TELFORD & WREKIN COUNCIL

AUDIT COMMITTEE – 28 JANUARY 2021
CABINET – 18 FEBRUARY 2021
COUNCIL – 4 MARCH 2021

2020/21 TREASURY UPDATE REPORT AND 2021/22 TREASURY MANAGEMENT STRATEGY

REPORT OF THE CHIEF FINANCE OFFICER (DIRECTOR: FINANCE & HUMAN RESOURCES)

LEAD CABINET MEMBER – CLLR RAE EVANS

PART A – SUMMARY REPORT

1. SUMMARY OF MAIN PROPOSALS

1.1 The report updates members on Treasury Management activities during 2020/21 to-date and details the Treasury Strategy recommended to be adopted for 2021/22.

The strategy in 2020/21 and recent years has been to limit investments in third parties, which reduces the Council's exposure to counterparty risk, and to take advantage of lower interest rates for borrowing. Maintaining high levels of very cheap temporary financing has generated surplus treasury management returns of more than £20.7m in over the past 5 years which has reduced the impact of Government cuts to the Council's grants and therefore helped to protect front line services.

In November 2020 the Public Works Loan Board (PWLB) (currently the main source of long-term lending for Local Authorities), following consultation, removed the 100 basis points increase imposed from October 2019. However, in conjunction with this the Government has also published revised lending terms for the PWLB which stipulate that PWLB loans will no longer be available to local authorities planning to buy investment assets primarily for yield. This strategy is based on the premise that the authority intends to avoid this activity in order to retain access to PWLB loans.

It should be noted that the Council's budget for 2020/21 and the Cabinet's proposals issued for consultation in January 2021 for 2021/22 include an allowance for locking in all the anticipated financing requirement at fixed interest rates that are higher than current PWLB rates for any duration (from 1 year to 50 years) which ensures that the Council's budget in relation to Treasury Management is robust. The Council will continue to receive regular advice from a firm of independent expert advisors specialising in all aspects of local government treasury management and we will act in accordance with the advice received.

The report also sets out expected external financing requirements. We have an excellent track record of complying with all the prudential indicators and limits agreed by Council and are operating well within the overall approved credit ceiling. The proportion of the Council's net revenue budget used to service loan repayment is 9.7% in the current financial year. This compares to 10.1% for the average unitary authority.

The Council has increased its external financing requirements in recent years to include investment in NuPlace which provides high quality homes for rent from a reliable landlord, mainly at market rent levels and has enabled brownfield sites to be brought back in to use. The council has also expanded the Property Investment Portfolio (the PIP) to attract and retain jobs for local people and to provide other regeneration benefits for our residents. An ancillary consequence of these investments is that it is anticipated they will bring long term capital growth which will strengthen the Council's balance sheet as well as generating revenue returns well in excess of the associated loan repayment charges. They will also bring other direct and indirect financial and other benefits to the residents of the Borough including additional income from council tax, business rates and new homes bonus which will be used to help support front line services such as Adult Social Care, as well as protecting and creating jobs for local people. The Council's solar farm generates an index linked surplus of around £200k pa which is also used to help support front line services.

This report, and the Prudential Indicators report, which will be considered by Cabinet on 18th February and Full Council on 4th March, set out our overall approach to treasury management and the controls that are put in place to ensure that council taxpayers' interests are protected and risks are managed as effectively as possible.

1.2 2020/21 TREASURY MANAGEMENT UPDATE

The treasury portfolio at the end of December 2020 showed overall net indebtedness of £242.5m (borrowing: £267.9m less investments: £25.4m). Base rates have remained at 0.10% throughout 2020/21 and are not expected to increase in the short term.

The borrowing strategy for 2020/21 is a continuation of that used for recent years which has provided considerable benefits to the Council, i.e. to:-

- take new borrowing within shorter maturities before gradually lengthening maturities, and
- take advantage of longer term loans when opportunities arise.

The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it a relatively expensive option. A HM Treasury consultation exercise on lowering PWLB rates concluded in July 2020 and new lending terms were published in November 2020. These confirmed a reduction of 1% in all Standard Rate and Certainty Rate PWLB loans but with a condition of accessing the PWLB being that local authorities will be asked to confirm that there is no intention to buy investment assets primarily for yield in the current or next two financial years.

To date in 2020/21 part of our Equal Instalment of Principal PWLB loans have matured. No new PWLB loans have been taken in 2020/21. Instead, short term borrowing has been used to fund short term cash flow requirements and take advantage of low interest rates.

As referred to above, a large part of the Council's total existing borrowing and planned further borrowings relates to funding projects which will deliver important and significant housing and regeneration benefits as well as generating some income.

These are budgeted to generate returns in excess of the annual loan repayment charges and other operating costs.

The overall investment strategy for 2020/21 is to gain maximum benefit but with security of the principal sum invested being the primary consideration. The weighted average return on internal investments at the end of December 2020 was 0.0% compared to a negative benchmark return for the period based on the average UK Debt Management Office's Debt Management Account Deposit Facility overnight rate.

A schedule of short-term investments is shown at Appendix F.

The Markets in Financial Instruments Directive II (MIFID II) came into place on 3 January 2018 and the Council has opted to be categorised as a professional client which allows access to financial services and advice it may otherwise be unable to obtain (such as advice from our treasury advisors). As part of the regulations, the authority must hold a minimum investment balance which is currently set at £10m.

1.3 TREASURY MANAGEMENT STRATEGY 2021/22

The Council's Treasury Management Strategy is set within the parameters of the relevant statute, guidance and accounting standards which include the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services and the Prudential Code.

The Council is currently expected to need to borrow up to £60.2m in 2021/22 based on the current capital programme plans and will adopt a flexible approach to borrowing. In consultation with its treasury management advisors consideration will be given to affordability, maturity profile of existing external financing, interest rate and refinancing risk as well as borrowing source, which is usually expected to be other local authorities or the Public Works Loan Board, but may also include the LGA Municipal Bonds Agency, European Investment Bank or commercial sources, and any new opportunities which may arise.

The strategy for any investments will generally be to reduce investments in order to reduce counter-party risk and to reduce net interest costs as longer-term borrowing rates will tend to be greater than we are able to earn on new investments, but we will look to lengthen investment periods, where cash flow permits, to achieve higher interest rates within acceptable risk parameters. We would generally anticipate holding investments equal to the requirements set out under MIFID II, currently £10m. Maximum investment levels with counterparties will be set to ensure prudent diversification is achieved whilst recognising that the strict investment criteria that the Council applies severely reduces the number of suitable available counterparties and therefore sums with individual counterparties may be up to £15m at any one time.

The report also includes: the Council's Minimum Revenue Provision Statement - the policy is in line with that previously agreed and the Prudential Indicators associated with Treasury Management for 2021/22.

2. RECOMMENDATIONS

2.1 Members are asked to

1. Note the treasury management activities for the first half year,
2. Note the Treasury Management Policy Statement (Appendix A) and
3. Recommend, by way of vote, that Cabinet and Full Council approve the Treasury Strategy, including the Annual Investment Strategy for 2021/22 together with the associated Treasury Prudential Indicators and the Minimum Revenue Provision Statement, which will apply from 2020/21 onwards.

3. SUMMARY IMPACT ASSESSMENT

<table>
<tr><td rowspan="4">COMMUNITY IMPACT</td><td colspan="2">Do these proposals contribute to specific priority plan objectives?</td></tr>
<tr><td>Yes</td><td>Maximisation of investment income whilst managing risks and minimising borrowing costs helps to support the Council's overall financial position and therefore the delivery of all service and policy objectives.</td></tr>
<tr><td colspan="2">Will the proposals impact on specific groups of people?</td></tr>
<tr><td>No</td><td></td></tr>
<tr><td>TARGET COMPLETION / DELIVERY DATE</td><td colspan="2">Part of ongoing Treasury Management Activities within the Treasury Management Strategy and Policy approved by Council.</td></tr>
<tr><td>FINANCIAL / VALUE FOR MONEY IMPACT</td><td>Yes</td><td>Where appropriate these are detailed in the body of the report.</td></tr>
<tr><td>LEGAL ISSUES</td><td>Yes</td><td>The Council's Treasury Strategy has to comply with the relevant statute, codes and guidance which are set out both in the main body of this report and its appendices. This reports demonstrates that the Council has had regard to the CIPFA guidance as required by the Local Government Act 2003.

