TREASURY MANAGEMENT STEWARDSHIP ANNUAL REPORT 2018/19

Report of the County Treasurer

Please note that the following recommendations are subject to consideration and determination by the Committee before taking effect.

Recommendations: (1) **That the Committee notes the report and considers whether it wishes to make any further comments to Cabinet on the 2018/19 Treasury Management outturn position.**
(2) **That the Committee recommends to Cabinet that the corrected Treasury Management Strategy for 2019/20 be approved**

1. Introduction

1.1. The County Council has adopted the CIPFA (Chartered Institute of Public Finance and Accountancy) Code of Practice for Treasury Management in the Public Services. A revised Code of Practice was published by CIPFA in December 2018 and a revised Policy Statement and Treasury Management Practices (TMPs) were agreed by Council in February 2018. The Treasury Management and Investment Strategy for 2018/19 was agreed by Council in February 2018 and forms part of the published budget book.

1.2. The purpose of this report is to show the outturn position, review performance and inform members of any key matters arising from the Council's Treasury and Debt Management activities during the 2018/19 financial year. The report also includes an update on the 2019/20 Strategy. This report, together with any comments offered by this committee, will be considered by Cabinet on 10th July.

2. Minimum Revenue Provision

2.1. Each year the Council has a statutory obligation to charge to the revenue account an annual amount of Minimum Revenue Provision (MRP), which is a charge to make provision for the repayment of the authority's external debt and internal borrowing. The charge is based on the historic borrowing required to fund the Council's capital programme.

2.2. The current policy, following a review during 2018/19, is to charge MRP based on the period of benefit of the capital investment, i.e. over the life of the asset. All supported borrowing up to 1st April 2008 will be charged over the life of the assets, calculated using the annuity method. The final outturn for MRP for 2018/19 was £14.853m.

3. Treasury Management Outturn Position 2018/19 - Borrowing

3.1. The overall aims of the borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses;
- A reduction in the average interest rate of the debt portfolio.

3.2. Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Therefore, the Medium Term Financial Strategy (MTFS) assumption was that no new long-term borrowing would be required.

3.3. In accordance with the MTFS, no long-term borrowing was undertaken during the 2018/19 financial year. Instead all borrowing required to fund capital expenditure was met from internal cash balances.

3.4. Active treasury management and the maintenance of levels of liquidity have ensured that no short-term borrowing was required during the financial year. Cash positions are monitored daily and modelled over a monthly horizon to ensure that anticipated liquidity levels are forecast accurately.

3.5. No opportunities arose during the 2018/19 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate any benefit of repaying the debt. The Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB policy imposes premium penalties for early repayment. With current low rates of interest these penalties would be of a significant cost. Therefore it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums.

3.6. At 31st March 2019 the level of long term debt stood at £507.85m as detailed in the table below.

Analysis of Long Term Debt

	Actual 31.03.18 £'m	Interest Rate %	Actual 31.03.19 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

3.7. The carrying amount for long term debt figure presented in the Statement of Accounts for 2018/19, comprising PWLB, LOBO and market debt, is £511.172m, £3.3m higher than the figure stated above. This difference is due to an accounting standard adjustment which requires us to record the value of our long term debt at its Net Present Value in the Statement of Accounts. The LOBOs (Lender Option Borrower Option) have stepped interest rates and are revalued annually based on the effective interest rate for the duration of the loan. There was £10.9m of PWLB interest outstanding at year end which is also taken into account. The revaluation has the effect of smoothing the stepping of the interest over the life of the loans.

4. Treasury Management Outturn Position 2018/19 - Investments

4.1. The overall aim of the Council's investment strategy is to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims;

- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

4.2. Following the flow of generally positive economic statistics over the Summer, the Bank of England's Monetary Policy Committee (MPC) came to a decision on 2 August to make the first increase in Bank Rate above 0.5% since the financial crash, to 0.75%. However, the MPC emphasised again that future Bank Rate increases would be gradual and would rise to a much lower equilibrium rate than before the crash.

4.3. Following the August rise in the base rate, the interest rates on offer to the Council increased, but there was only a limited scope to take advantage of the increased rates during the remainder of the financial year. The average interest rate earned on investments, excluding the CCLA property fund, for the year was 0.81%, against the full year budget target return of 0.55%. The CCLA property fund has yielded an average rate of 4.36% for the same period against a full year budget target of 4.5%. The combined total return from all investments was 0.97%.

4.4. Revenue lending during 2018/19, including the use of term deposits, call accounts and property funds, earned interest of £2.027 million against a full year budget of £1 million. The surplus achieved over budget can be partly attributed to the higher rates of interest earned compared to the target rate. The Council also had more cash to invest than forecast, as a result of slippage on the capital programme and additions to reserves during the year. The interest figure quoted is the return from the Council's Treasury Management activity and is different from the figure presented in the Outturn Report and the Statement of Accounts which also includes interest generated from a number of other sources.

4.5. All lending has been carried out in accordance with the Council's Treasury Management Strategy and with institutions on the list of approved counterparties.

4.6. The following table shows the County Council's fixed and variable rate investments as at the start and close of the financial year:

Schedule of Investments

	Maturing in:	Actual 31.03.18 £'m	Interest Rate %	Actual 31.03.19 £'m	Interest Rate %
Bank, Building Society & MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	107.50	0.73	147.50	1.01
	365 days & >	10.00	0.75	10.00	1.00
Callable Deposits					
Variable Rate					
Call Accounts		27.02	0.40	-	-
Notice Accounts		5.00	1.05	12.50	1.01
Money Market Funds (MMF's)		30.00	0.46	46.83	0.77
Property Fund		10.00	4.42	10.00	4.23
All Investments		**189.52**	**0.84**	**226.83**	**1.10**

4.7. The figure as at 31st March 2019 includes £11.7m related to the Growing Places Fund (GPF). This figure was approximately £12.8m as at 31st March 2018. Devon County Council is the local accountable body for the GPF, which was established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF funds, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

5. Prudential Indicators

5.1. Linked to its Treasury Management Strategy, the County Council is required to monitor its overall level of debt in line with the CIPFA Code of Practice. Part of the code requires consideration of a set of Prudential Indicators in order to allow the Council to form a judgement about the affordable, prudent and sustainable level of debt.

