**Report of the Section 151 Officer**

**Council – 28 February 2019**

# Treasury Management Strategy Statement, Prudential/Treasury Indicators, Investment Strategy and Minimum Revenue Provision Policy Statement 2019/20

| | |
|---|---|
| **Purpose:** | To recommend the Treasury Management Strategy Statement, Prudential Indicators, Investment Strategy and Minimum Revenue Provision Policy Statement for 2019/20 be approved. |
| **Policy Framework:** | None |
| **Consultation:** | Legal, Finance and Access to Services. |
| **Recommendation(s):** | It is recommended that Council approves the: |

1) Treasury Management Strategy and Prudential Indicators (Sections 2-7).

2) Investment Strategy (Section 8).

3) Minimum Revenue Provision (MRP) Statement (Section 9).

| | |
|---|---|
| **Report Author:** | Jeff Dong |
| **Finance Officer:** | Ben Smith |
| **Legal Officer:** | Debbie Smith |
| **Access to Services Officer:** | Rhian Millar |

## 1. Introduction

1.1 This strategy statement has been prepared in accordance with the revised CIPFA Treasury Management Code of Practice adopted by this Council in 2010 which has been recently revised in 2017. The Council's Treasury Management Strategy will be received and reviewed annually by Council and there will also be an interim year report providing summary of progress against that strategy. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the scrutiny of the Treasury Management function appreciate fully the implications of the Treasury Management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting. CIPFA has adopted the following as its definition of treasury management

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

1.2 CIPFA Prudential Code – Revised 2017

During the preparation of this year's Treasury management Strategy, CIPFA have recently made some changes to the Code in 2017. They were

- Minor changes to the treasury indicators which were initially developed in 2004
- Clarifying that the definition of 'Investments' above includes:-
- Treasury Management investments (as historically included in this Strategy, as well as
- investments made for policy reasons and managed outside of normal treasury management activity.

1.3 The latter change is primarily in response to increasing commercialisation activities undertaken by Local authorities. Examples of investments made for policy reasons and managed outside of normal treasury management activity include:-

- 'service investments' held in the course of provision and for the purposes of operational services
- 'commercial investments' which are taken mainly for financial reasons. These may be shares and loans in business structures e.g. subsidiaries; investments explicitly taken with the aim of making a financial surplus for the Council; non financial assets such as investment properties held primarily for financial benefit

1.4 Where, in addition to treasury management investment activity, organisations invest in other financial assets and property primarily for financial return, the Code requires that these investments should be proportional to the level of resources available to the organisation and the organisation should ensure that robust procedures for the consideration of risk and return are applied to these decisions.

1.5 The Code requires that all investments have an appropriate investment management and risk management framework. This includes making it explicit in any decision making:-

- the powers under which investment is made
- the governance process including arrangements in place to ensure appropriate due diligence to support decision making

- the extent to which capital invested is placed at risk
- the impact of potential losses on financial sustainability
- the methodology and criteria for assessing performance and monitoring process
- how knowledge and skills in managing such investments is arranged and that these are monitored, reported and highlighted explicitly in the decision making process and due diligence.

1.6 The most significant investments currently held by the Council and managed outside of normal treasury management activity are the Council's Investment Properties, which include various freeholds within the City held for strategic investments and/or income generation. The principles behind this strategy are outlined in the Capital Strategy, a separate report on this agenda

1.7 The Council will need to adhere to this strategy when considering any new proposals for non treasury investments as well as any updates to existing strategies, practices and reporting such as in the Statement of Accounts. It will be recommended that Council adopt the practices for Non Treasury Investments identified in a separate section of the Treasury Investment Strategy below in 8.7.

1.8 The Local Government Act 2003 requires the Council to have regard to the Prudential Code and to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Council is required to formally consider the Prudential and Treasury Indicators as detailed in section 2 of this report

1.9 The Act also requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy as required by Investment Guidance issued subsequent to the Act. This strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments. The management of the Council's Treasury Management activities are in line with the CIPFA Treasury Management Revised Code of Practice.

1.10 The recommended strategy for 2019/20 is based upon a view on interest rates, having considered leading market forecasts provided by the Council's treasury advisor, Link Asset Services. The overall strategy covers:

- Treasury Limits 2018/19-2022/23
- Prudential / Treasury Indicators
- The current portfolio position
- Prospects for interest rates including a summary of the economic background
- The Borrowing Requirement
- The Borrowing Strategy
- Gross v Net Debt Position
- Policy on Borrowing in Advance of Need

- Debt Rescheduling
- The Annual Investment Strategy
- Investment Policy
- Including non Treasury Investments
- Interest Rate Outlook
- Creditworthiness Policy
- Country Limits
- Policy on the Use of External Advisors
- Scheme of Delegation
- Pension Fund Cash
- Minimum Revenue Provision (MRP) Policy Statement

1.11 A glossary of terms used within this report is attached at Appendix A.

**2. Treasury Limits 2018/19 to 2022/23**

2.1 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to set a balanced budget. Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from: -

- increases in capital finance charges (principal and net interest) caused by increased borrowing to finance additional capital expenditure and

- any increases in running costs from new capital projects

are affordable within the projected revenue of the Council for the foreseeable future.

2.2 Under statute, the Council is required to set an Affordable Borrowing Limit i.e a limit which the Council can afford to borrow. In Wales, the Authorised Limit represents the legislative limit specified in section 3 of the Local Government Act 2003.

2.3 The Council must have regard to the Prudential Code when setting the Authorised Limit. This limit requires the Council to ensure that total capital investment remains within sustainable limits. The Authorised Limit must be set for the forthcoming financial year and the two successive financial years.

2.4 The Prudential Code for Capital Finance in Local Authorities requires Councils to calculate treasury indicators (formerly prudential indicators) which demonstrate prudence in the formulation of borrowing proposals. These are defined as:

- The Operational Boundary :
  *"…is based on expectations of the maximum external debt of the authority according to probable not simply possible events and being consistent with the maximum level of external debt projected by the estimates…."*

- The Authorised Limit :
  "..*the Authorised Limit must therefore be set to establish the outer boundary of the local authority's borrowing based on a realistic assessment of the risks. The authorised limit is certainly not a limit that an authority will expect to borrow up to on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes...*"

- Upper limits for borrowing of fixed and variable rate loans.
- Upper limit for investments for over 364 days.
- Upper and lower limits for the maturity profile of the Council's debt
- Estimates of the incremental impact of capital investment decisions on Council Tax / Housing rents
- Estimates of the ratio of financing costs to net revenue stream
- Estimates of the capital financing requirement

2.5 In setting and revising Prudential Indicators the authority is required to have regard to:-
- Affordability e.g revenue implications
- Prudence and sustainability e.g. implications for external borrowing
- Value for money e.g. option appraisals
- Stewardship of assets e.g. strategic planning
- Practicality e.g. achievability of forward plans

2.6 It is a requirement of the Code that Prudential / Treasury Indicators are regularly monitored and systems are in place to achieve compliance.

| **Treasury / Prudential Indicators** | | | | | | |
|---|---|---|---|---|---|---|
| | **2017/18** | **2018/19** | **2019/20** | **2020/21** | **2021/22** | **2022/23** |
| | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| | **Actual** | **Probable** | **Estimate** | **Estimate** | **Estimate** | **Estimate** |
| ***Capital Expenditure*** | | | | | | |
| GF | 40,379 | 66,651 | 53,842 | 22,880 | 18,690 | 12,815 |
| HRA | 45,835 | 47,705 | 67,313 | 63,440 | 45,260 | 49,735 |
| **TOTAL** | 86,214 | **114,356** | **121,155** | **86,320** | **63,950** | **62,550** |
| | | | | | | |
| ***Capital Financing Requirement 31st March*** | | | | | | |
| GF | 333,490 | 362,865 | 396,375 | 405,265 | 390,817 | 384,576 |
| HRA | 151,068 | 159,004 | 186,909 | 215,357 | 196,827 | 213,676 |
| Magistrates' Court ** | 1,354 | 1,300 | 1,248 | 1,198 | 1,150 | 1,104 |
| Credit Arrangements* | 1,898 | 453 | 274 | 138 | 33 | 10 |
| **Total** | **487,810** | **523,622** | **584,806** | **621,958** | **588,827** | **599,366** |
| | | | | | | |

| | | | | | | |
|---|---|---|---|---|---|---|
| ***Authorised limit for external debt*** | 458,535 | 681,958 | 681,958 | 681,958 | 681,958 | 681,958 |
| | | | | | | |
| ***Operational boundary for external debt*** | 458,535 | 641,958 | 641,958 | 641,958 | 641,958 | 641,958 |
| | | | | | | |
| ***Upper limit for fixed interest rate exposure*** | 78.6%/ £360,535 | 100%/ £681,958 | 100%/ £681,958 | 100%/ £681,958 | 100%/ £681,958 | 100%/ £681,958 |
| | | | | | | |
| ***Upper limit for variable rate exposure*** | 21.4%/ £98,000 | 40%/ £272,783 | 40%/ £272,783 | 40%/ £272,783 | 40%/ £272,783 | 40%/ £272,783 |
| | | | | | | |
| ***Upper limit for total principal sums invested for over 364 days*** | 0 | 40,000 | 40,000 | 40,000 | 40,000 | 40,000 |

* The GF Capital Financing Requirements includes arrangements classified as credit arrangements ( finance leases) under International Financial Reporting Standards ( IFRS) requirements as of 2011/12. However these continue to be budgeted on a revenue basis from the acquiring service and do not form part of the borrowing requirement.