The Director: Finance & Human Resources (Section 151 Officer) has responsibility for the administration of the financial affairs of the Council. In providing this report the Director: Finance & Human Resources is meeting one of the responsibilities of the post contained within the Council's Constitution at Part 2, Article 12, paragraph 12.04(f) which states "The Chief Financial Officer will contribute to the promotion and maintenance of high standards of governance, audit, probity and propriety, risk management and the approval of the statement of accounts through provision of support to the Audit Committee." This requirement within the Constitution reflects the requirements of the Local Government Finance act</td></tr>
</table>

		1988 to appoint an officer who is responsible for the good financial administration of an authority. The Local Government Finance Act 1992 requires authorities to set a balanced budget; the proposals in this report, together with other budget-related reports, demonstrates that the Council meets this requirement. AL 10/1/2021
OTHER IMPACTS, RISKS AND OPPORTUNITUES	Yes	The key opportunities and risks associated with treasury management activities are set out in the body of the report and in the Treasury Management Strategy and Policy approved by Council and will be regularly monitored throughout the year.
IMPACT ON SPECIFIC WARDS	No	

PART B – ADDITIONAL INFORMATION

4. 2020/21 TREASURY MANAGEMENT UPDATE

4.1 CURRENT PORTFOLIO POSITION

	31 March 2020 **Principal £m**	***31 Dec 2020*** **Principal £m**
Fixed Rate Borrowing – PWLB	176.637	169.838
Fixed Rate Borrowing – LOBO	25.000	25.000
Fixed Rate Borrowing – Market	15.000	15.000
Variable Rate Borrowing – Temporary Market	59.548	58.048
Total External Financing	**276.185**	**267.886**
Investments (excl. NuPlace share capital)	30.583	25.384
Total Investments	**30.583**	**25.384**
Net Indebtedness (excl. NuPlace)	**245.602**	**242.502**
Investment in NuPlace	13.300	14.800
	232.302	**227.702**

4.2 Interests Rates

UK interest rates have remained at 0.10% throughout 2020/21 to date. On the 5th November 2020 the Bank of England increased its Quantitative Easing programme to £895bn. This is an increase of £460bn since the beginning of the financial year, in response to the UK Government’s increase in borrowing to fund the fight against COVID19. Our treasury management advisors, are forecasting the Bank Rate to remain at the current 0.1% level until the first quarter of 2024, but further cuts to zero or possibly negative cannot be ruled out. Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

4.3 Borrowing & Rescheduling

The borrowing strategy for the current year has been to borrow temporarily to take advantage of low interest rates where possible and to undertake new longer term borrowing initially in shorter maturities before gradually extending maturities.

Rescheduling

During 2020/21 no rescheduling of debt has taken place as market conditions have not been favourable, however the scope for opportunities is regularly monitored.

New Borrowing

Between the period 1 June 2020 (previous Member update) and 31 December 2020, £68.0m of temporary loans have been raised in order to fund short-term cash flow requirements at various points. Interest rates have ranged from 0.05% to 0.33% - interest rates have remained low during this time. Outstanding temporary borrowing at 31 December 2020 was £58.0m

To date in 2020/21 part of our Equal Instalment of Principal PWLB loans have matured. No new PWLB loans have been taken in 2020/21.

4.4 Investments

The strategy for the current year is: The Authority's objective when investing money is to strike an appropriate balance between risk and return.

The majority of the Council's investments are internally managed – currently just temporary investments for cash flow purposes.

Temporary Investments

The majority of funds are invested following consideration by Council officers in order to maximise returns from day to day cash flows. In total £5,783m of investments were placed between 1 June and 31 December. Interest rates have ranged from -0.095% to +0.24% and periods ranged from overnight deposits to 3 days. £25.384m temporary investments were held at 31 December 2020.

The Council have placed investments using the UK DMO Debt Management Account Deposit Facility when interest rates associated with this counterparty have been negative. This effectively means that the Council has paid (albeit a very small amount) to ensure that investments have maximum security, in line with the CIPFA Prudential Code.

Longer Term Investments

We currently hold no longer term investments.

It should be noted that under the current guidance from our Treasury Advisors our investment policy would mean that new deposits with financial institutions should not be placed for longer than 13 months

Overall the weighted average return on all internal investments for the year to date was 0% compared to a negative benchmark return for the period due to the COVID19 pandemic.

Overall Position and Exposure

A full analysis of all Council investments at the end of December 2020 is shown in Appendix F.

Our current counterparty limit and maximum exposure is £15.0m for the current year with any one counterparty, with exception of the DMO which is unlimited as it is Government guaranteed. At the end of December the greatest exposure with a single counterparty was £16.8m with UK DMO (66.2% of the total portfolio).

The Council is guided by its Treasury advisers in assessing investments.

4.5 Leasing

Each year the Council arranges operating and finance leases for assets such as vehicles, computers and equipment. This helps to spread the cost over a number of years.

There have been no drawdowns to date in 2020/21.

5. TREASURY STRATEGY FOR 2021/22

5.1 Background

5.1.1 The CIPFA Treasury Management Code of Practice

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

Treasury risk management at the Authority is conducted within the framework of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2017 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. This report fulfils the Authority's legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code.

Investments held for service purposes or for commercial profit (if any) are considered in a different report, the Investment Strategy, which is also part of the Service & Financial Planning suite of reports considered by Cabinet and full Council.

5.1.2 External Context

Economic background: The impact on the UK from coronavirus, lockdown measures, the rollout of vaccines, as well as the new trading arrangements with the European Union (EU), will remain major influences on the Authority's treasury management strategy for 2021/22.

The Bank of England (BoE) maintained Bank Rate at 0.10% in December 2020 and Quantitative Easing programme at £895 billion having extended it by £150 billion in the previous month. The Monetary Policy Committee (MPC) voted unanimously for both, but no mention was made of the potential future use of negative interest rates. In the November Monetary Policy Report (MPR) forecasts, the Bank expects the UK economy to shrink -2% in Q4 2020 before growing by 7.25% in 2021, lower than the previous forecast of 9%. The BoE also forecasts the economy will now take until Q1 2022 to reach its pre-pandemic level rather than the end of 2021 as previously forecast. By the time of the December MPC announcement, a COVID-19 vaccine was approved for use, which the Bank noted would reduce some of the downside risks to the economic outlook outlined in the November MPR.

UK Consumer Price Inflation (CPI) for November 2020 registered 0.3% year on year, down from 0.7% in the previous month. Core inflation, which excludes the more volatile components, fell to 1.1% from 1.5%. The most recent labour market data for the three months to October 2020 showed the unemployment rate rose to 4.9% while the employment rate fell to 75.2%. Both measures are expected to deteriorate further due to the ongoing impact of coronavirus on the jobs market, particularly when the various government job retention schemes start to be unwound in 2021, with the BoE forecasting unemployment will peak at 7.75% in Q2 2021. In October, the headline 3-month average annual growth rate for wages were 2.7% for total pay and 2.8% for regular pay. In real terms, after adjusting for inflation, total pay growth was up by 1.9% while regular pay was up 2.1%.

GDP growth rebounded by 16.0% in Q3 2020 having fallen by -18.8% in the second quarter, with the annual rate rising to -8.6% from -20.8%. All sectors rose quarter-on-quarter, with dramatic gains in construction (41.2%), followed by services and production (both 14.7%). Monthly GDP estimates have shown the economic recovery slowing and remains well below its pre-pandemic peak. Looking ahead, the BoE's November MPR forecasts economic growth will rise in 2021 with GDP reaching 11% in Q4 2021, 3.1% in Q4 2022 and 1.6% in Q4 2023.