5.2. The purpose of the indicators is to demonstrate that:

- Capital expenditure plans are affordable;
- All external borrowing and other long term liabilities are within prudent and sustainable levels;
- Treasury management decisions are taken in accordance with professional good practice.

5.3. Three Prudential Indicators control the overall level of borrowing. They are:

- **The authorised limit** - this represents the limit beyond which any additional borrowing is prohibited until the limit is revised by the County Council. Revision may occur during the year if there are substantial and unforeseen changes in circumstances, for example, a significant delay in achieving forecast capital receipts. In normal circumstances this limit will not require revision until the estimate for the following year is revised as part of the budget setting process.
- **The operational boundary** – this indicator is based on the probable external debt and other long term liabilities during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable.
- **The upper limit for net debt** - the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement.

5.4. During the Budget process, the following Borrowing Limits were set for 2018/19:

- Maximum borrowing during the period (Authorised Limit) £777.76m.
- Expected maximum borrowing during the year (Operational Limit) £752.760m.
- Underlying Borrowing Requirement to Gross Debt - £90,964 under borrowing.
- Maximum amount of fixed interest exposure (as a percentage of total) 100%.
- Maximum amount of variable interest exposure (as a percentage of total) 30%.

5.5. Members are asked to note that during 2018/19 the Council remained within its set Borrowing Limits and complied with the interest rate exposure limits.

6. 2019/20 Update

6.1. The Treasury Management Strategy for 2019/20 is attached at Appendix 1 to this report. Following the presentation of the Strategy to the January meeting it was then incorporated into the budget book presented to Cabinet and then Council for approval. However, at that stage the section from below table 12 up to and including table 13 was inadvertently omitted from the final version. Therefore, it is recommended that the Corporate Infrastructure & Regulatory Services Scrutiny Committee recommends that Cabinet approves the version attached at Appendix 1 to correct the previous omission.

6.2. The Medium Term Financial Strategy assumes that, over the three year period, no new long-term borrowing will be required. This is still envisaged to be the case, although this will be kept under review.

6.3. The PWLB policy of imposing premium penalties for the early repayment of long term debt means there is little potential to repay further debt during the current financial year.

6.4. Forecasting future interest rates is difficult as the factors affecting interest rate movements are outside of the Council's control. Whilst short term rates are generally linked to the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. The County Council retains an external advisor, Link Asset Services (formerly Capita), who forecast future rates several years forward. Similar information is received from a number of other sources.

6.5. For 2019/20, the Council set a prudent target rate for lending to bank and building society deposits of 0.75%, with a target rate for the investment in the CCLA Property Fund of 4.5%. The 0.75% target rate took into account the August 2018 increase in the Bank of England base rate, which has resulted in increased rates being available compared to those available before the increase. However, it made no allowance for any further increases. Given the extension of the Brexit date to 31 October, there seems less likelihood of there being any capacity for further rate increases to have an impact on interest achieved in 2019/20. Link Asset Services are now forecasting an increase in the base rate up to 1.00% in March 2020, while other commentators expect that it will be much longer before a further increase takes place. It is anticipated that the budgeted income target of £1.6 million will be achieved. At this stage no action has been taken to implement any permitted non-specified investments, other than the £10m allocation to the CCLA Property Fund.

7. Summary

7.1. No long term or short-term borrowing was undertaken during 2018/19. It is not envisaged that any new long-term borrowing will be required over the next three year period but this will be reviewed annually.

7.2. No opportunities arose during the 2018/19 financial year to repay outstanding debt without incurring substantial premium penalties, which would negate the benefit of repaying the debt.

7.3. Investment income of £2.027 million was achieved in 2018/19 against a full year budget of £1 million. This represented a return of 0.97%, including the Property Fund investment. Successful prudent management of the Council's short-term cash reserves has delivered a surplus of £1.027 million for the 2018/19 financial year.

Mary Davis

Electoral Divisions: All
Local Government Act 1972
List of Background Papers - Nil
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Appendix 1

Treasury Management Strategy 2019/20 – 2021/22 and Prudential Indicators 2019/20 - 2023/24

Introduction

In February 2018, following the publication of a revised Code of Practice for Treasury Management by the Chartered Institute of Public Finance and Accountancy (CIPFA), the Council adopted a revised Treasury Management Policy Statement together with a statement of its 'Treasury Management Practices' (TMPs). No changes are proposed to these policies for 2019/20.

The policy requires the Council to consider a treasury strategy report, setting out the strategy and plans to be followed in the coming year, as part of the budget process. The key changes to the strategy in comparison with 2018/19 are changes to the policy for Minimum Revenue Provision (MRP) for the repayment of debt, and the addition of short dated bond funds and multi-asset income funds to the Strategy.

The Treasury Management Strategy sets out the County Council's policies in relation to: the management of the Council's cashflows, its banking, money market and capital market transactions; borrowing and investment strategies; monitoring of the level of debt and funding of the capital programme. The Treasury Management Strategy should be read in conjunction with the Capital Strategy.