** Legacy Magistrates' Court debt which is wholly recharged is included for completeness

| **Maturity structure of fixed rate borrowing during 2019/20-2022/23** | | |
|---|---|---|
| | **Upper limit %** | **Lower limit %** |
| Under 12 months | 60 | 0 |
| 12 months and within 24 months | 60 | 0 |
| 24 months and within 5 years | 60 | 0 |
| 5 years and within 10 years | 90 | 0 |
| | | |
| 10 years and above | 95 | 15 |

| **Ratio of Financing Costs to Net Revenue Stream** | | | | | | |
|---|---|---|---|---|---|---|
| | **Actual 2017/18 %** | **Revised 2018/19 %** | **Estimate 2019/20 %** | **Estimate 2020/21 %** | **Estimate 2021/22 %** | **Estimate 2022/23 %** |
| **General Fund** | 6.75 | 5.9 | 5.98 | 5.91 | 6.17 | 6.14 |
| **HRA** | 16.44 | 15.23 | 16.29 | 18.4 | 17.48 | 18.33 |
| | | | | | | |

Gross Debt v Capital Financing Requirement

The gross debt position versus the capital financing requirement is detailed below. The profile below assumes progressive external funding of the internalised borrowing and by the borrowing requirement informed by the capital programme.

| Comparison of average gross debt and capital financing requirement | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|---|---|---|---|---|---|---|
| | actual | probable | estimate | estimate | estimate | estimate |
| | £'000 | £'000 | £'000 | £'000 | £'000 | £'000 |
| **Average debt (gross)** | 433,161 | 513,770 | 573,770 | 613,770 | 573,770 | 589,770 |
| **Capital Financing Requirement at 31st March** | 486,456 | 523,622 | 584,806 | 621,958 | 588,827 | 599,366 |
| **Net Position** | 53,295 | 9,852 | 11,036 | 8,188 | 15,057 | 9,596 |

## 3 . The current portfolio position

3.1 The Council's projected debt portfolio position at 31/3/19 comprises:

| | Principal outstanding 31 March 2019 £'000 | Average rate of Interest % |
|---|---|---|
| Public Works Loan Board (fixed) | 444,083 | 4.41 |
| Money Market | 98,000 | 4.1 |
| Temporary | 2,193 | 0.55 |
| Welsh Govt. | 7,500 | 0 |
| **Total** | 551,776 | 4.28 |

3.2 The Council's forecast investment portfolio at 31 March 2019 is as follows:

| **Managed Investments** | Investments 31 March 2019 | 2018/19 Probable Investment Return | 2019/20 Estimated Investment Return |
|---|---|---|---|
| | | | |
| | £'000 | % | % |
| Internally Managed | 119,803 | 0.66 | 0.75% |

## 4. Prospects for Interest Rates

4.1 The Council's Treasury advisers (Link Asset Services) provided the following interest rate forecast for both short term ( bank rate) and long term (PWLB) interest rates as at January 2019. There is a downside risk to these forecasts if economic growth proves to be weaker and slower than currently forecast.

| Link Asset Services Interest Rate View | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Mar-21 | Jun-21 | Sep-21 | Dec-21 | Mar-22 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Bank Rate View | 0.75% | 0.75% | 1.00% | 1.00% | 1.00% | 1.25% | 1.25% | 1.25% | 1.50% | 1.50% | 1.75% | 1.75% | 1.75% | 2.00% |
| 3 Month LIBID | 0.80% | 0.90% | 1.00% | 1.10% | 1.20% | 1.30% | 1.40% | 1.50% | 1.50% | 1.60% | 1.70% | 1.80% | 1.90% | 2.00% |
| 6 Month LIBID | 0.90% | 1.00% | 1.20% | 1.30% | 1.40% | 1.50% | 1.60% | 1.70% | 1.70% | 1.80% | 1.90% | 2.00% | 2.10% | 2.20% |
| 12 Month LIBID | 1.10% | 1.20% | 1.30% | 1.40% | 1.50% | 1.60% | 1.70% | 1.80% | 1.90% | 2.00% | 2.10% | 2.20% | 2.30% | 2.40% |
| 5yr PWLB Rate | 2.00% | 2.10% | 2.20% | 2.20% | 2.30% | 2.30% | 2.40% | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.80% |
| 10yr PWLB Rate | 2.50% | 2.50% | 2.60% | 2.60% | 2.70% | 2.80% | 2.90% | 2.90% | 3.00% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% |
| 25yr PWLB Rate | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% | 3.50% | 3.50% | 3.60% | 3.60% |
| 50yr PWLB Rate | 2.70% | 2.70% | 2.80% | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% |

4.2 Economic Background

Attached at Appendix B is an economic background assessment provided by our Treasury advisers, Link Asset Services. This assessment has informed the proposed strategies .

## 5. The In Year Borrowing Requirement

5.1 The Council will have the following net capital borrowing / repayment requirements for 2018/19 to 2022/23:

| Borrowing and repayment requirements | 2017/18 Actual | 2018/19 Probable | 2019/20 Estimate | 2020/21 Estimate | 2021/22 Estimate | 2022/23 Estimate |
|---|---|---|---|---|---|---|
| | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** | **£'000** |
| To finance new capital expenditure by supported borrowing | 6,398 | 6,398 | 6,429 | 6,430 | 6,430 | 6,430 |
| To finance new capital expenditure by unsupported borrowing | 19,220 | 53,563 | 69,495 | 46,346 | 15,223 | 27,524 |
| To replace loans maturing/repaid prematurely/voluntary contributions | | 1 | 1 | 3001 | | |
| Less | | | | | | |
| Repayments (MRP) | 17,728 | 13,332 | 13,718 | 13,420 | 13,916 | 14,263 |
| Set aside capital receipts | 14 | 20 | 20 | 20 | 20 | 20 |
| **NET IN YEAR BORROWING /(REPAYMENT) REQUIREMENT** | **7,876** | **46,610** | **62,187** | **36,335** | **7,717** | **19,671** |
| Lease principal payments included within revenue (for information) | 183 | 194 | 179 | 137 | 105 | 22 |

5.2 The borrowing requirement above reflects known planned capital expenditure to date as outlined in the *"The Capital Budget and Programme 2018/19 – 2023/24"* elsewhere on this agenda and may or may not be funded in year as opportunities to borrow affordably arise.

5.3 It is clear, however, that there are significant potential projects which are currently being developed which may have a significant effect on the Council's proposals for Capital Expenditure during the period covered by this report but which have not been included for a number of reasons including:

- Schemes which are currently in the development stage where approval is required in terms of overall scheme approval, the overall level of expenditure within each scheme and the projected level of CCS contribution.

- Such schemes would encompass the current Swansea City Region Deal and the Swansea Central Development

- Schemes which are being developed outside of formal bid processes but where the current level of development is insufficient to estimate potential levels of CCS contributions and the nature and timing of funding requirements.

5.4 In considering the above, the Council shall determine that its plans are affordable, prudent and sustainable and shall formulate its Treasury Management , Borrowing & Investment Strategy and MRP Policy accordingly.

5.5 The above table in 5.1 details the net borrowing requirement for each financial year. In accordance with the Prudential Code, borrowing must be undertaken in line with a funding plan informed by the projected capital financing requirement. Borrowing may be financed from one or more of Public Works Loan Board loans; Money Market loans or internal loans. The precise choice and timing will depend on market conditions from time to time and will not necessarily mirror the profiling above.

5.6 At time of writing, borrowing rates are materially higher then investment rates as has been the case since the onset of the financial crisis. Considering this it has been determined that in the main the borrowing requirement for the capital programme shall be met by internalising the borrowing. However, as cashflow constraints and prospects for interest rate rises remain, we shall continue averaging in the borrowing requirement in 2018/19 and 2019/20 and in the forthcoming financial years to fund the capital programme when borrowing rates offer long term value and Cashflow requirements dictate .

Short term savings (by avoiding material new long term external borrowing) will be weighed against the potential additional long term extra costs (by delaying unavoidable new external borrowing until later when PWLB long term rates are forecast to be marginally higher).

5.7 Housing Revenue Account (HRA) Subsidy Reforms - Self Financing Settlement

As outlined in the report approved by Council on 2nd Dec 2014 entitled *"Reform of the Housing Revenue Account Subsidy System"* the Authority has entered into a Voluntary Agreement with Welsh Government to exit the current HRA subsidy system, resulting in more flexibility for the Authority in meeting affordable housing needs in the locale. In order to exit the current HRA subsidy system, a cash settlement amount had to be paid over to HM Treasury equal to a sum determined by formulae agreed in the Voluntary Agreement which resulted in a settlement figure of £73.58m for this Authority. The overriding principle of the HRA Reform is that all local housing authorities will be financially better off in revenue terms after the reforms.

5.8 The HRA reform settlement was required to be made to the Welsh Government on 1 April 2015 which was subject to a separate borrowing strategy dictated by the terms outlined in the Voluntary Agreement. The Council borrowed £73.58m from the PWLB and remitted this total amount to Welsh Government on April 2nd 2015.