GDP growth in the euro zone rebounded by 12.7% in Q3 2020 after contracting by -3.7% and -11.8% in the first and second quarters, respectively. Headline inflation, however, remains extremely weak, registering -0.3% year-on-year in November, the fourth successive month of deflation. Core inflation registered 0.2% y/y, well below the European Central Bank's (ECB) target of 'below, but close to 2%'. The ECB is expected to continue holding its main interest rate of 0% and deposit facility rate of -0.5% for some time but expanded its monetary stimulus in December 2020, increasing the size of its asset purchase scheme to €1.85 trillion and extended it until March 2022.

The US economy contracted at an annualised rate of 31.4% in Q2 2020 and then rebounded by 33.4% in Q3. The Federal Reserve maintained the Fed Funds rate at between 0% and 0.25% and announced a change to its inflation targeting regime to a more flexible form of average targeting. The Fed also provided strong indications that interest rates are unlikely to change from current levels over the next three years.

Former vice-president Joe Biden won the 2020 US presidential election. Mr Biden is making tackling coronavirus his immediate priority and will also be reversing several executive orders signed by his predecessor and take the US back into the Paris climate accord and the World Health Organization.

Credit outlook: After spiking in late March as coronavirus became a global pandemic and then rising again in October/November, credit default swap (CDS) prices for the larger UK banks have steadily fallen back to almost pre-pandemic levels. Although uncertainly around COVID-19 related loan defaults lead to banks provisioning billions for potential losses in the first half of 2020, drastically reducing profits, reported impairments for Q3 were much reduced in some institutions. However, general bank profitability in 2020 and 2021 may be significantly lower than in previous years.

The credit ratings for many UK institutions were downgraded on the back of downgrades to the sovereign rating. Credit conditions more generally though in banks and building societies have tended to be relatively benign, despite the impact of the pandemic.

Looking forward, the potential for bank losses to be greater than expected when government and central bank support starts to be removed remains a risk, suggesting a cautious approach to bank deposits in 2021/22 remains advisable.

Interest rate forecast: The Authority's treasury management adviser Arlingclose is forecasting that BoE Bank Rate will remain at 0.1% until at least the first quarter of 2024. The risks to this forecast are judged to be to the downside as the BoE and UK government continue to react to the coronavirus pandemic and the new EU trading arrangements.

The BoE extended its asset purchase programme to £895 billion in November while keeping Bank Rate on hold and maintained this position in December. However, further interest rate cuts to zero, or possibly negative, cannot yet be ruled out but this is not part of the Arlingclose central forecast.

Gilt yields are expected to remain very low in the medium-term while short-term yields are likely to remain below or at zero until such time as the BoE expressly rules out the chance of negative interest rates or growth/inflation prospects improve. The central case is for 10-year and 20-year to rise to around 0.60% and 0.90% respectively over the time horizon. The risks around the gilt yield forecasts are judged to be broadly balanced between upside and downside risks, but there will almost certainly be short-term volatility due to economic and political uncertainty and events.

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

For the purpose of setting the budget, it has been assumed that new treasury investments will be made at an average rate of 0.06%, and that new long-term loans will be borrowed at an average rate of 2.5%.

5.1.3 Local Context

The Authority's current level of external financing and investments is set out at Appendix B.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). The CFR, together with Usable Reserves, are the core drivers of the Authority's Treasury Management activities.

The Authority is able to borrow funds in excess of the current level of its CFR up to the projected level in 2023/24. The Authority is likely to only borrow in advance of need if it felt the benefits of borrowing at interest rates now compared to where they are expected to be in the future, outweighs the current cost and risks associated with investing the proceeds until the borrowing was actually required.

The forecasted movement in the CFR in coming years is one of the Prudential Indicators (PIs). The estimates, based on the current Revenue Budget and Capital Programmes, are:

Capital Financing Requirement (CFR)

	31/03/20 Actual £m	31/03/21 Estimate £m	31/03/22 Estimate £m	31/03/23 Estimate £m	31/03/24 Estimate £m
Capital Financing Requirement	460.087	481.408	541.572	573.530	590.381
Less: Other long term liabilities (e.g. PFI)	-51.288	-50.046	-50.895	-48.009	-44.837
Borrowing CFR	**408.799**	**431.362**	**490.677**	**525.521**	**545.544**
Less: External Borrowing	-276.185	-299.533	-359.746	-395.552	-416.409
Internal Borrowing	**132.614**	**131.829**	**131.829**	**129.969**	**129.135**

The table above shows an increasing Capital Financing Requirement and will require the Council to undertake additional longer term borrowing. Conversion from temporary borrowing to fixed long-term borrowing may also be required at the most appropriate time for the Council dependent on market conditions.

The row relating to external borrowing includes debt associated with funding the Council's Housing Investment Programme through NuPlace, the Telford Growth Fund/PIP investments, solar farm and other investments that have an element of income generation. The anticipated income from these projects is projected to generate a surplus after funding the debt and operational costs which will be used to support front line services. The outstanding debt relating to the Housing Investment Programme could be repaid by the eventual sale, in many years' time, of some or all of the properties held by the Council's wholly owned company.

CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. The CFR Table above shows that the Authority expects to fully comply with this recommendation.

5.1.4 Borrowing Strategy

The Authority currently holds £267.886m of loans, a decrease of £8.299m on the previous year, due to positive cash flow and as part of its strategy for funding previous years' capital programmes. The balance sheet forecast included in the CFR Table above shows that the Authority expects total cumulative borrowing to be up to £299.533 by the end of 2021/22 in line with the approved Capital Programme. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

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

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

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 1 – 2 years as official interest rates remain low, it is unlikely to be sustainable in the medium-term. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. External advisors will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2021/22 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

The Authority has previously raised the majority of its long-term borrowing from the PWLB but the government increased PWLB rates by 1% in October 2019 making it a relatively expensive option. A HM Treasury consultation on lowering PWLB rates concluded in July 2020 and new lending terms were published in November 2020. These confirmed a reduction of 1% in all Standard Rate and Certainty Rate PWLB loans but with a condition of accessing the PWLB being that local authorities will be asked to confirm that there is no intention to buy investment assets primarily for yield in the current or next two financial years. The Authority may also consider alternative options for borrowing any long-term loans, such as banks, pension funds and local authorities, and the possibility of issuing bonds and similar instruments, in order to lower interest costs and reduce over-reliance on one source of funding in line with the CIPFA Code.

Alternatively, the Authority may arrange forward starting loans, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

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

- HM Treasury's PWLB lending facility (formerly PWLB)
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- any other UK public sector body
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues
- Registered Housing providers
- Capital market bond investors

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

- leasing
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

LOBOs: The Authority holds £25.0m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £20m of these LOBOs have remaining options prior to the end of the financial year, and although the Authority understands that lenders are very unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. Rates payable were competitive compared to PWLB rates at the time that the loans were taken out. The

Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will not increase from the current £25.0m.

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

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

5.2 Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the current financial year, the Authority's investment balance has ranged between £13.6m and £70.6m. We expect to maintain an investment balance of between £10.0m and £20.0m in the forthcoming year – unless the MIFID requirement is relaxed in which case the amount of investment held may reduce.

Objectives: The CIPFA Code requires the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative Interest Rates: The COVID-19 pandemic has increased the risk that the Bank of England will set its Base Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. Since investments cannot pay negative income, negative rates will be applied by reducing the value of investments. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. In this event, the Council would seek, to the extent possible, to minimise and keep the impact of negative rates as low as possible within the framework of the Council's creditworthiness policy.

Strategy: All of the Authority's surplus cash remains invested in the UK Government through the Debt Management Account Deposit Facility (DMADF), short-term unsecured bank deposits and money market funds. This diversification of investments will represent a continuation of the strategy adopted in 2020/21.