The County Council is required to monitor its overall level of debt in line with the national code of practice drawn up by CIPFA. Part of this code requires consideration of a set of "prudential indicators" in order to form a judgement about the affordable, prudent and sustainable level of debt.

The prudential indicators, treasury management strategy and the annual investment strategy have been reviewed in line with the Capital Programme 2019/20 – 2023/24, and the Capital Strategy.

This Treasury Management Strategy document sets out:

- Minimum revenue provision;
- Capital expenditure funding;
- Prudential indicators on the impact of capital financing and monitoring of the level and make-up of debt;
- The current treasury position, debt and investments;
- Prospects for interest rates;
- The borrowing strategy; and
- The investment strategy.

Appendix 1

Treasury Management and Investment Strategy Overview

The Treasury Management and Investment Strategy sets out the MRP policy, capital expenditure funding, prudential indicators, the current treasury position, debt and investments; prospects for interest rates; the borrowing strategy; and the investment strategy.

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. Capital expenditure new starts have been limited to those that were financed from sources other than external borrowing. To meet the need for capital expenditure, the highest priority schemes across the Authority are funded from corporate capital receipts over the capital programme timescale.

The ability of the Council to repay further debt will depend on the cost of repayment and the availability of cash to fund the repayment. Under their current policy the Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB imposes premium penalties for early repayment. Current interest rate forecasts suggest that it is extremely unlikely that gilt yields will rise sufficiently to cancel out the premiums in the medium term.

With the Council continuing to face significant budget pressures, officers have been looking at whether the Treasury Management Strategy can be enhanced to provide the opportunity to gain higher returns on the investment of the Council's cash balances. This also takes into account that the Council now has a higher level of cash balances than it has had over the last 5 years. As a result, the proposed strategy includes the ability for the Council to invest in short-dated bond funds and multi-asset income funds. Short dated bond funds will invest in high quality short dated government or corporate bonds. Multi-asset income funds will invest in a wider range of investments designed to produce an income yield. In both cases, the funds concerned will invest in tradable instruments where the capital value of the investment will fluctuate.

Higher yielding investments will inevitably mean that there is an increased risk of loss of capital. However, given that cash balances are at a higher level than previously forecast, it may make sense to invest a small proportion of the Council's cash in higher yielding investments. In addition, Parliament has provided a statutory override, such that any capital gains or losses will not need to be accounted for in the general fund until the investments are realised, or until March 2023, when the statutory override ends. These would need to be seen as longer term investments, and by looking at the longer term the risk of capital loss would be mitigated.

Before any investment is made in either short-dated bond funds or multi-asset income funds a rigorous process will be undertaken to identify which funds would best meet the Council's requirements. Any allocations would only then be made in full consultation with the Cabinet Member for Resources Management. Officers are also investigating other ways to make savings by better use of the Council's cash balances, and will report back on any further initiatives during the year.

Following the Bank of England's decision to increase the base rate to 0.75% in November, the target return for 2019/20 for deposits with banks and building societies has been increased from 0.55% to 0.75% as banks and building societies have started to increase their rates. The target rate for the CCLA Property Fund will remain at 4.50%. Should investments be agreed in the other non-specified investments identified in the strategy then the targeted yield from those funds would be 2.00% for short dated bond funds and 3.50% for multi-asset income funds.

Minimum Revenue Provision

Minimum Revenue Provision (MRP) is a charge to the authority's revenue account to make provision for the repayment of the authority's external debt and internal borrowing. The authority has a statutory obligation to charge to the revenue account an annual amount of MRP.

In 2015/16 the authority changed from the 4% method of calculating MRP to the 'Asset Life: Equal Instalment method' which delivered significant revenue savings. MRP therefore, is currently calculated by dividing the existing debt over the estimated life of the asset on a straight-line basis. This means that each financial year the charge to the Council for existing debt is the same and does not change.

The authority has the option, under existing regulations, to apply the 'Asset Life: Annuity Method' instead of the equal instalment or 'straight-line' method. The annuity method reflects the fact that an assets deterioration is slower in the early years of its life and accelerates towards the latter years.

It is arguably the case that the annuity method provides a fairer charge than equal instalments, as it considers the time value of money; whereby paying £100 in 10 years' time is less of a burden than paying £100 today.

In order to calculate MRP under the Annuity method, an appropriate annuity rate needs to be selected. The percentage chosen corresponds with the Monetary Policy Committee's inflation target rate of 2.1%. MRP will increase by this percentage each year. By implementing this revised policy in 2018/19 the authority will deliver revenue savings of £3.925 millions, and a further £3.803 millions in 2019/20.

Switching from the Asset Life to Annuity method will have no impact on total amount debt set aside for the repayment of debt. MRP will still cover all existing debt repayments, including internal borrowing commitments.

Overall the total MRP to be set aside, and total debt repaid, will not alter. The revision in policy is a re-phasing; something akin to debt rescheduling.

The authority's MRP strategy is to charge all elements based on the period of benefit of the capital investment i.e. over the life of the asset.

All supported capital expenditure and unsupported borrowing up to 1st April 2008 will be charged over the life of the assets, calculated using the Annuity method.

Any unsupported (internal) borrowing post 1 April 2008 (including Vehicle and Equipment Loans Pool), Capitalisation Direction and charges to other public sector bodies will be charged over the life of the asset, on a straight line basis. The annuity method will not be applied to projects financed from internal borrowing, as this source of financing is applied to a wider range of projects with differing lives. Therefore, the existing equal instalment method is a more appropriate method of calculating MRP.

We will not provide for MRP in circumstances where the relevant expenditure is intended to be financed from external contingent income, where it has not yet been received but where we conclude that it is more probable than not that the income will be collected, for example when forward funding S106 contributions.

