

Appendix 4

Extract from WCC Treasury Management Strategy 2018/9

Background

In accordance with the County Council's Treasury Management Practices (TMPs) and The Chartered Institute of Public Finance and Accountancy's (CIPFA) Treasury Management in the Public Services: Code of Practice the Council is required to approve the Treasury Management Strategy and Annual Investment Strategy for 2018/19. The Treasury Management Strategy is reflected in the Personal Assurance Statement given by the Chief Financial Officer concerning the 2018/19 budget calculations.

Treasury management is undertaken by a small team of professionally qualified staff within financial services.

In addition the County Council employs Treasury Management advisors, Link Asset Services (formally Capita Asset Services), who provide information and advice on interest rate movements which is used to inform borrowing and investment decisions. The advisors have been engaged on a fixed term basis after a tendering procedure completed in August 2016.

Relevant information is also obtained from other financial commentators, the press and seminars arranged by other organisations, for example CIPFA and the Local Government Association.

Information received from these different sources is compared in order to ensure all views are considered and there are no significant differences or omissions from information given by the County Council's advisors.

All Treasury Management employees take part in the County Council's Staff Review and Development scheme, where specific individual development needs are highlighted training in Treasury Management activities and networking opportunities provided by both professional and commercial organisations are taken up where appropriate.

During 2018/19 the County Council has invested its surplus cash with selected Banks, AAA-rated Money market and cash-plus funds, the UK Debt Management Office and with other local authorities.

Economic Commentary

The Monetary Policy Committee, (MPC), increased the Bank Rate from 0.25% to 0.75% in August as it perceived increased inflationary risk, due to the perceived closing of the output gap, however the Bank of England has indicated that subsequent rises will be slow and gradual, with material risk of a pause or reversal of monetary tightening:

There is considerable uncertainty surrounding the circumstances of the UK's exit from the EU, scheduled for the 29th March 2019. A positive outcome with regards to market access and movement of goods and services could lead to accelerated growth and domestically generated inflation (from wage growth etc.) and possibly bring forward rate rises. However a no-deal scenario could have a broadly negative impact on activity and growth and may cause the Bank of England to re-enact a looser monetary policy.

On top of this there is potential for a Global slowdown precipitated by, amongst other things the ongoing US trade war with China and the US Government shutdown – both factors have led to rapid falls in share prices during the final quarter of 2018.

With the above in mind, Economic and interest rate forecasting with a reasonable degree of confidence remains virtually impossible. 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. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

Our Treasury Management Advisors, Link Asset Services continue to forecast gradual increases in rates (see below), however there is a considerable downside risk to this forecast:

| Link Asset Services Interest Rate View | | | | | | | | | | | | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| | 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% | 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 | 0.90% | 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 | 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 | 1.20% | 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 | 2.10% | 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% | 2.60% | 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% | 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% | 2.80% | 2.90% | 2.90% | 3.00% | 3.10% | 3.10% | 3.20% | 3.20% | 3.30% | 3.30% | 3.40% | 3.40% |

Treasury Management Strategy

The Prudential Code for Capital Finance requires the Council to set a number of Prudential Code Indicators. The Treasury Management Strategy has been developed in accordance with these indicators.

Borrowing Strategy

PWLB rates and gilt yields rose sharply in the wake of the June General Election and the September MPC meeting, otherwise rates have remained volatile, with no discernible trend. It is likely that volatility could continue to occur for the foreseeable future, with the balance of risks generally biased to the downside; with political turmoil exerting downward pressure, but inflation and debt concerns exerting upward pressure.

The overall balance of risks to economy in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation. Rates on loans of 5 years are expected to be around 2.20%, while rates on longer term loans are expected to be around 2.90% by the middle of 2019/20. The County Council has assumed a borrowing rate for 2018/19 of 3.10% in setting the budget, with a working assumption to borrow halfway through the year. For medium-term planning purposes the County Council has assumed borrowing rates of 3.10% in 2019/20, 3.30% in 2020/21 and 3.30% in subsequent years. This is in-line with Link Asset Services' forecast for borrowing rates during Quarter 3 of each of those years.

The County Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with external debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure.

The strategy will be to borrow in order to replenish a proportion of the reserves and cash balances used to support capital expenditure since October 2008. This will mitigate any interest rate risk in that borrowing and will be taken before borrowing rates increase significantly. The timing of the borrowing will depend on cashflow requirements and forecast future developments and on interest rate movements and the forecast for those future movements. A mixture of shorter and longer-term loans will be taken in order to fit with the County Council's debt maturity profile.