5.9 The servicing and amortisation of this pool of debt shall be managed completely separtely from the remainder of the pooled ( GF and HRA) debt portfolio and recharged directly to the HRA.

**6. Borrowing Strategy**

6.1 Long term borrowing rates are expected to be significantly higher than rates available for investment deposits. It is likely that this position will pertain in the short to medium term.

In addition, the continuing uncertain economic conditions has maintained the need for caution in managing credit counterparty risk. There is still the risk of a bank / institution defaulting on the payment of interest due or repayment of amounts invested.

At the current time, long term PWLB and market rates offer attractive funding opportunities and some borrowing may be taken in the short to medium term to average in the long term borrowing requirement demanded by the council's capital programme reported separately on this agenda and to address cash flow requirements.

6.2 However, the overall strategy - with a view to minimising interest costs and the risk of default by counterparties - is therefore to continue to internalise the majority of the borrowing requirement for the capital programme with a view to averaging in the remainder of the borrowing requirement as cashflow and interest rates dictate in the medium to long term.

6.3 <u>Policy on borrowing in advance of need</u>

The Council has only a limited power to borrow in advance of need.

In determining whether borrowing will be undertaken in advance of need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to borrow in advance of need
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow
- consider the merits and demerits of alternative forms of funding
- consider the alternative interest rate bases available, the most appropriate periods to fund and which repayment profiles to use.

**7 Debt Rescheduling**

7.1 The introduction of different PWLB rates on 1 November 2007 for new borrowing (as opposed to early repayment of debt) and the setting of a spread between the two rates (of about 0.4%-0.5% for the longest period loans narrowing down to 0.25%-0.30% for the shortest loans), has meant that PWLB to PWLB debt restructuring is now much less attractive than before that date.

7.2 Due to short term borrowing rates being expected to be cheaper than longer term rates, there may be opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of their short term nature and the likely cost of refinancing short term loans, once they mature, compared to the current rates of longer term debt in the existing debt portfolio. Any rescheduling needs to be considered net of any premium payable which in light of current interest rates is likely to be considerable.

7.3 In actively managing credit counterparty and interest rate risks, consideration will also be given to running down investment balances by repaying debt prematurely as short term rates on investments are likely to be significantly lower than rates paid on current debt.

However, a repayment strategy will only be considered if a loan repayment offers value in terms of discount / associated costs and does not compromise the Council's long term debt management policies. In this respect, we will need to be mindful of the potential future need to arrange new long term loans as market conditions change from time to time.

7.4 Notwithstanding the above, it is not envisaged that there will not be any debt rescheduling opportunities in the remainder of 2018/19 or 2019/20 in the PWLB portfolio, however there may be opportunities to review the Authority's market debt dependent upon counterparty appetite. All rescheduling decisions will be reported to the Cabinet Member for Resources in the quarter following action.

## 8. The Annual Investment Strategy

8.1 Investment policy

8.1.1 The Council will have regard to the National Assembly of Wales' Guidance on Local Government Investments ("the Guidance") issued in March 2004 (and subsequent amendments); CIPFA's Revised Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA Treasury Management Code") and the Local Authorities (Capital Finance and Accounting) (Wales) (Amendment) Regulations 2004 SI 1010(W.107). The Council's investment priorities are: -

(a) to ensure the security of capital
(b) to ensure the liquidity of investments.
(c) to maximise interest returns (yield) commensurate with (a) and (b)

The investment strategy will be implemented with security of investment as the main consideration. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity.

8.1.2 The investment criteria are outlined in Appendix C.

8.1.3 Amendments to the arrangements, limits and criteria detailed in Appendix C may be made by the Section 151 Officer and advised to the Cabinet Member for Finance & Strategy in the quarter following action.

Appendix G is the list of UK financial institutions (counterparties) which satisfy the Council's minimum credit criteria as at 28th January 2019

8.1.4 It is anticipated that the Council will continue to hold internally managed sums during 2019/20 ensuring a suitable spread of investment risks. The Council has fixed benchmarks against which investment performance will be measured, i.e. the 7 day LIBID rate (internally managed).

8.1.5 Interest Rate Outlook:
**Investment returns expectations.** Bank Rate is forecast to stay flat at 0.5% until quarter 2 2018 and not to rise above 0.75% until Dec 2019. Bank Rate forecasts for financial year ends (March) are:

- 2018/19 0.75%
- 2019/20 1.25%
- 2020/21 1.50%
- 2021/22 2.00%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs earlier) if economic growth strengthens. However, should the pace of growth slow, there could be a downside risk.

8.1.6 For its cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (1-3 months) in order to benefit from the compounding of interest. However longer dated deposits will be made with appropriate counterparties if opportunities arise.

8.1.7 During and following the end of the financial year, the Council will report on its investment activity as part of its Mid Term Treasury Management Report and its Annual Treasury Management Report.

8.2 Creditworthiness Policy
This Council uses the creditworthiness service provided by our Treasury Management Advisors. This service has been progressively enhanced over the years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies. Fitch, Moodys and Standard & Poors form the core element.

Appendix C outlines the Council's creditworthiness policy. Details of Fitch's short and long term ratings are at Appendix D.

The creditworthiness service does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swaps (CDS) spreads to give early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most

creditworthy countries

This modelling approach combines credit ratings, credit watches, credit outlooks and CDS spreads in a weighted scoring system. The end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments.

All credit ratings will be monitored regularly with reference to the credit ratings report and updates. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

There will be no future use of a counterparty/investment scheme which fails the credit rating tests .

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

Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data, market information, information on government support for banks and the credit ratings of that government support.

8.3 Country Limits

The Authority has not made any new overseas deposits for several years since the financial crisis. Going forward, continued caution will be required when considering future opportunities to make overseas investments. There are no plans to make overseas investments at this time.

If such opportunities arise then the Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide a rating) The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix E. This list will be added to or deducted from should ratings change in accordance with this policy.

8.4 Policy on the use of external advisers

The Council uses the services of an external Treasury Management adviser namely - Link Asset Services Treasury Management Advisors.

The Council recognises that responsibility for Treasury Management decisions remains with the Council at all times and as such, we will ensure that undue reliance is not placed upon external advisers.

However it is recognised that there is value in employing external advisers in relation to Treasury Management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

8.5 Scheme of Delegation

The role and responsibilities of the Council, Cabinet Member for Resources and the S 151 officer are as follows:

(i) Council

- to receive and review reports on Treasury Management policies, practices and activities
- to receive and review the annual strategy.
- to receive and review amendments to the Authority's adopted clauses, Treasury Management policy statement
- to consider and approve the annual budget
- to receive and review the division of responsibilities

(ii) Cabinet Member for Resources

- to receive and review regular briefings/reports
- to receive and review the Treasury Management policy and procedures

(iii) Section 151 Officer

- to recommend clauses, Treasury Management policy for approval
- Implement and keep up to date operational Treasury Management practices
- to review the same regularly and monitor compliance
- to submit regular Treasury Management policy reports
- to submit budgets and budget variations
- to receive and review management information reports
- to review the performance of the Treasury Management function
- to ensure the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function
- to ensure the adequacy of internal audit, and liaise with external audit
- to recommend the appointment of external service providers.

8.6 Pension Fund Cash

The Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009 which was implemented on 1st January 2010. Any investments made by the Pension Fund will comply with the requirements of SI 2009 No 393 and will comply with the prevailing City & County of Swansea Treasury Management Policies, Practices and Strategies.

8.7 Non Treasury Investments

The Council recognises that investment for non-treasury management purposes in other financial assets and property, primarily for financial return, requires careful investment management. Such activity includes loans supporting service outcomes, investments in subsidiaries, and investment property portfolios. The Council will ensure that all the organisation's investments are covered in its capital strategy, investment strategy or equivalent, and will set out, where relevant, the organisation's risk appetite and specific policies and arrangements for non-treasury investments if undertaking such investments. It is recognised that the risk appetite for these activities may differ from that for treasury management. The Capital Strategy Report also on this agenda outlines the strategy for these non treasury investments

8.8 Markets in Financial Instruments Directive II ( MIFID II)
The EU Regulation MIFID II came into force in Jan 2018. Pre Jan 2018, this Authority was recognised as a professional investor. The new directive required financial institutions to recognise all investors as retail clients. This ensured maximum protections but also precluded some forms of investments, only available to professional clients. Financial Institutions may elect to opt up clients upon request, if they can demonstrate suitable professional competency and governance frameworks are in place. This Authority has successfully elected to opt up to professional status with all its counterparties and service providers.

**9. Minimum Revenue Provision Policy Statement**

9.1 Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery. It is inappropriate to charge the entirety of this expenditure in the year in which it is incurred i.e the expenditure benefits more than a single year of account. As such, the resulting costs are spread over several years. The manner of spreading these costs is through an annual Minimum Revenue Provision (MRP) which was previously determined under Regulation and now is determined under Guidance.

9.2 Statutory instrument WSI 2008 no.588 section 3 states that "..a local authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be prudent,,"

The previous requirement to make a 2% MRP charge for the Housing Revenue Account share of the Capital Financing Requirement (CFR) until 2020/21 when lifetime of asset shall be adopted is unchanged by this instrument.