Capital financing costs are also affected by PFI contracts and finance leases coming 'on Balance Sheet'. The MRP policy for PFI contracts will remain unchanged, with MRP being charged over the period of benefit of the capital investment i.e. over the life of the asset.

The main Prudential Indicator to measure the acceptable level of borrowing remains the ratio of financing costs to total revenue stream. The figures for MRP shown in table 6 reflect the adoption of this strategy.

Appendix 1

Capital Expenditure

Table 1 shown below, summarises the Capital Programme and liabilities from capital projects that will appear on the balance sheet in future years. The Capital Programme has been tested for value for money via option appraisal and for prudence, affordability and sustainability by looking at the impact that the proposed Capital Programme has on the revenue budget and through the Prudential Indicators.

Table 1 – Capital Expenditure

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Total Capital programme	**110,900**	**103,225**	**101,643**	**97,145**	**68,531**
Funded by:					
Gross borrowing	6,112	11,401	6,126	3,179	1,500
Other capital resources	104,788	91,824	95,517	93,966	67,031
Total capital programme funding	**110,900**	**103,225**	**101,643**	**97,145**	**68,531**
Total capital expenditure	**110,900**	**103,225**	**101,643**	**97,145**	**68,531**

Prudential Indicators

Capital Financing Requirement

The Capital Financing Requirement represents the Council's underlying debt position. It shows the previous and future spend for capital purposes that has been or will be financed by borrowing or entering into other long term liabilities. The Capital Financing Requirement and debt limits will be higher than the Council's external debt, as they will be partly met by internal borrowing from the Council's internal cash resources. This reduces the cost of the required borrowing, but the Council also needs to ensure that a prudent level of cash is retained.

The forecast Capital Finance Requirement for 2019/20 and the following four years are shown in table 2 below.

Table 2 – Capital Financing Requirement

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Underlying borrowing requirement	613,096	619,209	622,375	623,862	652,166
Other long-term liabilities	128,637	123,888	118,485	112,918	106,854
Capital financing requirement	**741,732**	**743,097**	**740,860**	**736,780**	**759,020**

Limits to Debt

The Authorised Limit represents the level at which the Council is able to borrow and enter into other long term liabilities. Additional borrowing beyond this level is prohibited unless the limit is revised by the Council. Table 3 details the recommended Authorised Limits for 2019/20 – 2023/24.

Table 3 – Authorised Limits

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Authorised limits for borrowing	648,096	654,209	657,375	658,862	687,166
Authorised limit for other long-term liabilities	128,637	123,888	118,485	112,918	106,854
Authorised limit for external debt	**776,732**	**778,097**	**775,859**	**771,780**	**794,020**

The Operational Boundary is based on the anticipated level of external debt needed during the year. Variations in cash flow may lead to occasional, short term breaches of the Operational Boundary that are acceptable. Sustained breaches would be an indication that there may be a danger of exceeding the Authorised Limits. Table 4 details the recommended Operational Boundaries for 2019/20 and following years.

Table 4 - Operational Limits

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Operational limits for borrowing	623,096	629,209	632,375	633,862	662,166
Operational limit for other long-term liabilities	128,637	123,888	118,485	112,918	106,854
Operational limit for external debt	**751,732**	**753,097**	**750,860**	**746,780**	**769,020**

The forecast opening balance for External Borrowing at 1 April 2019 is £507.85 million and remains unchanged at 31 March 2020.

The Council also needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement. Table 5 details the Capital Financing Requirement against the total gross debt plus other long term liabilities. The level of under borrowing reflects the use of internal borrowing from the Council’s internal cash resources.

Table 5 – Underlying Borrowing Requirement to Gross Debt

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Capital financing requirement	741,732	743,097	740,860	736,780	759,020
Gross borrowing and other long-term liabilities	636,487	631,738	626,335	620,769	614,706
Under/ (over) borrowing	**105,246**	**111,360**	**114,525**	**116,011**	**144,314**

The debt management strategy and borrowing limits for the period 2019/20 to 2023/24 have been set to ensure that over the medium term net borrowing will only be for capital purposes.

Ratio of Financing Cost to Net Revenue Stream

Table 6 below shows the relationship between Capital Financing Costs and the Net Revenue Stream for 2019/20 and future years. Financing cost is affected by Minimum

Revenue Provision (MRP), interest receivable and payable and reductions in other long term liabilities.

Table 6 – Ratio of Financing Costs to Net Revenue Stream

	2019/20 Estimate £'000	2020/21 Estimate £'000	2021/22 Estimate £'000	2022/23 Estimate £'000	2023/24 Estimate £'000
Minimum revenue provision	12,685	12,692	12,547	12,754	13,072
Interest payable	26,017	26,017	26,017	26,017	26,017
Recharges and other adjustments	(325)	(478)	(625)	(799)	(1,027)
Interest receivable	(1,600)	(1,600)	(1,600)	(1,600)	(1,600)
Capital financing cost (excluding other long-term liabilities)	36,777	36,631	36,339	36,372	36,462
Capital financing costs of other long-term liabilities	15,362	14,625	14,901	14,636	14,689
Capital financing costs including other long-term liabilities	52,139	51,256	51,240	51,008	51,151
Estimated net revenue stream	**509,988**	**539,870**	**538,435**	**541,775**	**541,775**
Ratio of financing costs (excluding other long term liabilities) to net revenue stream	**7.21%**	**6.79%**	**6.75%**	**6.71%**	**6.73%**
Ratio of financing costs (including other long-term liabilities) to net revenue stream	10.22%	9.49%	9.52%	9.41%	9.44%

Treasury Management Prudential Indicators

Where external borrowing is required it can either be at fixed or variable rates of interest, and can be taken out for periods from a year to 50 years. The use of prudential indicators seeks to reduce the risks associated with fixed and variable interest rate loans and with borrowing for different loan periods.