Business models: Under the new IFRS 9 standard, the accounting for certain investments depends on the Authority's "business model" for managing them. The Authority aims to achieve value from its internally managed treasury investments by a business model of collecting the contractual cash flows and therefore, where other criteria are also met, these investments will continue to be accounted for at amortised cost.

Approved counterparties: The Authority may invest its surplus funds with any of the counterparty types listed in the table below, subject to the cash limits (per counterparty) and the time limits shown.

Sector	Time limit	Counterparty limit	Sector limit
The UK Government	50 years	Unlimited	n/a
Local authorities & other government entities	25 years	£15.0m	Unlimited
Secured investments*	25 years	£15.0m	Unlimited
Banks (unsecured)*	13 months	£15.0m	Unlimited
Building societies (unsecured)*	13 months	£15.0m	Unlimited
Registered providers (unsecured)*	5 years	£15.0m	Unlimited
Money market funds*	n/a	£10.0m	Unlimited
Strategic pooled funds	n/a	£10.0m	Unlimited
Real estate investment trusts	n/a	£10.0m	Unlimited
Other investments*	5 years	£7.5m	Unlimited

This table must be read in conjunction with the notes below

Minimum credit rating: Treasury investments in the sectors marked with an asterisk will only be made with entities whose lowest published long-term credit rating is no lower than A-. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

Government: Loans to, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is a lower risk of insolvency, although they are not without risk. Investments with the UK Government may be made in unlimited amounts for up to 50 years.

Secured investments: Investments secured on the borrower's assets, which limits the potential losses in the event of insolvency. The amount and quality of the security will be a key factor in the investment decision. Covered bonds and reverse repurchase agreements with banks and building societies are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used. The combined secured and unsecured investments with any one counterparty will not exceed the cash limit for secured investments.

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

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

Money market funds: Pooled funds that offer same-day or short notice liquidity and very low or no price volatility by investing in short-term money markets. They have the advantage over bank accounts of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a small fee. Although no sector limit applies to money market funds, the Authority will take care to diversify its liquid investments over a variety of providers to ensure access to cash at all times.

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

Real estate investment trusts: Shares in companies that invest mainly in real estate and pay the majority of their rental income to investors in a similar manner to pooled property funds. As with property funds, REITs offer enhanced returns over the longer term, but are more volatile especially as the share price reflects changing demand for the shares as well as changes in the value of the underlying properties.

Other investments: This category covers treasury investments not listed above, for example unsecured corporate bonds and company loans. Non-bank companies cannot be bailed-in but can become insolvent placing the Authority's investment at risk.

Operational bank accounts: The Authority may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £15.0m per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

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

- no new investments will be made,

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

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

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

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2020, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority's cash balances, then the surplus will be deposited with the UK Government via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Investment Limits: The Authority has revenue reserves, which could be used to cover investment losses which were £114.988m on 1st April 2020 although not all of these are available. In order that no more than 50% of reserves (as recommended by the code) will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) will be £15 million, which is clearly well within the limit. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes.

Limits will also be placed on investments in brokers' nominee accounts (e.g. King & Shaxson), foreign countries and industry sectors. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Approved Instruments: The Authority may lend or invest money using any of the following instruments:

- interest-bearing bank accounts

- fixed term deposits and loans
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £5 million in total
- certificates of deposit
- bonds, notes, bills, commercial paper and other marketable instruments, and shares in money market funds and other pooled funds,

Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

Liquidity management: The Authority uses cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

5.3 Ethical Investments

The Council will not knowingly directly invest in organisations whose activities include practices which directly pose a risk of serious harm to individuals or groups, or whose activities are inconsistent with the mission and values of the Council. At the same time the Council will take full responsibility for proper management of risk and safeguarding its investments by ensuring that they are diversified and made with organisations suitably credit assessed.

The Council's lending activity will be subject to (in order of rank)

- the assessment of meeting the minimum lending criteria as specified in the current Treasury Management Strategy and the minimum credit ratings as outlined in the Strategy.
- meeting the Security, Liquidity & Yield (SLY) criteria as set out in the current Treasury Management Strategy, and
- investments are not contrary to the values outlined in the Ethical Investment Framework (Appendix G)

5.4 Related Matters

Financial derivatives: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

In line with CIPFA Code, the Authority will seek external advice and will consider that the advice before entering into financial derivatives to ensure that it fully understands the implications.

Markets in Financial Instruments Directive (MIFID): The Authority has opted up to professional client status with its providers of financial services, including advisers, banks, brokers and fund managers, allowing it access to a greater range of services but with the greater regulatory protections afforded to individuals and small companies. Given the size and range of the Authority's treasury management activities, the Chief Financial Officer believes this to be the most appropriate status.

5.5 Financial Implications

The budget for investment income in 2021/22 is £0.02m, based on an average investment portfolio of £31.25m at an interest rate of 0.06%. The budget for debt interest paid in 2021/22 is £9.14m, based on an average debt portfolio of £325.2 at an average interest rate of 2.81%. If actual levels of investments and borrowing, or actual interest rates, differ from those forecast, performance against budget will be correspondingly different.

5.6 Balanced Budget Requirement

The Authority complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

6.0 <u>2021/22 MRP STATEMENT</u>

6.1 The Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 08 (SI 08/414) place a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

NB This does not preclude other prudent methods.

MRP in 2021/22: Options 1 and 2 may be used only for supported expenditure.

Methods of making prudent provision for self-financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses).

The MRP Statement will be submitted to Council before the start of the 2021/22 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Council at that time.

The Council will calculate MRP by the following methods –

Historic MRP (re pre 2007/08 borrowing). This will be calculated by dividing the balance at 31/3/07 (calculated in accordance with regulations) by 50 for an annual charge that charges over a finite period rather than a 4% reducing balance. Broadly in line with option 3.

MRP in respect of prudential borrowing, government supported allocations since 2007/08 and PFI will be charged over the life of the asset on an annuity basis (option 3 in the regulations).

MRP for borrowing in respect of NuPlace is set at £0 due the expectation that the value will appreciate over time and that the houses could all eventually be sold in which case the Council would apply the capital receipts arising to reduce the Capital Financing Requirement until the original principal borrowed had been fully repaid.

Along the same lines as NuPlace, MRP for borrowing in respect of the Council's Property Investment Portfolio will be calculated as 20% of the value of the annuity MRP to reflect that although there will normally be capital appreciation, although a downturn in the economy could result in reductions in value of commercial/industrial investment properties.

Also MRP in respect of leases brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability which is broadly in line with the life of the asset.

Capital expenditure incurred during 2021/22 will not be subject to a MRP charge until 2022/23.

7. OTHER ITEMS

7.1 Monitoring and Reporting on the Treasury Outturn and Prudential Indicators

The Director: Finance & Human Resources will report to the Audit Committee on treasury management activity / performance and Performance Indicators as follows -

- Half yearly against the strategy approved for the year. The authority will produce an outturn report on its treasury activity no later than 31st July after the financial year end and an update report alongside the Treasury Strategy in the last quarter of the financial year, and

Audit Committee will be responsible of the scrutiny of treasury management activity and practices rather than the Budget & Finance Scrutiny Committee.

7.2 Training

CIPFA’s Code of Practice requires the responsible officer to ensure that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

Reviewing and addressing training needs: The authority regularly reviews the training needs of its staff involved with treasury management and ensures that staff are appropriately trained.

7.3 Investment Consultants / Treasury Advisors

The Council uses Arlingclose as its external treasury management advisers.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times.

8. BACKGROUND PAPERS

CIPFA Code of Practice for Treasury Management in Local Authorities
Temporary Borrowing Records
PWLB records
Investment records
Draft Treasury Strategy provided by Arlingclose
Local Government Act 2003
CLG Guidance on Local Authority Investments
Audit Commission – Risk and Return

Report prepared by
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Ken Clarke, Director Finance & Human Resources (01952) 383100

TREASURY MANAGEMENT POLICY STATEMENT

1. INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.

1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
- Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

1.3 The Council will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, a mid-year review and an annual report after its close, in the form prescribed in its TMPs.