9.3 Along with the above duty, the Welsh Assembly Government issued guidance in March 2008 which requires that a Statement on the Council's Policy for its annual MRP should be submitted to the full Council for review before the start of the financial year to which the provision will relate. The Council is legally obliged to 'have regard' to the guidance.

9.4 The Welsh Assembly Government guidance outlined four broad options to adopt for the calculation of MRP. They are:

- Option 1- Regulatory Method
- Option 2 - Capital Financing Requirement Method
- Option 3 - Asset Life Method
- Option 4 – Depreciation Method

The options and guidance are detailed at Appendix F.

9.5 The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/09 and revised its MRP Policy for 2018/19 in

December 2018 in accordance with the main recommendations contained within the guidance issued by the Welsh Government

9.6 The major proportion of the MRP chargeable will relate to the historic debt liability (pre 2008/09) that will now be charged at the rate of 2.5%% straight line. ( equivalent to amortising over a 40 year asset life). Then other expenditure incurred using ‘unsupported borrowing’ will under delegated powers be subject to MRP under option 3 which will be charged over a period commensurate with the estimated useful life applicable to the nature of the expenditure or in accordance with the existing capitalisation directive.

9.7 Estimated life periods will be determined under delegated powers having taken professional advice. The Section 151 Officer reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

9.8 Going forward, it is proposed that all GF debt arising from capital expenditure supported by the WG through supported borrowing or the Local Government Borrowing Initiative will be charged MRP at 2.5% straight line ( equivalent to being amortised over a 40 year asset life) and all other capital expenditure and other ‘capitalised’ expenditure will be repaid under option 3 as appropriate unless otherwise superseded by any accompanying capitalisation directive/guidance. All HRA debt to be amortised at 2% until 2020/21 when new borrowing shall be amortised over the useful life of the asset.

## 10 Legal Implications

10.1 The Authority is under a duty to make arrangements for the proper administration of its financial affairs. Failure to do so will be a breach of that duty. The statutory provisions and guidance imposing such a duty on the Authority are as set out in the main body of the Report.

## 11. Equality Impact Implications

11.1 The Council is subject to the Public Sector Equality Duty (Wales) and must, in the exercise of their functions, have due regard to the need to:

- Eliminate unlawful discrimination, harassment and victimisation and other conduct prohibited by the Act.
- Advance equality of opportunity between people who share a protected characteristic and those who do not.
- Foster good relations between people who share a protected characteristic and those who do not.

Our Equality Impact Assessment (EIA) process ensures that we have paid due regard to the above. We have undertaken an EIA screening which demonstrates there are no equality impact implications arising directly from this report (Appendix H)

| | |
|---|---|
| **Background papers:** | The revised CIPFA Treasury Management Code of Practice 2011<br><br>The revised CIPFA Prudential Code for Capital Finance in Local Authorities 2011<br><br>The revised CIPFA Prudential Code for Capital Finance in Local Authorities 2017 |
| **Appendices:** | Appendix A – Glossary of Terms<br>Appendix B – Treasury Advisors' View On The Economic Background<br>Appendix C – Investment Criteria and creditworthiness policy<br>Appendix D – Credit Rating Agency Definitions<br>Appendix E – Approved Countries for Investment<br>Appendix F Minimum Revenue Provision Guidance<br>Appendix G – Approved Internal Counterparty Lending List<br>Appendix H – Equality Impact Assessment |

**Appendix A**

**Treasury Management – Glossary Of Terms**

| | |
|---|---|
| **Annualised Rate of Return** | Represents the average return which would have been achieved each year. |
| **Authorised Limit** ***( can also be considered as the affordable borrowing limit)*** | The authorised limit must be set to establish the outer boundary of the local authority's borrowing based on a realistic assessment of the risks. The authorised limit is certainly not a limit that an authority will expect to borrow up to on a regular basis. It is crucial that it is not treated as an upper limit for borrowing for capital expenditure alone since it must also encompass borrowing for temporary purposes. It is the expected maximum borrowing need, with some headroom for unexpected movement. |
| **Bank Rate** | The Official Bank rate paid on commercial bank reserves i.e. reserves placed by commercial banks with the Bank of England as part of the Bank's operations to reduce volatility in short term interest rates in the money markets. |
| **Base Rate** | Minimum lending rate of a bank or financial institution in the UK. |
| **Basis Points (bp)** | A basis point is 0.01 of 1% (100 bp = 1%) |
| **Borrowing** | In the Code, borrowing refers to external borrowing. Borrowing is defined as both:-<br>• Borrowing repayable with a period in excess of 12months<br>• Borrowing repayable on demand or within 12months |
| **Capital Expenditure** | The definition of capital expenditure starts with all those items which can be capitalised in accordance with the Statement of Recommended Practice (SORP). To this must be added any items that have/will be capitalised in accordance with legislation that otherwise would not be capitalised. Prudential indicators for current and future years are calculated in a manner consistent with this definition. |

| | |
|---|---|
| **Capital Financing Charges (see financing costs also)** | These are the net costs of financing capital i.e. interest and principal, premium less interest received and discounts received. |
| **Capital Financing Requirement** | The Capital Financing Requirement is simply the total outstanding capital expenditure, which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. |
| **CIPFA** | The Chartered Institute of Public Finance and Accountancy. One of the leading professional accountancy bodies in the UK and the only one which specialises in the public services. |
| **Counterparty** | The organisations responsible for repaying the Council's investment upon maturity and for making interest payments. |
| **Credit Rating** | This is a scoring system that lenders issue people with to determine how credit worthy they are.<br><br>The Credit Rating components are as follows:<br><br>1. The AAA ratings through to C/D are long-term rating definitions and generally cover maturities of up to five years, with the emphasis on the ongoing stability of the institution's prospective financial condition. AAA are the most highly rates, C/D are the lowest. This Council does not invest with institutions lower than AA- for investments over 364 days<br><br>2. F1/A1/P1 are short-term rating definitions used by Moody's, S&P and Fitch Ratings for banks and building societies based on their individual opinion on an institution's capacity to repay punctually its short-term debt obligations (which do not exceed one year). This Council does not invest with institutions lower than F1/A1/P1 for investments under 364 days. |
| **Debt** | For the purposes of the Code, debt refers to the sum of borrowing (see above) and other long-term liabilities (see below). It should be noted that the term borrowing used with the |

| | |
|---|---|
| | Act includes both borrowing as defined for the balance sheet and other long terms liabilities defined as credit arrangements through legislation. |
| **Discounts** | Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount. This is calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out. |
| **Financing Costs** | The financing costs are an estimate of the aggregate of the following:-<br>• Interest payable with respect to borrowing<br>• Interest payable under other long-term liabilities<br>• Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount to be met from government grants and local taxpayers (premiums and discounts)<br>• Interest earned and investment income<br>• Amounts required in respect of the minimum revenue provision plus any additional voluntary contributions plus any other amounts for depreciation/impairment that are charged to the amount to be met from government grants and local taxpayers |
| **Financial Reporting Standards (FRSs)** | These are standards set by governing bodies on how the financial statements should look and be presented. |
| **Investments** | Investments are the aggregate of:-<br><br>• Long term investments<br>• Short term investments (within current assets)<br>• Cash and bank balances including overdrawn balances<br><br>From this should be subtracted any investments that are held clearly and explicitly |

| | |
|---|---|
| | in the course of the provision of, and for the purposes of, operational services. |
| **IMF** | International Monetary Fund |
| **LOBO (Lender's Option/ Borrower's Option** | Money Market instruments that have a fixed initial term (typically one to ten year) and then move to an arrangement whereby the lender can decide at pre-determined intervals to adjust the rate on the loan. At this stage the borrower has the option to repay the loan. |
| **London Inter-Bank Bid Rate (LIBID)** | The interest rate at which major banks in London are willing to borrow (bid for) funds from each other. |
| **Managed Funds** | <u>In-House Fund Management</u><br>Surplus cash arising from unused capital receipts and working cashflows can be managed either by external fund managers or by the Council's staff in-house. The in-house funds are invested in fixed deposits through the money markets for periods up to one year.<br><br><u>Externally Management Funds</u><br>Fund managers appointed by the Council invest surplus cash arising from unused capital receipts in liquid instruments such as bank certificates of deposit and government stocks. The fund managers' specialist knowledge should ensure a higher rate of earnings on the managed funds than would be otherwise obtained. |
| **Maturity** | The date when an investment is repaid or the period covered by a fixed term investment. |
| **Minimum Revenue Provision (MRP)** | The amount required by statute to be principal repayment each year. |
| **Monetary Policy Committee (MPC)** | This is a body set up by the Government in 1997 to set the repo rate (commonly referred to as being base rate). Their primary target (as set by the Government) is to keep inflation within plus or minus 1% of a central target of 2% in two year time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth |

