
|--|-------------------------------|----------------------|----------------------|----------------------|----------------------|
| Operational boundary - borrowing | 218.0 | 210.8 | 206.1 | 217.4 | 214.1 |
| Operational boundary - PFI, leases & Right of use assets | 2.9 | 3.9 | 3.9 | 3.9 | 3.9 |
| Operational boundary - total external debt | 220.9 | 214.8 | 210.0 | 221.3 | 218.0 |

The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit but reflects the estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the Authorised Limit. It is expected that this will allow for movements such as normal variations in working capital and equates to the maximum external debt projected.

The Operational Boundary represents a key management tool for in-year monitoring by the Head of Finance or Deputy. The limits for borrowing and other long-term liabilities are identified separately. The Council is asked to approve these limits and to delegate authority to the Head of Finance or Deputy, to manage the Authority's borrowing within these limits under normal circumstances. If this boundary is exceeded, it will be reported to Audit Committee or Council at the next opportunity but as it is a management tool, it is not required to be amended.

In taking its decisions on the 2020/21 budget report, the Council is asked to note that the Authorised Limit determined for 2020/21 would be the statutory limit determined under section 3(1) of the local Government Act 2003.