1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to Audit Committee and for the execution and administration of treasury management decisions to Director: Finance & Human Resources, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.

1.5 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

2.1 The Council defines its treasury management activities as:

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

This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management."

2.2 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt. The Council will look to minimise borrowing through the use of maturing investments to fund capital expenditure rather than reinvestment.

2.3 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority's investments followed by the yield earned on investments remain important but are secondary considerations. Generally as investments mature they will not be reinvested but be used to minimise borrowing.

EXISTING PORTFOLIO PROJECTED FORWARD

	Current Portfolio £m	%	31/03/21 Estimate £m	31/03/22 Estimate £m	31/03/23 Estimate £m	31/03/24 Estimate £m	31/03/25 Estimate £m
External Borrowing:							
Fixed Rate – PWLB	169.8	53.5	169.0	224.7	260.6	281.4	275.4
Fixed Rate – LOBO	25.0	7.9	25.0	25.0	25.0	25.0	25.0
Fixed Rate – Market	15.0	4.7	15.0	15.0	15.0	15.0	15.0
Variable Rate – PWLB	0	0.0	0	0	0	0	0
Variable Rate – Market	58.0	18.3	90.5	95	95	95	95
Total External Borrowing	**267.8**	**84.4**	**299.5**	**359.7**	**395.6**	**416.4**	**410.4**
IFRS Long Term Liabilities:							
PFI	49.7	15.6	49.7	50.6	47.7	44.5	41.1
Finance Leases	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Total Gross External Debt	**317.5**	**100.0**	**349.2**	**410.3**	**443.3**	**460.9**	**451.5**
Investments:							
Managed in-house	0	0.0	0	0	0	0	0
Short-term monies (Deposits / monies on call / MMFs)	25.4	100.0	20.0	20.0	20.0	20.0	20.0
Long-term investments (maturities over 12 months)	0	0.0	0	0	0	0	0
Total Investments	**25.4**	**100.0**	**20.0**	**20.0**	**20.0**	**20.0**	**20.0**
(Net Borrowing Position) / Net Investment Position	**-292.1**		**-329.2**	**-390.3**	**-423.3**	**-440.9**	**-431.5**

Prudential Indicators 2020/21 to 2024/25

1 Background:

There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

2. Gross debt and the Capital Financing Requirement:

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

The Director: Finance & Human Resources reports that the authority had no difficulty meeting this requirement in 2019/20, nor are there any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. Estimates of Capital Expenditure:

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

	20/21 Approved £m	20/21 Revised £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m
Total	**83.854**	**63.701**	**101.855**	**41.619**	**21.357**

3.2 Capital expenditure will be financed or funded as follows:

	20/21 Approved £m	20/21 Revised £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m
Capital receipts	12.492	5.785	6.300	5.300	0.500
Government Grants	28.801	28.002	24.552	0.000	0.000
Revenue / External contributions	12.963	6.566	10.790	0.513	0.000
Total Financing	54.256	40.353	41.642	5.813	0.500
Prudential Borrowing	29.598	23.348	60.213	35.806	20.857

	20/21 Approved £m	20/21 Revised £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m
Total Funding	29.598	23.348	60.213	35.806	20.857
Total Financing and Funding	**83.854**	**63.701**	**101.855**	**41.619**	**21.357**

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs. The definition of financing costs is set out in the Prudential Code.

4.2 The ratio is based on costs net of investment income.

	20/21 Approved %	20/21 Revised %	21/22 Estimate %	22/23 Estimate %	23/24 Estimate %	24/25 Estimate %
Total	**7.44**	**5.38**	**6.39**	**6.90**	**6.77**	**7.05**

5. Capital Financing Requirement:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing.

	20/21 Approved £m	20/21 Revised £m	21/22 Estimate £m	22/23 Estimate £m	23/24 Estimate £m	24/25 Estimate £m
Total CFR	**496.686**	**481.408**	**541.572**	**573.530**	**590.381**	**586.505**

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/20	**£m**
Borrowing	276.185
Other Long-term Liabilities	51.288
Total	**327.473**

7. Authorised Limit and Operational Boundary for External Debt:

7.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

7.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities. This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

7.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

7.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

	20/21 Approved £m	**20/21 Revised £m**	**21/22 Estimate £m**	**22/23 Estimate £m**	**23/24 Estimate £m**	**24/25 Estimate £m**
Borrowing	450	450	450	480	500	500
Other long term liabilities	64	64	64	64	54	54
Total	**514**	**514**	**514**	**544**	**554**	**554**

7.5 The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

7.6 The Director: Finance & Human Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Audit Committee.

	20/21 Approved £m	**20/21 Revised £m**	**21/22 Estimate £m**	**22/23 Estimate £m**	**23/24 Estimate £m**	**24/25 Estimate £m**
Borrowing	430	430	430	460	480	480
Other long term liabilities	60	60	60	60	50	50
Total	**490**	**490**	**490**	**520**	**530**	**530**

8. Gross Debt and the Capital Finance Requirement

8.1 The purpose of this treasury indicator is to highlight a situation where the Council is planning to borrow in advance of need. If these figures exceed CFR (which they don't) they would indicate we are borrowing in advance of need.

Gross and Net Debt	20/21 Estimated £m	21/22 Authorised £m	22/23 Authorised £m	23/24 Authorised £m	24/25 Authorised £m
Outstanding Borrowing (at nominal value)	299.533	359.746	395.552	416.409	416.409
Other Long-term Liabilities (at nominal value)	50.046	50.895	48.009	44.837	41.465
Gross Debt	**349.579**	**410.641**	**443.561**	**461.246**	**457.874**

9. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

9.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments / total debt net of total investments)

9.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

	Existing level (or Benchmark level) at 31/03/20 %	20/21 Approved %	20/21 Revised %	21/22 Estimate %	22/23 Estimate %	23/24 Estimate %	24/25 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100	100	100
Upper Limit for Variable Interest Rate Exposure	70	70	70	70	70	70	70
Local Indicator – Upper limit for net variable rate exposure*.	70	70	70	70	70	70	70

*Net principal re gross variable rate borrowing and investments divided by gross borrowing plus investments

9.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council’s treasury management strategy.

10. Maturity Structure of Fixed Rate borrowing:

10.1 This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

10.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Existing level 31.12.20 %	Lower Limit for 21/22 %	Upper Limit for 21/22 %
under 12 months	12	0	70
12 months and within 24 months	0	0	30
24 months and within 5 years	18	0	50
5 years and within 10 years	12	0	75
10 years and within 20 years	14	0	75
20 years and within 30 years	1	0	75
30 years and within 40 years	10	0	100
40 years and within 50 years	19	0	100
50 years and above	13	0	100

11. Credit Risk:

11.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

11.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council’s assessment of counterparty credit risk.

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

	Target
Portfolio average credit score	6 or lower, which is equivalent to a credit rating of 'A' or higher

11.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

12. Upper Limit for total principal sums invested over 1 year:

12.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	20/21 Approved %	20/21 Revised %	21/22 Estimate %	22/23 Estimate %	23/24 Estimate %	24/25 Estimate %
Upper Limit	**95**	**95**	**95**	**95**	**95**	**95**

Arlingclose Economic & Interest Rate Forecast January 2020

Underlying assumptions:

- The medium-term global economic outlook has improved with the distribution of vaccines, but the recent upsurge in coronavirus cases has worsened economic prospects over the short term.

- Restrictive measures and further lockdowns are likely to continue in the UK and Europe until the majority of the population is vaccinated by the second half of 2021. The recovery period will be strong thereafter, but potentially longer than previously envisaged.

- Signs of a slowing UK economic recovery were already evident in UK monthly GDP and PMI data, even before the second lockdown and Tier 4 restrictions. Employment is falling despite an extension to support packages.

- The need to support economic recoveries and use up spare capacity will result in central banks maintaining low interest rates for the medium term.