| | |
|---|---|
| | and employment. |
| **Money Market** | Consists of financial institutions and deals in money and credit.<br><br>The term applied to the institutions willing to trade in financial instruments. It is not a physical creation, but an electronic/telephone one. |
| **Net Borrowing** | For the purposes of the Code, net borrowing refers to borrowing (see above) net of investments (see above). |
| **Net Revenue Stream** | Estimates for net revenue stream for current and future years are the local authority's estimates of the amounts to be met from government grants and local taxpayers. |
| **Operational Boundary** | This is based on expectations of the maximum external debt of the authority according to probable not simply possible – events and being consistent with the maximum level of external debt projected by the estimates. It is not a limit and actual borrowing could vary around this boundary for short periods. |
| **Other Long Term Liabilities** | The definition of other long term liabilities is the sum of the amounts in the Council's accounts that are classified as liabilities that are for periods in excess of 12months, other than borrowing (see definition above). |
| **Premature Repayment of Loans (debt restructuring/rescheduling)** | A facility for loans where the Council can repay loans prior to the original maturity date. If the loan repaid has a lower interest rate than the current rate for a loan of the same maturity period the Council can secure a cash discount on the repayment of the original loan. If the loan replaced has a higher rate of interest than the current rate for a loan of the same maturity period, a cash penalty is payable to the lender. |
| **Premia** | Where the prevailing current interest rate is lower than the fixed rate of a long term loan, which is being repaid early, the lender can charge the borrower a premium. This is |

| | |
|---|---|
| | calculated on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out. |
| **Prudential Code** | The Prudential Code is the largely self regulatory framework outlined by CIPFA for managing/monitoring capital investment in local government. |
| **Public Works Loan Board (PWLB)** | A Government agency which provides loans to local authorities. Each year, it issues a circular setting out the basis on which loans will be made available. Loans can be either at a fixed rate or on a variable rate basis. They can be repaid on either an annuity, equal instalment of principal or maturity basis. The interest rate charged is linked to the cost at which the Government itself borrows. |
| | |
| **Risk** | <u>Counterparty Credit Risk</u><br>The risk that a counterparty defaults on its obligations.<br><br><u>Inflation Risk</u><br>The risk that growth in the Authority's investment income does not keep pace with the effects of inflation on its expenditure.<br><br><u>Interest Rate Risk</u><br>The risk that changes in rates of interest creates an unexpected or unbudgeted burden on the Council's finances.<br><br><u>Liquidity Risk</u><br>The risk that cash will not be available when it is needed.<br><br><u>Operational Risk</u><br>The risk of loss through fraud, error, corruption, system failure or other eventualities in Treasury Management dealings, and failure to maintain effective contingency management arrangements.<br><br><u>Refinancing Risk</u><br>The risk that the Authority is unable to replace its maturing funding arrangements on |

| | |
|---|---|
| | appropriate terms. |
| **Set Aside Capital Receipts** | A proportion of money received by the Council for the sale of fixed assets must be set aside to repay debt. |
| **SORP** | Statement of Recommended Practice, published by CIPFA (Local Authority Accounting Body). This sets out guidelines regarding the Council's financial matters. |
| **Specified/Non Specified investments** | Specified investments are sterling denominated investments for less than 364 days as identified in Appendix C in line with statutory investment regulations. Non-specified investments are all other investments identified in Appendix C in line with statutory investment regulations. |
| **Supranational Bonds** | These are bonds issued by institutions such as the European Investment Bank and World Bank. As with Government bonds (Gilts) they are regarded as the safest bond investments with a high credit rating. |
| **Temporary Borrowing and Investment** | Loans which are capable of being repaid within one year. The term of the loans will be negotiated from overnight to 364 days. |
| **Treasury Management** | Treasury Management has the same definition as in CIPFA's code of Practice of Treasury Management in the Public Services.<br><br>"The management of the organisation's 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." |
| **Yield Curve** | The line resulting from portraying interest rate graphically for a series of periods, e.g. 7days, 1month, 3, 6, 9, and 12months. When longer-term interest rates are higher than short-term rates the yield curve slopes upwards and is described as positive. When the opposite prevails the yield curve is referred to as inverse. |

**Appendix B**

## Treasury Advisors' View On The Economic Background

1.2

**GLOBAL OUTLOOK. World growth** has been doing reasonably well, aided by strong growth in the US. However, US growth is likely to fall back in 2019 and, together with weakening economic activity in China, overall world growth is likely to weaken.

**Inflation** has been weak during 2018 but, at long last, unemployment falling to remarkably low levels in the US and UK has led to a marked acceleration of wage inflation which is likely to prompt central banks into a series of increases in central rates. The EU is probably about a year behind in a similar progression.

**KEY RISKS - central bank monetary policy measures**
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as quantitative easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

**The key issue now** is that that period of stimulating economic recovery and warding off the threat of deflation, is coming towards its close. A new period has already started in the US, and more recently in the UK, of reversing those measures i.e. by raising central rates and, (for the US), reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of a reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this also encouraged investors into a search for yield and into investing in riskier assets such as equities. Consequently, prices in both bond and equity markets rose to historically high valuation levels simultaneously. This now means that both asset categories are vulnerable to a sharp downward correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery, by taking too rapid and too strong action, or, conversely, let inflation run away by taking action that was too slow and/or too weak. **The potential for central banks to get this timing and strength of action wrong are now key risks.**

The world economy also needs to adjust to a sharp change in **liquidity creation** over the last five years where the US has moved from boosting liquidity by QE purchases, to reducing its holdings of debt. In addition, the European Central Bank has cut back its QE purchases substantially and is likely to end them completely by the end of 2018.

**UK.** The flow of positive economic statistics since the end of the first quarter this year has shown that pessimism was overdone about the poor growth in quarter 1 when adverse weather caused a temporary downward blip. Quarter 1 at 0.1% growth in GDP was followed by a return to 0.4% in quarter 2; quarter 3 is expected to be robust at around +0.6% but quarter 4 is expected to weaken from that level.

At their November meeting, the MPC repeated their well-worn phrase that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate, (where monetary policy is neither expansionary of contractionary), than before the crash; indeed they gave a figure for this of around 2.5% in ten years time but declined to give a medium term forecast. However, with so much uncertainty around Brexit, they warned that the next move could be up or down, even if there was a disorderly Brexit. While it would be expected that Bank Rate could be cut if there was a significant fall in GDP growth as a result of a disorderly Brexit, so as to provide a stimulus to growth, they warned they could also *raise* Bank Rate in the same scenario if there was a boost to inflation from a devaluation of sterling, increases in import prices and more expensive goods produced in the UK replacing cheaper goods previously imported, and so on. In addition, the Chancellor has held back some spare capacity to provide a further fiscal stimulus if needed.

It is unlikely that the MPC would increase Bank Rate in February 2019, ahead of the deadline in March for Brexit. Getting parliamentary approval for a Brexit agreement on both sides of the Channel will take well into spring next year. However, in view of the hawkish stance of the MPC at their November meeting, the next increase in Bank Rate is now forecast to be in May 2019. The following increases are then forecast to be in February and November 2020 before ending up at 2.0% in February 2022.

**Inflation.** The Consumer Price Index (CPI) measure of inflation has been falling from a peak of 3.1% in November 2017 to 2.4% in October. In the November Bank of England quarterly inflation report, inflation was forecast to still be marginally above its 2% inflation target two years ahead, (at about 2.1%), given a scenario of minimal increases in Bank Rate. This inflation forecast is likely to be amended upwards due to the Bank's inflation report being produced prior to the Chancellor's announcement of a significant fiscal stimulus in the Budget; this is likely to add 0.3% to GDP growth at a time when there is little spare capacity left in the economy, particularly of labour.

As for the **labour market** figures in September**,** unemployment at 4.1% was marginally above a 43 year low of 4% on the Independent Labour Organisation measure. A combination of job vacancies hitting an all-time high, together with negligible growth in total employment numbers, indicates that employers are now having major difficulties filling job vacancies with suitable staff. It was therefore unsurprising that wage inflation picked up to 3.2%, (3 month average regular pay, excluding bonuses). This meant that in real terms, (i.e. wage rates less CPI inflation), earnings are currently growing by about 0.8%, the highest level since 2009. This increase in household spending power is likely to feed through into providing some support to the overall rate of economic growth in the coming months. This tends to confirm that the MPC was right to start on a cautious increase in Bank Rate in August as it views wage inflation in excess of 3% as increasing inflationary pressures within the UK economy.

In the **political arena**, there is a risk that the current Conservative minority government may be unable to muster a majority in the Commons over Brexit. However, our central position is that Prime Minister May's government will endure, despite various setbacks, along the route to reaching an orderly Brexit in March 2019. If, however, the UK faces a general election in the next 12 months, this could result in a potential loosening of monetary and fiscal policy and therefore medium to longer dated gilt yields could rise on the expectation of a weak pound and concerns around inflation picking up.

**USA.** President Trump's massive easing of fiscal policy is fuelling a, (temporary), boost in consumption which has generated an upturn in the rate of strong growth which rose from 2.2%, (annualised rate), in quarter 1 to 4.2% in quarter 2 and 3.5%, (3.0% y/y), in quarter 3, but also an upturn in inflationary pressures. In particular, wage rates were increasing at 3.1% y/y in October and heading higher due to unemployment falling to a 49 year low of 3.7%. With CPI inflation over the target rate of 2% and on a rising trend towards 3%, the Fed increased rates another 0.25% in September to between 2.00% and 2.25%, this being the fourth increase in 2018. They also indicated that they expected to increase rates four more times by the end of 2019. The dilemma, however, is what to do when the temporary boost to consumption wanes, particularly as the recent imposition of tariffs on a number of countries' exports to the US, (China in particular), could see a switch to US production of some of those goods, but at higher prices. Such a scenario would invariably make any easing of monetary policy harder for the Fed in the second half of 2019. However, a combination of an expected four increases in rates of 0.25% by the end of 2019, together with a waning of the boost to economic growth from the fiscal stimulus in 2018, could combine to depress growth below its potential rate, i.e. monetary policy may prove to be too aggressive and lead to the Fed having to start on cutting rates. The Fed has also been unwinding its previous quantitative easing purchases of debt by gradually increasing the amount of monthly maturing debt that it has not been reinvesting.