Borrowing at fixed rates of interest for long periods can give the opportunity to lock into low rates and provide stability, but means that there is a risk of missing possible opportunities to borrow at even lower rates in the medium term. Variable rate borrowing can be advantageous when rates are falling, but also means that there is a risk of volatility and a vulnerability to unexpected rate rises.

Borrowing for short periods or having large amounts of debt maturing (and having to be re-borrowed) in one year increases the risk of being forced to borrow when rates are high.

The Council's policy has been to borrow at fixed rates of interest when rates are considered attractive.

The proposed Prudential Indicators for 2018/19 and beyond are set out in Table 7.

Table 7 – Treasury Management Prudential Indicators

Prudential Indicators	Upper Limit %	Lower Limit %
Limits on borrowing at fixed interest rates	100	70
Limits on borrowing at variable interest rates	30	0
Percentage of Fixed Rate Debt maturing in:		
Under 12 months	20	0
12 Months to within 24 months	25	0
24 Months to within 5 Years	30	0
5 years and within 10 Years	35	0
10 years and within 20 years	45	0
20 years and within 35 years	60	0
35 years and within 50 years	75	20

The limits have been set taking into account the CIPFA Code of Practice which requires that the maturity date for LOBO (Lender Option Borrower Option) loans is assumed to be the next call date, rather than the total term of the loan. This will apply to the Council's Money Market loans.

Monitoring the Indicators

It is important to monitor performance against forward looking indicators and the requirement that borrowing should only be for capital purposes. The total level of borrowing will be monitored daily against both the operational boundary and the authorised limit. If monitoring indicates that the authorised limit will be breached, a report will be brought to the Cabinet outlining what action would be necessary to prevent borrowing exceeding the limit and the impact on the revenue budget of breaching the limit. It will be for the Cabinet to make recommendations to the County Council to raise the limit if it is felt appropriate to do so.

The indicators for capital expenditure, capital financing requirement, capital financing costs and the treasury management indicators will be monitored monthly. Any significant variations against these indicators will be reported to the Cabinet.

Analysis of Long Term Debt

The following Table 8 shows the County Council's fixed and variable rate debt as at 31 March 2018 and 31 December 2018 (current).

The interest rates shown do not include debt management costs or premiums/discounts on past debt rescheduling.

There has been no movement in the Council's external debt over the last financial year, as no new borrowing has been required and no further opportunities have arisen to repay debt.

Table 8 – Analysis of Long Term Debt

	Actual 31.03.18 £'m	Interest Rate %	Current 31.12.18 £'m	Interest Rate %
Fixed Rate Debt				
PWLB	436.35	4.99	436.35	4.99
Money Market	71.50	5.83	71.50	5.83
Variable Debt				
PWLB	0.00		0.00	
Money Market	0.00		0.00	
Total External Borrowing	**507.85**	**5.11**	**507.85**	**5.11**

Schedule of Investments

The following schedule shows the County Council's fixed and variable rate investments as at 31 March 2018 and as at 31 December 2018 (current).

Table 9 – Schedule of Investments

	Maturing in:	Actual 31.03.18* £'m	Interest Rate %	Current 31.12.18* £'m	Interest Rate %
Bank, Building Society and MMF Deposits					
Fixed Rates					
Term Deposits	< 365 days	107.50	0.73	137.50	0.96
	365 days & >	10.00	0.75	10.00	1.00
Callable Deposits					
Variable Rate					
Call Accounts		27.02	0.40	0.00	
Notice Accounts		5.00	1.05	12.50	1.01
Money Market Funds (MMFs)		30.00	0.46	22.45	0.75
Property Fund		10.00	4.42	10.00	4.25
All Investments		**189.52**	**0.84**	**192.45**	**1.06**

The Council's cash balance available for investment varies during the year, with the balance building up during the first half of the financial year, and then tapering down towards the end of the financial year. It is now anticipated that the cash balances at 31st March 2019 will be lower than those at the start of the year.

The recent investment performance of the County Council's cash has been affected by the low interest rates introduced as part of the measures used to alleviate the global credit crunch. Interest rates have also been impacted by the introduction of new banking regulations requiring banks to hold higher levels of liquidity to act as a buffer.

* The figures as at 31 March 2018 and 31 December 2018 include respectively around £12.8m and £11.6m related to the Growing Places Fund (GPF). Devon County Council has agreed to be the local accountable body for the GPF, which has been established by the Department for Communities and Local Government to enable the development of local funds to address infrastructure constraints, promoting economic growth and the delivery of jobs and houses. The Council is working in partnership with the Local Economic Partnership, and interest achieved on the GPF cash, based on the average rate achieved by the Council's investments, will accrue to the GPF and not to the County Council.

The rates on offer increased marginally during 2018/19, following the Bank of England's decision to increase the base rate up to 0.75%, but continue to be low in comparison to the past, and the returns on the County Council's cash investments are forecast to remain at low levels for the foreseeable future; however, the Treasury Management Strategy will continue to ensure a prudent and secure approach.

Prospects for Interest Rates

Forecasting future interest rate movements even one year ahead is always difficult. The factors affecting interest rate movements are clearly outside the Council's control. Whilst short term rates are influenced by the Bank of England's Base Rate, long term rates are determined by other factors, e.g. the market in Gilts. Rates from overseas banks will be influenced by their national economic circumstances. The County Council retains an external advisor, Link Asset Services, who forecast future rates several years forward. Similar information is received from a number of other sources.