- Brexit will weigh on UK activity. The combined effect of Brexit and the after-effects of the pandemic will dampen growth relative to peers, maintain spare capacity and limit domestically generated inflation. The Bank of England will therefore maintain loose monetary conditions for the foreseeable future.

- Longer-term yields will also remain depressed, anchored by low central bank policy rates, expectations for potentially even lower rates and insipid longer-term inflation expectations. There is a chance yields may follow a slightly different path in the medium term, depending on investor perceptions of growth and inflation, or the deployment of vaccines.

Forecast:

- Arlingclose expects Bank Rate to remain at the current 0.10% level.

- Our central case for Bank Rate is no change, but further cuts to zero, or perhaps even into negative territory, cannot be completely ruled out, especially with likely emergency action in response to a no-deal Brexit.

- Gilt yields will remain low in the medium term. Shorter term gilt yields are currently negative and will remain around zero or below until either the Bank expressly rules out negative Bank Rate or growth/inflation prospects improve.

- Downside risks remain, and indeed appear heightened, in the near term, as the government reacts to the escalation in infection rates and the Brexit transition period ends.

	Mar-21	Jun-21	Sep-21	Dec-21	Mar-22	Jun-22	Sep-22	Dec-22	Mar-23	Jun-23	Sep-23	Dec-23	Mar-24
Official Bank Rate													
Upside risk	0.00	0.00	0.15	0.15	0.15	0.15	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10	0.10
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
3-month money market r													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Arlingclose Central Case	0.10	0.10	0.15	0.15	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20	0.20
Downside risk	0.30	0.40	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
1yr money market rate													
Upside risk	0.05	0.05	0.10	0.10	0.15	0.20	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.15	0.15	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30
Downside risk	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15	0.15
5yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.00	0.00	0.05	0.10	0.15	0.20	0.20	0.20	0.25	0.25	0.25	0.25	0.25
Downside risk	0.40	0.45	0.50	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60
10yr gilt yield													
Upside risk	0.30	0.35	0.40	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.25	0.30	0.35	0.35	0.40	0.40	0.45	0.45	0.50	0.55	0.55	0.55	0.60
Downside risk	0.50	0.50	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55	0.55
20yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.70	0.70	0.75	0.75	0.75	0.80	0.80	0.85	0.85	0.85	0.85	0.90	0.90
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
50yr gilt yield													
Upside risk	0.40	0.40	0.45	0.45	0.50	0.50	0.55	0.60	0.60	0.65	0.65	0.70	0.70
Arlingclose Central Case	0.60	0.60	0.65	0.65	0.65	0.70	0.70	0.75	0.75	0.75	0.75	0.80	0.80
Downside risk	0.30	0.30	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40

PWLB Certainty Rate (Maturity Loans) = Gilt yield + 0.80%
PWLB Infrastructure Rate (Maturity Loans) = Gilt yield + 0.60%

Recommended Sovereign and Counterparty List (Section 8)

- ***Group Limits*** *- For institutions within a banking group, the authority executes a limit at the highest of any of the single banks within that group.*
- ***Sovereign Limit*** *– The Council will only invest a maximum of £15m of the portfolio with non UK sovereigns***.**

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit £m	Maximum Group Limit (if applicable) £m	Council Holding At 31/12/20 £m
Term Deposits / CDs / Call Accounts	UK	Santander UK Plc (Banco Santander Group)	15	15	0
Term Deposits / CDs / Call Accounts	UK	Bank of Scotland (Lloyds Banking Group)	15	15	0
Term Deposits / CDs / Call Accounts	UK	Lloyds (Lloyds Banking Group)	15	15	3.6
Term Deposits / CDs / Call Accounts	UK	Barclays Bank Plc	15	15	0
Term Deposits / CDs / Call Accounts	UK	HSBC Bank Plc	15	15	0
Term Deposits / CDs / Call Accounts	UK	Nationwide Building Society	15	15	0
Term Deposits / CDs / Call Accounts	UK	NatWest (RBS Group)	15	15	0
Term Deposits / CDs / Call Accounts	UK	Royal Bank of Scotland (RBS Group)	15	15	0
Term Deposits / CDs / Call Accounts	UK	Standard Chartered Bank	15	15	0
Term Deposits / CDs / Call Accounts	UK	Close Brothers Limited	15	15	0
Term Deposits / CDs / Call Accounts	UK	Goldman Sachs International Bank	15	15	0

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit £m	Maximum Group Limit (if applicable) £m	Council Holding At 31/12/20 £m
Term Deposits / CDs / Call Accounts	UK	Leeds Building Society	15	15	0
Term Deposits / CDs / Call Accounts	Australia	Australia and NZ Banking Group	15	15	0
Term Deposits / CDs / Call Accounts	Australia	Commonwealth Bank of Australia	15	15	0
Term Deposits / CDs / Call Accounts	Australia	National Australia Bank Ltd (National Australia Bank Group)	15	15	0
Term Deposits / CDs / Call Accounts	Australia	Westpac Banking Corp	15	15	0
Term Deposits / CDs / Call Accounts	Canada	Bank of Montreal	15	15	0
Term Deposits / CDs / Call Accounts	Canada	Bank of Nova Scotia	15	15	0
Term Deposits / CDs / Call Accounts	Canada	Canadian Imperial Bank of Commerce	15	15	0
Term Deposits / CDs / Call Accounts	Canada	Royal Bank of Canada	15	15	0
Term Deposits / CDs / Call Accounts	Canada	Toronto-Dominion Bank	15	15	0
Term Deposits / CDs / Call Accounts	Finland	Nordea Bank Finland	15	15	0
Term Deposits / CDs / Call Accounts	Finland	Pohjola Bank	15	15	0
Term Deposits / CDs / Call Accounts	Germany	Deutche Bank AG	15	15	0
Term Deposits / CDs / Call Accounts	Germany	Landesbank Hessen – Thuringen (Helaba)	15	15	0

Instrument	Country/ Domicile	Counterparty	Maximum Counterparty Limit £m	Maximum Group Limit (if applicable) £m	Council Holding At 31/12/20 £m
Term Deposits / CDs / Call Accounts	Netherlands	ING Bank NV	15	15	0
Term Deposits / CDs / Call Accounts	Netherlands	Rabobank	15	15	0
Term Deposits / CDs / Call Accounts	Netherlands	Bank Nederlandse Gemeenten	15	15	0
Term Deposits / CDs / Call Accounts	Singapore	DBS Bank Ltd	15	15	0
Term Deposits / CDs / Call Accounts	Singapore	Oversea-Chinese Banking Corporation (OCBC)	15	15	0
Term Deposits / CDs / Call Accounts	Singapore	United Overseas bank (UOB)	15	15	0
Term Deposits / CDs / Call Accounts	Sweden	Svenska Handelsbanken	15	15	0
Term Deposits / CDs / Call Accounts	Switzerland	Credit Suisse	15	15	0
Term Deposits / CDs / Call Accounts	US	JP Morgan Chase Bank	15	15	0

***Please note this list could change if, for example, a counterparty/country is upgraded, and meets our other creditworthiness tools. Alternatively, if a counterparty is downgraded, this list may be shortened. The counterparty list was correct as at 31 December 2020*

Summary of Treasury Investments

Total risk per counterparty as at 31 December 2020

	Credit Rating	Total £000
Fixed Deposits		
Lloyds	UK A+	3,604
Debt Management Office	UK Government	16,800
Money Market Funds	AAAm	4,980
Total cash deposits		**25,384**

Credit Risk Rating: 1.6

Sovereign Analysis:

Lloyds Bank	100% UK
DMO	100% UK
MMFs	7.4% UK / 92.6% NON-UK

Ethical Investment Framework – Telford and Wrekin Council

At the current time the Council's treasury activity consists principally of making short-dated loans to the UK Government (through the Debt Management Agency Deposit Facility) and to banks and building societies which adheres to the S-L-Y principles of (Security, Liquidity and Yield, in that order).