The tariff war between the US and China has been generating a lot of heat during 2018, but it is not expected that the current level of actual action would have much in the way of a significant effect on US or world growth. However, there is a risk of escalation. The results of the mid-term elections are not expected to have a material effect on the economy.

**Eurozone.** Growth was 0.4% in quarters 1 and 2 but fell back to 0.2% in quarter 3, though this is probably just a temporary dip. In particular, data from Germany has been mixed and it could be negatively impacted by US tariffs on a significant part of manufacturing exports e.g. cars. For that reason, although growth is still expected to be in the region of nearly 2% for 2018, the horizon is less clear than it seemed just a short while ago. Having halved its quantitative easing purchases of debt in October 2018 to €15bn per month, the European Central Bank has indicated it is likely to end all further purchases in December 2018. Inflationary pressures are starting to build gently so it is expected that the ECB will start to increase rates towards the end of 2019.

**China.** Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems. Progress has been made in reducing the rate of credit creation, particularly from the shadow banking sector, which is feeding through into lower economic growth. There are concerns that official economic statistics are inflating the published rate of growth.

**Japan** - has been struggling to stimulate consistent significant GDP growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy. It is likely that loose monetary policy will endure for some years yet to try to stimulate growth and modest inflation.

**Emerging countries.** Argentina and Turkey are currently experiencing major headwinds
and are facing challenges in external financing requirements well in excess of their reserves of foreign exchange. However, these countries are small in terms of the overall world economy, (around 1% each), so the fallout from the expected recessions in these countries will be minimal.

**INTEREST RATE FORECASTS**

The interest rate forecasts provided by Link Asset Services in paragraph 4.1 are predicated on an assumption of an agreement being reached on Brexit between the UK and the EU. In the event of an orderly non-agreement exit, it is likely that the Bank of England would take action to cut Bank Rate from 0.75% in order to help economic growth deal with the adverse effects of this situation. This is also likely to cause short to medium term gilt yields to fall. If there was a disorderly Brexit, then any cut in Bank Rate would be likely to last for a longer period and also depress short and medium gilt yields correspondingly. It is also possible that the government could act to protect economic growth by implementing fiscal stimulus.

**The balance of risks to the UK**

- The overall balance of risks to economic growth in the UK is probably neutral.
- The balance of risks to increases in Bank Rate and shorter term PWLB rates, are probably also even and are broadly dependent on how strong GDP growth turns out, how slowly inflation pressures subside, and how quickly the Brexit negotiations move forward positively.

One risk that is both an upside and downside risk, is that all central banks are now working in very different economic conditions than before the 2008 financial crash as there has been a major increase in consumer and other debt due to the exceptionally low levels of borrowing rates that have prevailed for ten years since 2008. This means that the neutral rate of interest in an economy, (i.e. the rate that is neither expansionary nor deflationary), is difficult to determine definitively in this new environment, although central banks have made statements that they expect it to be much lower than before 2008. Central banks could therefore either over or under do increases in central interest rates.

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

- **Brexit** – if it were to cause significant economic disruption and a major downturn in the rate of growth.
- **Bank of England monetary policy** takes action too quickly, or too far, over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- A resurgence of the **Eurozone sovereign debt crisis**, possibly in **Italy**, due to its high level of government debt, low rate of economic growth and vulnerable banking system, and due to the election in March of a government which has made a lot of anti-austerity noise. At the time of writing, the EU has rejected the proposed Italian budget and has demanded cuts in government spending which the Italian government has refused. The rating agencies have started on downgrading Italian debt to one notch above junk level. If Italian debt were to fall below investment grade, many investors would be unable to hold it. Unsurprisingly, investors are becoming increasingly concerned by the actions of the Italian government and consequently, Italian bond yields have risen sharply – at a time when the government faces having to refinance large amounts of debt maturing in 2019.
- Weak capitalisation of some **European banks**. Italian banks are particularly vulnerable; one factor is that they hold a high level of Italian government debt - debt which is falling in value. This is therefore undermining their capital ratios and raises the question of whether they will need to raise fresh capital to plug the gap.
- **German minority government.** In the German general election of September 2017, Angela Merkel's CDU party was left in a vulnerable minority position dependent on the fractious support of the SPD party, as a result of the rise in popularity of the anti-immigration AfD party. Then in October 2018, the results of the Bavarian and Hesse state elections radically undermined the SPD party and showed a sharp fall in support for the CDU. As a result, the SPD is reviewing whether it can continue to support a coalition that is so damaging to its electoral popularity. After the result of the Hesse state election, Angela Merkel announced that she would not stand for re-election as CDU party leader at her party's convention in December 2018. However, this makes little practical difference as she is still expected to aim to continue for now as the Chancellor. However, there are five more state elections coming up in 2019 and EU parliamentary elections in May/June; these could result in a further loss of electoral support for both the CDU and SPD which could also undermine her leadership.
- **Other minority eurozone governments.** Spain, Portugal, Netherlands and Belgium all have vulnerable minority governments dependent on coalitions which could prove fragile. Sweden is also struggling to form a government due to the anti-immigration party holding the balance of power, and which no other party is willing to form a coalition with.
- **Austria, the Czech Republic and Hungary** now form a strongly

anti-immigration bloc within the EU while **Italy,** this year, has also elected a strongly anti-immigration government. Elections to the EU parliament are due in May/June 2019.

- Further increases in interest rates in the US could spark a **sudden flight of investment funds** from more risky assets e.g. shares, into bonds yielding a much improved yield. In October 2018, we have seen a sharp fall in equity markets but this has been limited, as yet. Emerging countries which have borrowed heavily in dollar denominated debt, could be particularly exposed to this risk of an investor flight to safe havens e.g. UK gilts.
- There are concerns around the level of **US corporate debt** which has swollen massively during the period of low borrowing rates in order to finance mergers and acquisitions. This has resulted in the debt of many large corporations being downgraded to a BBB credit rating, close to junk status. Indeed, 48% of total investment grade corporate debt is now rated at BBB. If such corporations fail to generate profits and cash flow to reduce their debt levels as expected, this could tip their debt into junk ratings which will increase their cost of financing and further negatively impact profits and cash flow.
- **Geopolitical risks,** especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.

**Upside risks to current forecasts for UK gilt yields and PWLB rates**

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

**Appendix C**

## Creditworthiness Policy and Investment Criteria

The Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands

- Yellow 5 years *
- Dark pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

| Y | Pi1 | Pi2 | P | B | O | R | G | N/C |
|---|---|---|---|---|---|---|---|---|
| 1 | 1.25 | 1.5 | 2 | 3 | 4 | 5 | 6 | 7 |
| Up to 5yrs | Up to 5yrs | Up to 5yrs | Up to 2yrs | Up to 1yr | Up to 1yr | Up to 6mths | Up to 100days | No Colour |

| | Colour (and long term rating where applicable) | Money and/or % Limit | Time Limit |
|---|---|---|---|
| **Banks /UK Govt debt*** | **yellow** | **£120m** | **5yrs** |
| **Banks** | **purple** | **£25m** | **2 yrs** |
| **Banks** | **orange** | **£25m** | **1 yr** |
| **Banks – part nationalised** | **blue** | **£30m** | **1 yr** |
| **Banks** | **red** | **£25m** | **6 mths** |
| **Banks** | **green** | **£25m / %** | **100 days** |
| **Banks** | **No colour** | **Not to be used** | |
| **Council's banker** | **-** | **£30m / %** | **5 yrs** |
| **Other institutions limit** | **-** | **£25m** | **1yr** |
| **DMADF** | **AAA** | **unlimited** | **6 months** |
| **Local authorities** | **n/a** | **£30m** | **5yrs** |
| | **Fund rating** | **Money and/or % Limit** | **Time Limit** |
| **Money market funds** | **AAA** | **£25m / %** | **liquid** |
| **Enhanced money market funds with a credit score of 1.25** | **Dark pink / AAA** | **£25m / %** | **liquid** |
| **Enhanced money market funds with a credit score of 1.5** | **Light pink / AAA** | **£25m / %** | **liquid** |

** Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt*

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

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

All credit ratings will be monitored before deals are underatken and The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' creditworthiness service.