This is the same situation for the Fire Authority

Annual Investments Strategy

The County Council's Investment Strategy has been drawn up having regard to both the Communities and Local Government's Guidance on Local Authorities Investments and the CIPFA Treasury Management in Public Services Code of Practice and CIPFA Cross-Sectoral Guidance Notes. This strategy will be revised and presented to Council if changes occur outside those envisaged within this strategy.

The policy objective for the County Council is the prudent investment of its cash balances. The investment priorities are firstly the security of capital (protecting sums from capital loss) and secondly the liquidity of investments (ensuring cash is available when required). Only when these two priorities are met will the third, of achieving the optimum return on investments, be taken into account.

The County Council will not borrow money purely to invest. The County Council will only borrow up to 12 months in advance of cash being required to fund its capital expenditure and the amount borrowed will not exceed the annual borrowing requirement.

The investments, which the County Council is able to use for the prudent

management of cash balances are categorised as 'Specified Investments' and 'Non-Specified Investments'.

A Specified Investment offers high security and high liquidity, must be in sterling and have a maturity date of less than a year. Any Specified Investment must be with the United Kingdom Government, a local authority in England or Wales or a similar body in Scotland or Northern Ireland, a parish or community council, a AAA-rated Money Market Fund, a bank which is part-owned by the UK Government, or with a body of high credit quality. The County Council defines a body of high credit quality as counterparties who satisfy the criteria as described below:

- ☐ For overnight investments, or money placed in instant access accounts, the council defines a body of high credit quality as firstly having the below Short-Term ratings:

| Agency: | Short-Term |
|--------------------|------------|
| Fitch | F1 |
| Moodys | P-1 |
| Standard and Poors | A-1 |

- ☐ For unsecured term deposits between 2 and 364 days, the council will firstly define a body of high credit quality as having the below Long-term ratings:

| Agency: | Long-Term |
|--------------------|-----------|
| Fitch | A+ |
| Moodys | A1 |
| Standard and Poors | A+ |

- ☐ The County Council will undertake continued due diligence and will not automatically lend to Counterparties that merely satisfy the above criteria. As additional consideration, the County Council will assess for each:

- ☐ Input from Treasury Advisors
- ☐ Other market data from a reputable source
- ☐ Press coverage
- ☐ Market presence by the Counterparty
- ☐ Availability of suitable products from the Counterparty
- ☐ Ease of execution with the Counterparty
- ☐ Level of Customer service from the Counterparty

□ The above list is not exhaustive, the County Council may at any time exclude a Counterparty should it perceive any reasonable doubt concerning its Creditworthiness; the 2011 Code and subsequent revisions advise that subjective criteria may be used, in line with the Council's risk appetite.

□ For secured term deposits, the council defines high credit quality as an instrument that has the above ratings with every agency that rates it.

□ Enhanced Money Market funds or Cash Plus funds, which carry a AAA-rating from at least one rating agency.

Non Specified Investments have a range of vehicles not covered by the definition of

Specified Investments, which are set out in the Treasury Management Practices (TMPs) and generally carry more risk.

The only types of non-specified investments the County Council will enter into or hold during the coming financial year are as below:

- A routine term deposit with a counterparty as described above for Specified Investments, for a period of more than 1 year. This type of investment will be considered when rates are favourable and cash balances allow. The Council's prudential indicators allow no more than £10 million to be invested in this category.
- Investments in Pooled Property Funds, these will be considered as having a 5 to 10-year term.

The credit ratings of Fitch, Moodys and Standard and Poors are monitored at least weekly, ratings watches and downgrades are acted upon immediately. Any other information that is deemed relevant to the creditworthiness of any Counterparty will be acted upon, in line with the 2009 code revision.

The County Council may hold cash within its current account overnight as a transactional control to mitigate the risk of going overdrawn and incurring penalty and interest charges. On limited occasions the County Council may also leave funds in this account when it is impractical and/or not economically feasible to invest elsewhere. These balances are considered as cash or cash equivalents and not investments.

The County Council will aim to have not less than 50% of its investments returnable within 28 days with at least 20% within 7 days.

MIFID II

The County Council has elected to opt-up to Professional Client status for most of its Counterparties, on the grounds of the typical size of its Investment portfolio and the volume of Transactions on the relevant market. This was

primarily concerned with maintaining access to the financial instruments used. A few selected Counterparties indicated that the County Council would not need to opt-up to Professional Client status to continue service.

A schedule of the County Council's status with its Counterparties (Retail or Professional) is maintained as part of the Treasury Management Practices and will be reviewed annually and/or when a counterparty is added or removed

Appendix 5

Prudential Indicators 2018/19 Out-turn

Introduction

The Prudential Code for Capital Finance in Local Authorities (Prudential Code) has been developed by the Chartered Institute of Public Finance and Accountancy (CIPFA) to provide a code of practice to underpin the system of capital finance embodied in Part 1 of the Local Government Act 2003.