The preservation of capital is the Council's principal and overriding priority. The banks and building societies on the Council's lending list are selected only if the institutions and the sovereign meet a minimum credit criteria. In accordance with its social and corporate governance responsibilities, the Council seeks to support institutions which additionally have an ethical and responsible approach to environmental and social issues including employment and global trade. These "ethical" criteria and their basis are described below.

1. Environmental and Social Standards

Equator Principles

The Equator Principles (EPs) are a voluntary set of guidelines based on the environmental and social standards practiced by the International Finance Committee when evaluating financing projects. Financial institutions that adopt the Principles agree to use a screening process aiming to ensure that environmental and social assessments help inform decisions to finance development projects. This allows signatories to engage proactively with their stakeholders on environmental and social policy issues.

The EPs are a screening framework for determining, assessing and managing environmental and social risk in project finance transactions for major infrastructure and industrial projects. The EPs are adopted voluntarily by financial institutions and are applied where total project capital costs exceed US$10 million. The EPs are primarily intended to provide a minimum standard for due diligence to support responsible risk decision-making. They are based on the International Finance Corporation's performance standards on social and environmental sustainability and on the World Bank Group Environmental Health and Safety Guidelines.

Financial institutions which are signatories to the EPs commit to not providing loans to projects where the borrower will not or is unable to comply with their respective social and environmental policies and procedures that implement the EPs.

The following banks relating to institutions on the Council's lending list have adopted the Equator Principles:

- Lloyds Banking Group (parent of Bank of Scotland plc and Lloyds Bank plc)
- Banco Santander (parent of Santander UK plc)
- Svenska Handelsbanken AB (parent of Handelsbanken UK)
- Barclays plc (parent of Barclays Bank)
- HSBC Holding plc (parent of HSBC plc)
- Nat West Group plc
- Royal Bank of Scotland
- Standard Chartered plc
- Australia and New Zealand Banking Group
- Commonwealth Bank Australia
- Westpac Banking Corp.
- Bank of Montreal

- Bank of Nova Scotia
- Canadian Imperial Bank of Commerce
- Royal Bank of Canada
- Nordea Bank Finland
- Deutche Bank AG
- ING Bank NV
- Credit Suisse
- JP Morgan Chase Bank

http://www.equator-principles.com/index.php/members-reporting

2. Human Rights, Labour and Environment

The **UN Global Compact** is a strategic policy initiative for businesses that are committed to aligning their operations and strategies with ten universally accepted principles in the areas of human rights, labour, environment and anti-corruption.

Corporations which sign up to the UN Global Compact are encouraged to themselves embrace and in turn, support and enact, within their sphere of influence, a set of core values which are derived from:

- The Universal Declaration of Human Rights
- The International Labour Organization's Declaration on Fundamental Principles and Rights at Work
- The Rio Declaration on Environment and Development
- The United Nations Convention Against Corruption

Human Rights

- Principle 1: Businesses should support and respect the protection of internationally proclaimed human rights; and
- Principle 2: make sure that they are not complicit in human rights abuses.

Labour

- Principle 3: Businesses should uphold the freedom of association and the effective recognition of the right to collective bargaining;
- Principle 4: the elimination of all forms of forced and compulsory labour;
- Principle 5: the effective abolition of child labour; and
- Principle 6: the elimination of discrimination in respect of employment and occupation.

Environment

- Principle 7: Businesses should support a precautionary approach to environmental challenges;
- Principle 8: undertake initiatives to promote greater environmental responsibility; and
- Principle 9: encourage the development and diffusion of environmentally friendly technologies.

Anti-Corruption

- Principle 10: Businesses should work against corruption in all its forms, including extortion and bribery.

The following banks relating to institutions on the Council's lending list are participants/stakeholders of the UN Global Compact:

- Lloyds Banking Group
- Svenska Handelsbanken AB
- Gruppo Santander (ultimate parent of Santander UK plc)
- HSBC
- Royal Bank of Scotland
- Standard Chartered
- Nationwide Building Society
- NatWest Group plc
- The Royal Bank of Scotland Group
- Australia and New Zealand Banking Group
- Commenwealth Bank of Australia
- National Australia Bank
- Westpac Banking Corp.
- Nordea Bank AB
- ING Bank NV
- Rabobank Group
- DBS Bank Ltd
- Credit Suisse

http://www.unglobalcompact.org/ParticipantsAndStakeholders/index.html

Limitations to ethical policies:

It should be noted here that the individual institutions which have signed up to the Equator Principles and to the Global Compact screen borrowers before lending for infrastructure and industrial projects.

However, financial institutions also engage daily in money market and interbank lending transactions; the criteria for such lending is based primarily on credit risk assessment (i.e. the assessment of their lending being repaid in full and on time when it is due). Being a signatory to the EPs will not necessarily be a critical feature of such credit assessment and the Council is not in a position to monitor interbank lending. The same applies to an individual financial signing up to the UN Global Compact.

It should also be noted that becoming a signatory of voluntary guidelines (Equator Principle or Global Compact) does not guarantee that that institution's policies and practices are of a better standard than those institutions which are not signatories to the voluntary guidelines.

Activist investment: The Council does not invest directly in shares traded on the markets or in corporate bonds. Not only are such investments inherently higher risk investments, and requires a distinct and separate set of fund management expertise. Under current legislation (SI 2003 No 3146) the purchase of share capital or loan capital of a body corporate is a capital expenditure investment which, on sale or maturity, becomes a capital receipt and is unsuitable for the Council's treasury investments which are primarily the cash management of its operating surpluses and reserves. Corporate bond and equity investments would however be made by the Council's pension fund (run by Shropshire Council.

Other than through its pension fund (which is measured by Shropshire Council), the Council cannot seek to influence decision making at a company by voicing concerns, engaging in a dialogue with management, or lobbying other shareholders for support. Activist investors attempt to purchase sufficient shares or obtain seats on the board with the goal of effecting major change in the company to make the company more valuable financially or socially (for example to change management policies and adopt better governance; optimise shareholder value through acquisitions/divestitures, be more socially responsible etc).

Credit Ratings – A Guide.

Long-term credit ratings and Sovereign Ratings

Fitch Rating' long-term credit ratings are set up along a scale from 'AAA' to 'D', first introduced in 1924 and later adopted and licensed by Standard & Poors (S&P). Moody's also uses a similar scale, but names the categories differently. Like S&P, Fitch also uses intermediate modifiers for each category between AA and CCC (i.e., AA+, AA, AA-, A+, A, A-, BBB+, BBB, BBB- etc.).

Investment grade

- **AAA** : the best quality, reliable and stable
- **AA** : good quality, a bit higher risk than AAA
- **A** : economic situation can affect finance
- **BBB** : medium class counterparties, which are satisfactory at the moment

Non-investment grade

- **BB** : more prone to changes in the economy
- **B** : financial situation varies noticeably
- **CCC** : currently vulnerable and dependent on favourable economic conditions to meet its commitments
- **CC** : highly vulnerable, very speculative bonds
- **C** : highly vulnerable, perhaps in bankruptcy or in arrears but still continuing to pay out on obligations
- **D** : has defaulted on obligations and Fitch believes that it will generally default on most or all obligations
- **NR** : not publicly rated

Short-term credit ratings

Fitch's short-term ratings indicate the potential level of default within a 12-month period.

- **F1+** : best quality grade, indicating exceptionally strong capacity of obligor to meet its financial commitment
- **F1** : best quality grade, indicating strong capacity of obligor to meet its financial commitment
- **F2** : good quality grade with satisfactory capacity of obligor to meet its financial commitment
- **F3** : fair quality grade with adequate capacity of obligor to meet its financial commitment but near term adverse conditions could impact the obligor's commitments
- **B** : of speculative nature and obligor has minimal capacity to meet its commitment and vulnerability to short term adverse changes in financial and economic conditions
- **C** : possibility of default is high and the financial commitment of the obligor are dependent upon sustained, favourable business and economic conditions
- **D** : the obligor is in default as it has failed on its financial commitments.