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

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

**Investment Criteria for Specified and Non Specified Investments**

1.1 Investments will be made in accordance with the following terms:

1.1.1 **<u>Specified Investments</u>:**

(All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable and the principal sum to be repaid at maturity is the same as the initial sum invested other than investments in the UK Government.)

| **Instrument** | **Minimum Credit Criteria** | **Use** | **Max investment** |
|---|---|---|---|
| Debt Management Agency Deposit Facility | -- | In-house | £120M |
| Term deposits – UK government | -- | In-house | £120M |
| Term deposits – other LAs | -- | In-house | £25M with each counterparty |
| Term deposits – banks and building societies | Short-term F1,P1,A1, Long-term AA- or UK nationalised banks<br><br>Blue<br>Orange<br>Red<br>Green<br>No Colour | In-house and fund managers<br><br>12 months<br>12 months<br>6 months<br>100 days<br>Not for use | £25M with each counterparty/ See 2 and 3 below |
| Term deposits – Banks | Short-term | In-house and | £30M with each |

| | | | |
|---|---|---|---|
| nationalised by highly credit rated sovereign countries | F1,P1,A1, Long-term AA-<br><br>Blue<br>Orange<br>Red<br>Green<br>No Colour | fund managers<br><br>12 months<br>12 months<br>6 months<br>100 days<br>Not for use | counterparty/ See 2 and 3 below |
| Government guarantee on all deposits by high credit rated sovereign countries | AA- | In-house and fund managers | £25M with each counterparty/ See 2 and 3 below |
| UK Government supported banking sector | AA- | In-house and fund managers | £30M with each counterparty/ See 2 and 3 below |

1.1.2 **<u>Non-Specified Investments</u>:**

A maximum of 35% will be held in aggregate of Council managed funds in non-specified investments. A maximum of 50% of aggregate funds managed by the Council's external fund managers will be held in non-specified investments.

| Instrument | Min Credit/Colour Criteria | Use | Maximum Period | Maximum Investment |
|---|---|---|---|---|
| Term deposits – UK government (with maturities in excess of 1 year) | | In-house | 5 years | £30M |
| Term deposits – other Local Authorities (with maturities in excess of 1 year) | | In-house | 5 years | £25M with each counterparty |
| Deposits with banks and building societies covered by UK government guarantee | Short-term F1,P1,A1 Long-term AA-<br><br>Blue<br>Orange | Fund managers/ in-house | See 2 and 3 below<br><br>12 months<br>12 months | See 2 below/£30m with each counterparty |
| Certificates of deposits issued by banks and building societies covered by UK government guarantee | Short-term F1,P1,A1 Long-term AA-<br><br>Blue<br>Orange | Fund managers/in house | See 2 and 3 below<br><br>12 months<br>12 months | See 2 below/£25m with each counterparty |
| UK Government Gilts | - | Fund Managers/in house | See 2 and 3 below/5 years | See 2 below /£25M |
| Treasury Bills | - | Fund Managers/in | See 2 and 3 below/5 | See 2 below /£25M |

| | | | | |
|---|---|---|---|---|
| | | house | years | |
| Term deposits – banks and building societies (with maturities in excess of 1 year) | Short-term F1,P1,A1 Long-term AA-, or UK nationalised banks<br><br>Blue<br>Orange | In-house | 5 years<br><br><br>12 months<br>12 months | £25M with each counterparty |
| Certificates of deposits issued by banks and building societies | Short-term F1,P1,A1 Long-term AA-,<br><br>Blue<br>Orange | fund managers/in-house | 10 years<br><br><br>12 months<br>12 months | See 2 below/£25M with each counterparty |
| UK Government Gilts with maturities in excess of 1 year | AAA | Fund Managers/in house | 10 years | See 2 below/£25M with each counterparty |
| Bonds issued by multilateral development banks | AAA | In-house on a 'buy-and-hold' basis.<br><br>Also for use by fund managers | 5 years<br><br><br>10 years | £25M with each counterparty and<br>See 2 below |
| Bonds issued by a financial institution which is guaranteed by the UK government | - | In-house on a 'buy-and-hold' basis.<br><br><br>Also for use by fund managers | 5 years<br><br><br><br>10 years | £25M with each counterparty<br><br><br>See 2 below |
| Sovereign bond issues (i.e. other than the UK govt) | AAA | In- house<br><br>Fund Managers | 5 years<br><br>10 years | £25M with each counterparty<br><br>See 2 below |
| Corporate Bonds : [under SI 1010 (W.107)] | Long-term AA- | In- house<br><br>Fund Managers | 5 years<br><br>10years | £25M with each counterparty<br><br>See 2 below |
| Gilt Funds and Bond Funds | Long-term AA- | In- house<br><br>Fund Managers | 5 years<br><br>10years | £15M<br><br>See 2 below |
| Money Market Funds | AAA | In- house<br><br>Fund Managers | n/a<br><br>n/a | £25M<br><br>See 2 a below |
| Property funds | - | Fund | n/a | £20M |

| | | | | |
|---|---|---|---|---|
| | | managers | | See 2 below |
| Floating Rate Notes | Long-term AA- | Fund managers | 10 years | See 2 below |
| Treasury Bills | N/A | Fund Managers | 10 years | See 2 below |
| Local authority mortgage guarantee scheme | Short-term F1,P1,A1 Long-term AA-, | In-house | 10 years | £25m with each counterparty |

**Appendix D**

***Fitch International Long-Term Credit Ratings***

International Long-Term Credit Ratings (LTCR) may also be referred to as Long-Term Ratings. When assigned to most issuers, it is used as a benchmark measure of probability of default and is formally described as an Issuer Default Rating (IDR). The major exception is within Public Finance, where IDRs will not be assigned as market convention has always focused on timeliness and does not draw analytical distinctions between issuers and their underlying obligations. When applied to issues or securities, the LTCR may be higher or lower than the issuer rating (IDR) to reflect relative differences in recovery expectations. The following rating scale applies to foreign currency and local currency ratings:

| **Investment Grade** | **Definition** |
|---|---|
| AAA | Highest credit quality. 'AAA' ratings denote the lowest expectation of credit risk. They are assigned only in case of exceptionally strong capacity for payment of financial commitments. This capacity is highly unlikely to be adversely affected by foreseeable events. |
| AA | Very high credit quality. 'AA' ratings denote expectations of very low credit risk. They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events. |
| A | High credit quality. 'A' ratings denote expectations of low credit risk. The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to changes in circumstances or in economic conditions than is the case for higher ratings. |
| BBB | Good credit quality. 'BBB' ratings indicate that there are currently expectations of low credit risk. The capacity for payment of financial commitments is considered adequate but adverse changes in circumstances and economic conditions are more likely to impair this capacity. This is the lowest investment grade category. |
| **Speculative Grade** | **Definition** |
| BB | Speculative. 'BB' ratings indicate that there is a possibility of credit risk developing, particularly as the result of adverse economic change over time; however, business or financial alternatives may be available to allow financial commitments to be met. Securities rated in this category are not investment grade. |

| | |
|---|---|
| B | Highly speculative.<br>• For issuers and performing obligations, 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favourable business and economic environment.<br>• For individual obligations, may indicate distressed or defaulted obligations with potential for extremely high recoveries. Such obligations would possess a Recovery Rating of 'RR1' (outstanding). |
| CCC | For issuers and performing obligations, default is a real possibility. Capacity for meeting financial commitments is solely reliant upon sustained, favourable business or economic conditions.<br>• For individual obligations, may indicate distressed or defaulted obligations with potential for average to superior levels of recovery. Differences in credit quality may be denoted by plus/minus distinctions. Such obligations typically would possess a Recovery Rating of 'RR2' (superior), or 'RR3' (good) or 'RR4' (average). |
| CC | For issuers and performing obligations, default of some kind appears probable.<br>• For individual obligations, may indicate distressed or defaulted obligations with a Recovery Rating of 'RR4' (average) or 'RR5' (below average). |
| C | • For issuers and performing obligations, default is imminent.<br>• For individual obligations, may indicate distressed or defaulted obligations with potential for below-average to poor recoveries. Such obligations would possess a Recovery Rating of 'RR6' (poor). |
| RD | Indicates an entity that has failed to make due payments (within the applicable grace period) on some but not all material financial obligations, but continues to honour other classes of obligations. |
| D | Indicates an entity or sovereign that has defaulted on all of its financial obligations. Default generally is defined as one of the following:<br>• Failure of an obligor to make timely payment of principal and/or interest under the contractual terms of any financial obligation;<br>• The bankruptcy filings, administration, receivership, liquidation or other winding-up or cessation of business |

| | |
|---|---|
| | • The distressed or other coercive exchange of an obligation, where creditors were offered securities with diminished structural or economic terms compared with the existing obligation. |

***Fitch International Short-Term Credit Ratings***

The following ratings scale applies to foreign currency and local currency ratings. A Short-term rating has a time horizon of less than 13 months for most obligations, or up to three years for US public finance, in line with industry standards, to reflect unique risk characteristics of bond, tax, and revenue anticipation notes that are commonly issued with terms up to three years. Short-term ratings thus place greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

| **Short Term Rating** | **Current Definition** |
|---|---|
| F1 | Highest credit quality. Indicates the strongest capacity for timely payment of financial commitments; may have an added "+" to denote any exceptionally strong credit feature. |
| F2 | Good credit quality. A satisfactory capacity for timely payment of financial commitments, but the margin of safety is not as great as in the case of the higher ratings. |
| F3 | Fair credit quality. The capacity for timely payment of financial commitments is adequate; however, near term adverse changes could result in a reduction to non investment grade. |
| B | Speculative. Minimal capacity for timely payment of financial commitments, plus vulnerability to near term adverse changes in financial and economic conditions. |
| C | High default risk. Default is a real possibility. Capacity for meeting financial commitments is solely reliant upon a sustained, favourable business and economic environment. |
| D | Indicates an entity or sovereign that has defaulted on all of its financial obligations. |

**Appendix E**

**Approved Countries for Investment as at Dec 2018**

AAA

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

AA+

- Finland
- U.S.A.