The key objectives of the Prudential Code are to ensure that capital investment plans are affordable, prudent and sustainable.

The Prudential Code supports a system of self-regulation that is achieved by the setting and monitoring of a suite of Prudential Indicators that directly relate to each other. The indicators establish parameters within which the Authority should operate to ensure the objectives of the Prudential Code are met.

Recent revisions to the code have reduced the number of mandatory indicators, but the Treasurer believes that they provide useful information to the Authority so they continue to be included.

Prudential Indicators

The Prudential Indicators for which the Authority set limits are as follows:

1. Capital Expenditure

The actual amount of capital expenditure that was incurred during 2018/19 was as follows:

| | Original (Feb 2018) £m | Revised (Feb 2019) £m | Provisional Out-turn £m |
|---|------------------------------|-----------------------------|-------------------------------|
| Capital Expenditure | 11.645 | 7.925 | 6.667 |
| Revenue Expenditure for Capital Under Statute (REFCUS) | | | 1.370 |
| | 11.645 | 7.925 | 8.037 |

2. Ratio of Financing Costs to Net Revenue Stream

Financing Costs include the amount of interest payable in respect of borrowing or other long term liabilities and the amount the Authority is required to set aside to repay debt, less interest and investments income.

The actual Net Revenue Stream is the 'amount to be met from government grants and local taxation' taken from the annual Statement of Accounts, and the estimated figure is the Authority's budget net of any transfers to or from the balances.

The indicator only requires that the costs associated with capital expenditure are

measured in this way. However the Authority has used, and may continue to use Operational Leasing as a cost effective method of acquiring vehicles. In the spirit of the Prudential Code these costs are included for comparative purposes.

| | Original (Feb 2018) £m | Revised (Feb 2019) £m | Provisional Out-turn £m |
|--------------------|------------------------------|-----------------------------|-------------------------------|
| Financing Costs | 2.608 | 2.618 | 1.827 |
| Net Revenue Stream | 30.953 | 30.956 | 32.549 |
| Ratio | 8.43% | 8.46% | 5.61% |

3. Capital Financing Requirement (CFR)

The capital financing requirement is a measure of the extent to which the Authority needs to borrow to support capital expenditure. It does not necessarily relate to the actual amount of borrowing at any one point in time. The Authority arranges its treasury management activity via a Service Level Agreement (SLA) with Worcestershire County Council (WCC) which has an integrated treasury management strategy where there is no distinction between revenue and capital cash flow, and the day to day position of external borrowing and investments can change constantly.

The capital financing requirement concerns only those transactions arising from capital spending, whereas the amount of external borrowing is a consequence of all revenue and capital cash transactions combined together following recommended treasury management practice.

| | Original (Feb 2018) £m | Revised (Feb 2019) £m | Provisional Out-turn £m |
|------------------------|------------------------------|-----------------------------|-------------------------------|
| CFR at 31st March 2019 | 23.468 | 21.622 | 20.131 |

4. Authorised Limit

The Authorised Limit represents an upper limit of borrowing that could be afforded in the short term but may not be sustainable.

5. Operational Boundary

The Operational Boundary represents an estimate of the most likely, prudent, but not worst case scenario and provides a parameter against which day to day treasury management activity can be monitored.

The limits for these indicators set for 2017/18 and the final out-turn are given below, and it can be confirmed that the out-turn figure represents the maximum borrowing at any point in the year, i.e. the Authorised limit was not exceeded.

| | £m |
|---|--------|
| Authorized Limit at 31st March 2019 | 29.000 |
| Operational Boundary at 31st March 2019 | 26.000 |
| Actual Borrowing at 31st March 2019 | 10.637 |

6. Fixed Interest Rate Exposures

The Authority set an upper limit on its fixed interest rate exposures as follows:

| | £m |
|-------------------------------------|--------|
| Upper Limit at 31st March 2019 | 29.000 |
| Actual Borrowing at 31st March 2019 | 10.637 |

7. Variable Interest Rate Exposures

The Authority set an upper limit on its variable interest rate exposures, however all current borrowing is at fixed rates.

8. Maturity Structure of Borrowing

The upper and lower limits for the maturity structure of borrowings are as follows:

| | Lower Limit £m | Actual £m | Upper Limit £m |
|-------------------------------------|----------------------|---------------------|----------------------|
| Under 12 months | 0.000 | | 2.659 |
| Over 12 months but within 24 months | 0.000 | 1.500 | 2.659 |
| Over 24 months but within 5 years | 0.000 | 3.302 | 5.319 |
| Over 5 years but within 10 years | 0.000 | 0.347 | 7.978 |
| Over 10 years | 2.659 | 5.488 | 10.105 |
| | | 10.637 | |