Support Ratings (1 – 5)

The Purpose and Function of Support Ratings

Support Ratings are Fitch Ratings' assessment of a potential supporter's propensity to support a bank and of its ability to support it. Its propensity to support is a judgment made by Fitch Ratings. Its ability to support is set by the potential supporter's own Issuer Default Ratings, both in foreign currency and, where appropriate, in local currency. Support Ratings do not assess the intrinsic credit quality of a bank. Rather they communicate the agency's judgment on whether the bank would receive support should this become necessary. These ratings are exclusively the expression of Fitch Ratings' opinion even though the principles underlying them may have been discussed with the relevant supervisory authorities and/or owners.

Timeliness and Effectiveness Requirements

Fitch Ratings' Support Rating definitions are predicated on the assumption that any necessary "support" is provided on a timely basis. The definitions are also predicated on the assumption that any necessary support will be sufficiently sustained so that the bank being supported is able to continue meeting its financial commitments until the crisis is over.

Obligations and Financial Instruments Covered

In terms of these definitions, unless otherwise specified, "support" is deemed to be in terms of foreign currency. It is assumed that typically the following obligations will be supported: senior debt (secured and unsecured), including insured and uninsured deposits (retail, wholesale and interbank); obligations arising from derivatives transactions and from legally enforceable guarantees and indemnities, letters of credit, and acceptances; trade receivables and obligations arising from court judgments.

Likewise, the agency does not assume that the following capital instruments will be supported when sovereign support is involved: preference/preferred shares or stock; hybrid capital (tier 1 and upper tier 2), including reserve capital instruments (RCIs) and variations upon RCIs; and common/ordinary equity capital. It is also assumed that there will be no support for any moral obligation on securitizations. The sovereign support status of subordinated debt is difficult to categorize in advance; it is assessed on a case by case basis, distinguishing among different jurisdictions.

Definitions:

1: A bank for which there is an extremely high probability of external support. The potential provider of support is very highly rated in its own right and has a very high propensity to support the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'A-'.

2: A bank for which there is a high probability of external support. The potential provider of support is highly rated in its own right and has a high propensity to provide support to the bank in question. This probability of support indicates a minimum Long-Term Rating floor of 'BBB-'.

3: A bank for which there is a moderate probability of support because of uncertainties about the ability or propensity of the potential provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'BB-'.

4: A bank for which there is a limited probability of support because of significant uncertainties about the ability or propensity of any possible provider of support to do so. This probability of support indicates a minimum Long-Term Rating floor of 'B'.

5: A bank for which external support, although possible, cannot be relied upon. This may be due to a lack of propensity to provide support or to very weak financial ability to do so. This probability of support indicates a Long-Term Rating floor no higher than 'B-' and in many cases no floor at all.

GLOSSARY

Term	Meaning
Affordable Borrowing Limit	The amount the authority would normally borrow at any point of time in the year. This boundary might be exceeded temporarily but only in exceptional circumstances. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Annuity	A method of repaying a loan where the cash payment remains constant over the life of the loan, but the proportion in interest reduces and the proportion of principal repayment increases ove time.
Authorised Borrowing Limit	The maximum amount the authority can borrow at any point of time in the year. This limit should never be exceeded. The limit is set by Full Council at the beginning of March and is a prudential indicator.
Bail-in	A method of rescuing a failing financial institution by cancelling some of its deposits and bonds. Investors may suffer a haircut but may be given shares in the bank as part compensation. See also bail-out
Bail-out	A method of rescuing a failing financial institution by the injection of public money. This protects investors at the expense of the taxpayer.
Call account	A deposit account that can be called back, normally on instant access.
Capital Financing Requirement CFR)	This represents the underlying need for the authority to borrow and represents the assets of the authority less the long term capital liabilities.
Credit Default Swaps (CDS)	CDS are bought by investors to insure against defaults (i.e. the counterparty not being able to repay). The higher the cost/premium then the higher the risk – CDS therefore given a market view of the credit worthiness of an organisation.
Credit Ratings	Rating on the ability of an organisation to meet its obligations; ratings are assigned by independent, specialist companies, such as Fitch and Moody's using market intelligence they gather.
Credit Risk	The risk that the debtor will default on their obligations
Counterparty	The organisation that you are conducting your business with.
Debt Management Account Deposit Facility	Provided by the Debt Management Office, users can place cash in secure fixed-term deposits. Deposits are guaranteed by the government and therefore have the equivalent of a sovereign triple-A credit rating.
Derivative Instruments	A security whose price is dependent upon or derived from one or more underlying assets. The derivative itself is merely a contract between two or more parties. Its value is determined by fluctuations in the

	underlying asset. The most common underlying assets include stocks, bonds, commodities, currencies, interest rates and market indexes. Most derivatives are characterized by high leverage. For example, a stock option is a derivative because it derives its value from the value of a stock. An interest rate swap is a derivative because it derives its value from one or more interest rate indices.
Discounts	These relate to Public Works Loans Board loans. If rates have increased since the borrowing was undertaken then part of the benefit that PWLB will achieve from being able to loan out at that higher rate are passed back to an authority if they repay the loan early.
Fund Managers	Independent investment managers who work to a specific mandate and invest funds on behalf of the Council
IFRS	International Financial Reporting Standards, the set of accounting rules in use by UK local authorities since 2010.
Inflation	The rise in prices of goods and services over a period of time.
Interest Rate Risk	The risk that the value of an investment will change due to changes to the interest rate.
Internal Borrowing	This is where the amount of an authority's borrowing is less than its CFR or underlying need to borrow and represents the use of internal balances rather than borrowing from the market.
LIBID	London inter-bank bid rate. Interest rate at which prime banks will **borrow** money in the London inter-bank market.
LIBOR	London inter-bank offer rate. Interest rate at which prime banks will **lend** money in the London inter-bank market. Fixed every day by the British Bankers Association to five decimal places.
Liquidity Risk	The risk of not being able to trade an investment quickly to release cash.
LOBO	Lender's Option Borrower's Option – a long term loan where the lender has the option to propose an increase in the interest rate on pre-determined dates. The borrower thenhas the option to either accept the new rate or repay the loan without penalty. LOBOs increase the borrower's interest rate risk and the loan should therefore attract a lower rate of interest initially.
Minimum Revenue Provision (MRP)	This is the amount charged against the Income and Expenditure Account for the year in relation to the repayment of debt on borrowing in order to fund capital expenditure.

Money Market Fund (MMF)	Mutual funds that invest in short term debt instruments. They offer a higher level of security than banks and interest rates are generally higher.
Obligor	An individual or company that owes debt to another individual or company (the creditor), as a result of borrowing or issuing bonds.
Premia	This is the penalty applied to the early redemption of PWLB loans where rates have fallen since the loan was undertaken.
Prudential Code	A professional code of practice which provides regulatory framework to local authorities on capital expenditure, investments and borrowing activities.
Prudential Indicators	A set of indicators developed within the Prudential Code which define thresholds for investment and borrowing within a local authority.
PWLB	Public Works Loans Board – a Government agency providing long and short term loans to local authorities. Interest rates are generally lower than the private sector and slightly higher than the rates at which the Government themselves may borrow.
Quantitative Easing	This is where the government buy back their own gilt issuance to effectively pump money into the financial markets of the economy.
Re-scheduling	This relates to repaying existing borrowing early and replacing it with borrowing for a different period usually, but not necessarily, at lower rates
Return	The gain from holding an investment over a given period
Security	An investment instrument, other than an insurance policy or fixed annuity, issued by a corporation, government or other organisation which offers evidence of debt or equity.
Sovereign Exposure	Risk of exposure to one particular country.
Supranational Bonds	These are bonds (similar to gilts) issued by multi government development organisations and are supported by all of the governments who form part of the organisation. E.g. European Investment Bank and are usually very secure.
Treasury Management Code (TM Code)	CIPFA's Code of Practice for Treasury Management in the Public Services and Cross-Sectoral Guidance Notes, to which local authorities are required by law to have regard.