AA

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

AA-

- Belgium
- Qatar

**Appendix F**

## Minimum Revenue Provision

### 1. Government Guidance

The Welsh Assembly Government issued new guidance in March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council are legally obliged by section 21 (1b) to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Where the CFR was nil or negative on the last day of the preceding financial year, the authority does not need to make an MRP provision. MRP in the current financial year would therefore by zero,

**Option 1: Regulatory Method**

Under the previous MRP regulations, General Fund MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This option is available for the General Fund share of capital financing requirement which relates to capital expenditure incurred prior to 1 April 2008. It may also be used for new capital expenditure up to the amount which is deemed to be supported by the Welsh Assembly Government annual supported borrowing allocation. The use of the commutation adjustment to mitigate the MRP charge is also allowed to continue under this option.

**Option 2: Capital Financing Requirement Method**

This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

**Option 3: Asset Life Method.**
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

The guidance suggests that any new borrowing which receives no Government support and is therefore self-financed would fall under option 3

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -

- Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
- No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:

> Equal instalment method – equal annual instalments which are calculated using a simple formula set out in paragraph 9 of the MRP guidance,
>
> under this approach, the MRP is provided by the following formula
>
> A – B divided by C
>
> A is the amount of capital expenditure in respect of the asset financed by borrowing or credit arrangements
>
> B is the total provision made before the current financial year in respect of that expenditure
>
> C is the inclusive number of financial years from the current year to that in which the estimated life of the asset expires
>
> Annuity method – annual payments gradually increase during the life of the asset with an appropriate interest rate used to calculate the annual amount

Under both options, the authority may make additional voluntary revenue provision and this may require an appropriate reduction in later years' MRP

In addition adjustments to the calculation to take account of repayment by other methods (e.g. application of capital receipts) should be made as necessary.

**Option 4: Depreciation Method**
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

**2. Date of implementation**
The previous statutory MRP requirements cease to have effect after the 2006/07 financial year. However, the same basis of 4% charge in respect of the GF share of CFR may continue to be used without limit until the 2009/10 financial year, relative to expenditure incurred up to 31/3/2008.

The guidance suggests that Options 3 and 4 should be applied to any capital expenditure which results in an increase in the CFR and does not relate to the authority's Supported Capital Expenditure.

The guidance also provides the authority with discretion to apply Options 3 or 4 to all capital expenditure whether or not supported and whenever it is incurred.

Any capitalised expenditure incurred after 1 April 2008 which gives rise to an increase in the GF CFR should be repaid by using option 3 as adapted by paragraphs 23 and 24 of the guidance.

**Appendix G**

**Active Internal Credit UK Counterparty List (as at 31 January 2019)**

| Institution | Country | Bank/BS | Fitch Ratings | | |
|---|---|---|---|---|---|
| | | | L Term | Support | S Term |
| Abbey National Treasury Services PLC | UK | Bank | A | 1 | F1 |
| Bank of Scotland PLC | UK | Bank | A+ | 5 | F1 |
| Barclays Bank PLC | UK | Bank | A+ | 5 | F1 |
| Close Brothers Ltd | UK | Bank | A | 5 | F1 |
| Goldman Sachs International Bank | UK | Bank | A | 1 | F1 |
| HSBC Bank PLC | UK | Bank | AA- | 1 | F1+ |
| Lloyds Bank Corporate Markets Plc) | UK | Bank | A | 1 | F1 |
| Santander UK PLC | UK | Bank | A+ | 2 | F1 |
| Standard Chartered Bank | UK | Bank | A+ | 5 | F1 |
| Sumitomo Mitsui Banking Corporation Europe Ltd | UK | Bank | A | 1 | F1 |
| UBS Ltd. | UK | Bank | AA- | 1 | F1+ |
| Coventry Building Society | UK | BS | A | 5 | F1 |
| Leeds Building Society | UK | BS | A- | 5 | F1 |
| Nationwide Building Society | UK | BS | A | 5 | F1 |
| Skipton Building Society | UK | BS | A- | 5 | F1 |
| Yorkshire Building Society | UK | BS | A- | 5 | F1 |
| Debt Management Office | UK | | | | |
| Local Authorities | UK | | | | |

**Appendix H**

**Please ensure that you refer to the '[Screening Form Guidance](#)' while completing this form. If you would like further guidance please contact your support officer in the Access to Services team (see guidance for details).**

| **Section 1** |
|---|
| What service area and directorate are you from? |
| Service Area: Finance & Service Centre |
| Directorate:Resources |

## Q1(a) WHAT ARE YOU SCREENING FOR RELEVANCE?

| Service/ Function | Policy/ Procedure | Project | Strategy | Plan | Proposal |
|---|---|---|---|---|---|
| ☐ | ☐ | ☐ | ✓ | ☐ | ☐ |

**(b) Please name and describe below**

**TREASURY MANAGEMENT STRATEGY, PRUDENTIAL INDICATORS, INVESTMENT STRATEGY AND MINIMUM REVENUE PROVISION POLICY STATEMENT 2019/20**

## Q2(a) WHAT DOES Q1a RELATE TO?

| Direct front line service delivery | Indirect front line service delivery | Indirect back room service delivery |
|---|---|---|
| ☐ **(H)** | ☐ **(M)** | ✓**(L)** |

**(b) DO YOUR CUSTOMERS/CLIENTS ACCESS THIS SERVICE…?**

| Because they need to | Because they want to | Because it is automatically provided to everyone in Swansea | On an internal basis i.e. Staff |
|---|---|---|---|
| ☐ **(H)** | ☐ **(M)** | ☐ **(M)** | ✓ **(L)** |

## Q3 WHAT IS THE POTENTIAL IMPACT ON THE FOLLOWING…

| | High Impact **(H)** | Medium Impact **(M)** | Low Impact **(L)** | Don't know **(H)** |
|---|---|---|---|---|
| Age | ☐ | ☐ | ✓ | ☐ |
| Disability | ☐ | ☐ | ✓ | ☐ |
| Gender reassignment | ☐ | ☐ | ✓ | ☐ |
| Marriage & civil partnership | ☐ | ☐ | ✓ | ☐ |

| | | | | |
|---|---|---|---|---|
| Pregnancy and maternity | ☐ | ☐ | ✓ | ☐ |
| Race | ☐ | ☐ | ✓ | ☐ |
| Religion or (non-)belief | ☐ | ☐ | ✓ | ☐ |
| Sex | ☐ | ☐ | ✓ | ☐ |
| Sexual Orientation | ☐ | ☐ | ✓ | ☐ |
| Welsh Language | ☐ | ☐ | ✓ | ☐ |
| Poverty/social exclusion | ☐ | ☐ | ✓ | ☐ |
| Carers | ☐ | ☐ | ✓ | ☐ |
| Community cohesion | ☐ | ☐ | ✓ | ☐ |

**Q4 Have you / will you undertake any public consultation and engagement relating to the initiative?**

☐ **Yes** ✓ **No** **(If no, you need to consider whether you should be undertaking consultation and engagement – please see the guidance)**

**If yes, please provide details below**

**Q5(a) HOW VISIBLE IS THIS SERVICE/FUNCTION/POLICY/PROCEDURE/ PROJECT/ STRATEGY TO THE GENERAL PUBLIC?**

| High visibility to general public | Medium visibility to general public | Low visibility to general public |
|---|---|---|
| ☐ **(H)** | ☐ **(M)** | ✓ **(L)** |

**(b) WHAT IS THE POTENTIAL RISK TO THE COUNCIL'S REPUTATION?** ***(Consider the following impacts – legal, financial, political, media, public perception etc…)***

| High risk to reputation | Medium risk to reputation | Low risk to reputation |
|---|---|---|
| ☐ **(H)** | ✓ **(M)** | ☐ **(L)** |

**Q6 Will this initiative have an impact (however minor) on any other Council service?**

✓ **Yes** ☐ **No** **If yes, please provide details below**

The cost of capital for all capital projects undertaken by the Authority is informed by the TM strategy

**Q7 HOW DID YOU SCORE?** ***Please tick the relevant box below – NOTE: Q3 counts as a single H, M or L (and one H / M outscores any nº of Ls)***

**MOSTLY H and/or M** ⟶ **HIGH PRIORITY** ⟶ ☐ **EIA to be completed**

**Please go to Section 2**

**MOSTLY L** → **LOW PRIORITY / NOT RELEVANT** → ✓**Do not complete EIA Please go to Q8 followed by Section 2**

**Q8 If after completing the EIA screening process you determine that this service/function/policy/project is not relevant for an EIA you must provide adequate explanation below.**

This is a back office function which although important has little or no direct impact on the groups identified in Q3

**Section 2**

Please send this completed form to the Access to Services Team for agreement before obtaining email approval from your Head of Service.

| Screening form completed by: |
| --- |
| Name: Jeff Dong |
| Location: 1.4.1c civic centre |
| Telephone Number: 6934 |
| Date: 31/1/19 |

| Approval by Head of Service: |
| --- |
| Name: Ben Smith |
| Position: S 151 Officer |
| Date: 31/1/19 |

**Please return the completed form to accesstoservices@swansea.gov.uk**