Following a flow of generally positive economic statistics after the quarter ended 30 June 2018, the Bank of England's Monetary Policy Committee (MPC) came to a decision on 2 August 2018 to make the first increase in Bank Rate above 0.5% since the financial crash, from 0.5% to 0.75%. At their November meeting, the MPC left Bank Rate unchanged, but expressed some concern at the Chancellor's fiscal stimulus in his Budget, which could increase inflationary pressures.

Link Asset Services are forecasting that the overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently, with the market pricing in the next rise in base rate, up to 1.0% for around May 2019, followed by increases in February and November 2020, before ending up at 2.0% in February 2022. These forecasts are summarised in the following Table 10.

Table 10 – Base Rate Forecasts and PWLB Rates

Base Rate Forecasts	**Dec (act) 2018**	**March 2019**	**June 2019**	**Sep 2019**	**Dec 2019**	**March 2020**
Link Asset Services	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%
Capital Economics	0.75%	0.75%	1.00%	1.25%	1.50%	1.50%

PWLB Rates	**Dec (act) 2018**	**March 2019**	**June 2019**	**Sep 2019**	**Dec 2019**	**March 2020**
Link Asset Services forecast						
10 Year	2.50%	2.50%	2.60%	2.60%	2.70%	2.80%
25 Year	2.85%	2.90%	3.00%	3.10%	3.10%	3.20%
50 Year	2.58%	2.70%	2.80%	2.90%	2.90%	3.00%

However, these forecasts are based on a smooth transition for Brexit. The economic outlook will depend significantly on the nature of EU withdrawal, in particular the form of new trading arrangements, the smoothness of the transition to them and the responses of households, businesses and financial markets. The Bank of England has stated that its response to Brexit could be to shift policy in either direction. It could cut rates if it sees a disorderly Brexit damaging economic growth, but might be forced to hike rates if there is a run on the pound.

As a result, economic and interest rate forecasting remains difficult. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.

When budgeting for interest payments and receipts a prudent approach has been adopted to ensure that, as far as is possible, both budgets will be achieved.

Borrowing Strategy 2019/20 – 2021/22

The overall aims of the Council's borrowing strategy are to achieve:

- Borrowing at the lowest rates possible in the most appropriate periods;
- The minimum borrowing costs and expenses; and
- A reduction in the average interest rate of the debt portfolio.

Since 2009 the Council has followed a policy of containing the capital programme, taking out no new external borrowing and repaying debt whenever this can be done without incurring a financial penalty. This strategy has worked well in a period of austerity. The Council's external borrowing level has reduced by £102m since 2008/09, resulting in reduced Capital Financing Charges.

The capital programme continues to include new starts funded by grants or capital receipts but with no requirement for new external borrowing. There is no expectation that government funding will deviate from its current downward trajectory. The authority faces significant challenges in balancing its revenue budget in the coming years and it is therefore difficult to imagine how significant additional borrowing could be financed. As a result, the Medium Term Financial Strategy (MTFS) continues to assume that, over the three year period, no new long-term borrowing will be required, although this will be kept under review.

The potential to repay further debt, or refinance debt at lower rates, will continue to be closely monitored. The ability of the Council to repay further debt will depend on the cost of repayment and the availability of cash to fund the repayment.

The loans in the Council's current debt portfolio all have maturity dates beyond 2027. Under their current policy the Public Works Loan Board (PWLB) sets premature repayment rates, and where the interest rate payable on a current loan is higher than the repayment rate, the PWLB imposes premium penalties for early repayment. With current low rates of interest this would be a significant cost which would impair the benefit of repayment. Therefore, it will only make financial sense to repay debt early if the PWLB changes its current policy, or if interest rates rise and cancel out the repayment premiums. Current interest rate forecasts suggest that it is extremely unlikely that gilt yields will rise sufficiently to cancel out the premiums in the medium term.

It is forecast that as at 31 March 2019 the Council will have cash balances of around £160m. A prudent level of balances is required to meet cashflow. In addition, the cash balances will in part be made up of earmarked reserves and will therefore be committed to meeting Council expenditure. However, the level of cash balances would enable early repayments to be considered, should interest rates rise sufficiently to cancel out the premiums.

If short-term borrowing is required to aid cashflow, this will be targeted at an average rate of **0.6%**.

Investment Strategy 2019/20 – 2021/22

The County Council continues to adopt a very prudent approach to its investments. The majority of investments will be "Specified Investments" as defined by the Ministry of Housing, Communities and Local Government (MHCLG), For such investments, only a small number of selected UK banks and building societies, money market funds and Non-Eurozone overseas banks in highly rated countries are being used, subject to strict criteria and the prudent management of deposits with them. The lending policy is kept under constant review with reference to strict criteria for inclusion in the counterparty list. In addition, non-specified investments are included in the strategy, including the potential to invest in property funds, short-dated bond funds and multi-asset income funds.

The Treasury Management Strategy will continue to be set to ensure a prudent and secure approach.

The full County Council is required under the guidance in the CIPFA Treasury Management Code of Practice to approve an Annual Investment Strategy.

The overall aims of the Council's strategy continue to be to:

- Limit the risk to the loss of capital;
- Ensure that funds are always available to meet cash flow requirements;
- Maximise investment returns, consistent with the first two aims; and
- Review new investment instruments as they come to the Local Authority market, and to assess whether they could be a useful part of our investment process.

The overriding objective will be to invest prudently, with priority being given to security and liquidity before yield.

The outlook for cash investment remains challenging. Whereas in the past there has been a perception that Governments would not allow banks to fail, the current regulatory environment puts more emphasis on the requirement for investors to take a hit by funding a "bail-in". A bail-in is where the bank's creditors, including local authorities depositing money with them, bear some of the burden by having part of the debt they are owed written off. The balance of risk has therefore changed, and as a result the Council has considered alternative forms of investment in order to diversify its risk.

Under the Markets in Financial Instruments (MiFID II) directive, local authorities are now classed as retail clients by the Financial Conduct Authority (FCA). This has implications for the range of investments that are available to local authorities. While bank and building society deposits are unaffected by the new regulations, some banks have determined that they will only take term deposits from professional clients, and a range of alternative forms of investments are only available to professional clients. However, if the local authority meets criteria set by the FCA, then it can apply to the financial institutions with which it wishes to invest to request that the institution concerned "opts up" the local authority to elective professional client status. The Council has made applications and been opted up to elective professional client status where required.

Those counterparties who have confirmed that they will treat the Council as a professional client under the MiFID II regulations are set out in Table 11 below.

Table 11 – Counterparties that have "opted up" the Council to elective professional client status

Counterparty	Counterparty Type
Standard Chartered	UK Bank
Commomwealth Bank of Australia	Overseas Bank
CCLA	Property Fund
Aberdeen Standard	Money Market Fund
Insight	Money Market Fund

In addition, brokers Tradition and Tullett Prebon, and our treasury advisors, Link Asset Services, have opted up the Council to professional client status. The majority of bank and building society deposits are unaffected by the MiFID II regulations.

Subject to the MiFID II regulations, a variety of investment instruments are available to the Local Authority market. In addition to the notice accounts and fixed term deposits available from UK and overseas banks, it is also possible for the Council to invest, for example, in UK Government Gilts, bond funds and property funds. These alternative instruments would either require the Council to tie up its cash for significantly longer periods, thus reducing liquidity, or would carry a risk of loss of capital if markets go down. The Council has considered these alternatives and concluded that investment in a range of different funds should be permitted within the Treasury Management Strategy.

The Investment Strategy will be split between "Specified Investments", which meet criteria specified in guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG), and a range of longer term "Non-specified Investments".

Specified Investments

Specified Investments will be those that meet the criteria in the MHCLG Guidance, i.e. the investment:

- is sterling denominated;
- has a maximum maturity of 1 year;
- meets the "high credit quality" as determined by the Council or is made with the UK government or is made with a local authority in England, Wales Scotland or Northern Ireland or a parish or community council; and
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

Appendix 1

Specified Investments will include bank and building society deposits. Security is achieved by the creation of an 'Approved List of Counterparties'. These are the banks, building societies, money market funds and other public bodies with whom we are prepared to deposit funds. In preparing the list, a number of criteria will be used not only to determine who is on the list, but also to set limits as to how much money can be placed with them, and how long that money can be placed for.

Banks are expected to have a high credit rating. The Council uses the ratings issued by all three of the major credit rating agencies, Fitch, Moody's and Standard & Poor's, made available to the Council through its external Treasury Advisors. These are monitored daily.

The lowest rating published by any of the agencies is used to decide whether an institution is eligible for inclusion. Where the counterparty is only rated by two of the major ratings agencies the lowest rating published by either of the two is used. This rating also determines the maximum amount which can be loaned to an individual counterparty. Non-Eurozone overseas banks that meet the criteria are included from countries with a high Sovereign rating.

The time length of all deposits with financial institutions will be managed prudently, taking account of the latest advice from the Council's external advisors.

Money Market Funds have a portfolio comprised of short-term (less than one year) securities representing high-quality, liquid debt and monetary instruments. Following the financial crisis these funds were seen as higher risk and were therefore not used by the Council. However, the new regulatory environment around the concept of "bail-in" means that many money market funds are now regarded as a more secure form of investment than bank deposits, as they diversify their investments across a range of financial institutions to spread the risk, and will therefore be used where appropriate.

Money market funds must have an 'AAA' rating to be included on the counterparty list. They may be CNAV (Constant Net Asset Value), LVNAV (Low Volatility Net Asset Value) or VNAV (Variable Net Asset Value). Yields and prices will be monitored on a daily basis to ensure that there is minimal risk of loss of capital.

Other public sector bodies are principally arms of Government, or other local authorities, and although not rated are deemed suitable counterparties because of their inherent low risk.

The 'Approved List of Counterparties' specifies individual institutions and is formally reviewed at least monthly. Notification of credit rating downgrades (or other market intelligence) is acted upon immediately, resulting in any further lending being suspended.

Table 12 below summarises the current 'Approved List' criteria.

Appendix 1

Table 12 – Specified Investments Counterparty Approved List Criteria

Counterparty Type		Fitch	Moody's	Standard & Poor's	Credit Limit
UK Banks					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Building Societies					
	not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	not below	A- & F1	A3 & P-1	A- & A-1	£30 million
Non-Eurozone Overseas Banks					
	Sovereign Rating of	AAA	Aaa	AAA	
	and not below	AA- & F1+	Aa3 & P-1	AA- & A-1+	£50 million
	and not below	A- & F1	A3 & P-1	A- & A-1	£30 million
UK Public Bodies					
Central Government					
	– Debt Management Office				Unlimited
Local Government					
	– County Councils				£10 million
	– Metropolitan Authorities				£10 million
	– London Boroughs				£10 million
	– English Unitaries				£10 million
	– Scottish Authorities				£10 million
	– English Districts				£5 million
	– Welsh Authorities				£5 million
Fire & Police Authorities					£5 million
Money Market Funds		AAA	Aaa	AAA	£30 million

Where the short term rating of a counterparty is one notch below the stated criteria, but the counterparty meets the long term rating criteria, they may still be used subject to the advice of our external advisors (Link Asset Services) who will take into account a range of other metrics in arriving at their advice.

The counterparty limits shown in the table also apply at a banking group level. This ensures that the Council is not exposed to the risk of having maximum sums invested in multiple institutions owned by a group that encounters financial difficulties.

The credit ratings shown in the table for banks and building societies allow for greater sensitivity in recognising counterparty risk. Liquidity in investments is the second key factor in determining our strategy. Funds may be earmarked for specific purposes or may be general balances, and this will be a consideration in determining the period over which the investment will be made.

The Council has a self-imposed limit of ensuring that at least 15% of deposits will be realisable within one month.

The Council will look to invest in specified investments for a range of durations up to one year to ensure sufficient liquidity for cashflow purposes. Our treasury advisors, Link Asset Services, provide advice on the recommended maximum length of deposit for each of the counterparties that the Council uses, and their recommendations will be taken into account when determining the length of time that any deposit is placed for.

Non-Specified Investments

Non-specified investments are those that do not meet the criteria described above, but are intended to be a longer term investment, generating a higher yield, but with a slightly higher degree of risk.

The limit on non-specified investments will be set at no more than 25% of the total treasury investments at any time or £40m whichever is the lower.

The Council has previously decided that investment in a commercial property fund would be a prudent way to diversify risk and achieve a higher yield, as it would benefit from forecast growth in GDP. The CCLA Property Fund is therefore included as an approved counterparty, and an initial investment of £10 million was made in 2015.

In addition, short-dated bond funds and multi-asset income funds may be used. Short dated bond funds will invest in high quality short dated government or corporate bonds. Multi-asset income funds will invest in a wider range of investments designed to produce a higher income yield, but will have a higher level of risk. In both cases, funds will be targeted where the total return is likely to be higher than the income yield, to reduce the risk of capital loss should the investment need to be realised.

The Council will only use funds that are subject to a statutory override to IFRS9. Under the IFRS9 accounting standard unrealised gains and losses arising from funds previously measured as Available for Sale will now be classified as Fair Value through Profit and Loss and taken to the Comprehensive Income and Expenditure Account in the year they arise. As a result, any capital loss would impact on the yield gained from the investment.

However, Parliament has put in a statutory override for investments that fall under the following definitions:

- A money market fund;
- A collective investment scheme as defined in section 235 (1) of the Financial Services and Markets Act 2000;
- An investment scheme approved by the Treasury under section 11(1) of the Trustee Investments Act 1961 (local authority schemes)

The regulation (override) makes it clear that the revenue account should not be charged in respect of that fair value gain or loss and instead that amount should be charged to an account established, charged and used solely for the purpose of recognising fair value gains and losses in accordance with this regulation. The statutory override applies from 1st April 2018 to 31st March 2023. This reduces the risk to the Council of capital losses impacting on investment income, as any capital loss would only impact on the Council at the point that the investment is realised, or after the statutory override ends in March 2023. However, the risk of loss of capital at those points needs to be recognised, and these investments should be seen as longer-term investments.

Non-specified investments can also include bank and building society deposits of over a year, in line with the criteria set out in the section on Specified Investments.

Table 13 below summarises the 'Approved List' criteria for non-specified investments.

Table 13 – Non-Specified Investments Counterparty Approved List Criteria

Counterparty Type	Credit Limit
CCLA Property Fund	£30 million
Short-dated bond funds	£20 million
Multi-asset income funds	£20 million
Bank and Building Society Deposits over 1 year (meeting credit rating criteria as per Specified Investments)	£30 million

Where a bank or building society is considered for an investment of over one year, the credit limit will be applied to the total investments with that institution, including specified and non-specified investments, i.e. deposits above and below one year.

Interest Rate Targets

For the 2019/20 financial year it has been assumed that the average interest rate earned on lending to banks and building societies will be **0.75%** p.a. The target rate takes into account the November 2018 increase in the Bank of England base rate, which has resulted in increased rates being available compared to those available before the increase.

The yield from investment in the CCLA Property Fund is assumed to be **4.50%**. Further analysis will be required to identify short-dated bond funds and multi-asset income funds that would meet the Council's requirements. The targeted yield from those funds would be **2.00%** for short dated bond funds and **3.50%** for multi-asset income funds. Currently these are not factored into the budget for investment income.

The targets we have set for 2019/20 are considered to be achievable.

Given the degree of uncertainty about future economic prospects and the future level of interest rates, MTFS forecasts have been based on the average rates for lending to banks and building societies continuing to be 0.75% for 2020/21 and 2021/22. However, these will be reviewed in the light of changes to the rates on offer from the Council's counterparties over the MTFS period.

Investments that are not part of treasury management

The revised Treasury Management Code also requires the authority to report on investments in financial assets and property that are not part of treasury management activity, but where those investments are made primarily to achieve a financial return.

The Council does not currently have a policy of making commercial investments outside of its treasury management activity for mainly financial reasons. All capital investments outside of treasury management activities are held explicitly for the purposes of operational services, including regeneration, and are monitored through existing control frameworks.

The Authority does not generally invest in equity shares but does have two £1 shares in NPS (SW) Ltd, valued at £247,000 and an equity investment in Exeter Science Park Ltd to £1.881 million. At 31 March 2018 these shares were recognised in the balance sheet at £2.128 million. However, these are not held as financial investments, but for the purposes of providing operational services, including economic regeneration.

Performance Targets

The primary targets of the Treasury Management Strategy are to minimise interest payments and maximise interest receipts over the long term whilst achieving annual budgets, without taking undue risk. Where there are comparative statistics available for individual aspects of the Strategy these will be used to monitor performance. The Council will continue to review best practice at other authorities and work with its treasury advisors (Link Asset Services) to assess performance.