Kirklees COUNCIL

Name and date of meeting: **Corporate Governance and Audit Committee**
25 January 2019

Cabinet
29 January 2019

Council
13 February 2019

Title of report: Treasury Management Strategy 2019-20

Purpose of report

Under the CIPFA Code of Practice on Treasury Management (2017) and accompanying Prudential Code 2017 the Council must present a Treasury Management Strategy at the start of each financial year. Alongside the Treasury Management Strategy an Annual Investment Strategy must also be approved by Council.

Key Decision - Is it likely to result in spending or saving £250k or more, or to have a significant effect on two or more electoral wards?	**Yes**
Key Decision - Is it in the Council's Forward Plan (key decisions and private reports?)	**Key Decision: Yes** **Private Report/Private Appendix: N/A**
The Decision - Is it eligible for call in by Scrutiny?	**No**
Date signed off by Strategic Director and name **Is it also signed off by Service Director** **Is it also signed off by the Service Director Legal, Governance and Commissioning**	**N/A** **Eamonn Croston – 17 January 2019** **Julie Muscroft – 17 January 2019**
Cabinet member portfolio	**Corporate** **Graham Turner**

Electoral wards affected: **N/A**
Ward councillors consulted: **N/A**
Public or Private: **Public**

1 Summary

1.1 The Council has formally adopted CIPFA's Code of Practice on Treasury Management (2017 Edition), and accompanying Prudential Code 2017, and is thereby required to consider a treasury management strategy before the start of each financial year. In addition, the Ministry for Housing, Communities and Local Government (MHCLG) issued guidance on local authority investments in February 2018, which requires the Council to approve an annual Investment Strategy before the start of each financial year.

1.2 This report meets the requirements of the current CIPFA Codes and current MHCLG Guidance (2017 Edition).

1.3 Cabinet is responsible for the implementation and monitoring of the treasury management policies. The Corporate Governance and Audit Committee undertake a scrutiny role with regard to treasury management. Recent training for members of this Committee was provided in November 2018 by the Council's treasury management advisors/consultants, Arlingclose.

1.4 This report will:

(i) outline the outlook for interest rates and credit risk, and in light of this, recommend an investment strategy (Treasury Management Investments) for the Council to follow in 2019-20;

(ii) outline the current and estimated future levels of Council borrowing (internal and external) and recommend a borrowing strategy for 2019-20;

(iii) review the methodologies adopted for providing for the repayment of debt and recommend a policy for calculating the Minimum Revenue Provision from 2018-19 onwards;

(iv) review other treasury management matters including the policy on the use of financial derivatives, prudential indicators, the use of consultants, and the policy on charging interest to the Housing Revenue Account;

(v) as part of the new treasury management regulations, to recommend an annual Investment Strategy (Non-Treasury Investments) for the Council in 2019-20 in line with MHCLG (2017) guidance.

2 Information required to take a decision

The following paragraphs 2.1 to 2.4 have been provided by our Treasury Management external advisors, Arlingclose:

<u>Economic Background</u>

2.1 The UK's progress negotiating its exit from the European Union, together with its future trading arrangements, will continue to be a major influence on the Authority's treasury management strategy for 2019/20. UK Consumer Price Inflation (CPI) for October was up 2.4% year/year, slightly below the consensus forecast and broadly in line with the Bank of England's November Inflation Report. The most recent labour market data for October 2018 showed the unemployment rate edged up slightly to 4.1% while the employment rate of 75.7% was the joint highest on record. The 3-month average annual growth rate for pay excluding bonuses was 3.3% as wages continue to rise steadily and provide some pull on general inflation. Adjusted for inflation, real wages grew by 1.0%, a level still likely to have little effect on consumer spending.

2.2 Following the Bank of England's decision to increase Bank Rate to 0.75% in August, no changes to monetary policy has been made since. However, the Bank expects that should the economy continue to evolve in line with its November forecast, further increases in Bank Rate will be required to return inflation to the 2% target. The Monetary Policy Committee (MPC) continues to reiterate that any further increases will be at a gradual pace and limited in extent.

Interest Rate Forecast

2.3 Following the increase in Bank Rate to 0.75% in August 2018, the Authority's treasury management adviser Arlingclose is forecasting two more 0.25% hikes during 2019 to take official UK interest rates to 1.25%. The Bank of England's MPC has maintained expectations for slow and steady rate rises over the forecast horizon. The MPC continues to have a bias towards tighter monetary policy but is reluctant to push interest rate expectations too strongly. Arlingclose believes that MPC members consider both that ultra-low interest rates result in other economic problems, and that higher Bank Rate will be a more effective policy weapon should downside Brexit risks crystallise when rate cuts will be required.

2.4 The UK economic environment remains relatively soft, despite seemingly strong labour market data. Arlingclose's view is that the economy still faces a challenging outlook as it exits the European Union and Eurozone growth softens. While assumptions are that a Brexit deal is struck and some agreement reached on transition and future trading arrangements before the UK leaves the EU, the possibility of a "no deal" Brexit still hangs over economic activity. As such, the risks to the interest rate forecast are considered firmly to the downside.

Borrowing and Investment – General Strategy for 2019-20

2.5 The Capital Financing Requirement (CFR) represents the Council's underlying need to finance capital expenditure by borrowing or other long-term liability arrangements. An authority can choose to borrow externally to fund its CFR. If it does this, it is likely that it would be investing externally an amount equivalent to its total reserves, balances and net creditors. Alternatively, an authority can choose not to invest externally but instead use these balances to effectively "borrow internally" and minimise external borrowing. In between these two extremes, an authority may have a mixture of external and internal investments / external and internal borrowing.

Table 1 below sets out the forecast CFR position for the Council as at March 2019 and forecast CFR and borrowing requirements over the following 3 years:

Table 1: Balance Sheet Forecast

	2018-19 £m	2019-20 £m	2020-21 £m	2021-22 £m
General Fund CFR - Non PFI	462.8	508.9	555.0	591.8
PFI	49.3	45.8	42.6	39.4
HRA CFR - Non PFI	175.3	170.7	165.7	162.8
PFI	52.9	50.5	48.1	45.2
Total CFR	740.3	775.9	811.4	839.2
Less: PFI debt liabilities*	102.2	96.3	90.7	84.6
Borrowing CFR	638.1	679.6	720.7	754.6
Finance via;				
Deferred Liabilities	3.9	3.7	3.6	3.6
Internal Borrowing	136.6	136.6	136.6	136.6
External Borrowing	497.6	539.3	580.5	614.5
Total	638.1	679.6	720.7	754.6
Investments	30.0	30.0	30.0	30.0

**£102.2m PFI Liabilities (£5.9m falling due in 2019-20)*

2.6 Prior to 2009-10 the Council's policy had been to borrow up to its CFR, investing externally the majority of its balances. With the onset of instabilities in the financial markets and the economic downturn, the policy changed to one of ensuring the security of the Council's balances. This coincided with significant falls in investment returns, making the budgetary benefit of maximising external borrowing more marginal. Thus, the Council has chosen to steadily reduce monies invested externally and instead has used internal balances to offset new borrowing requirements.

2.7 The external borrowing necessary to fund the projected rise in CFR highlighted in Table 1 (above) will be a mixture of long and short-term borrowing. The cost of borrowing has been historically low over the past decade. Recent incremental uplifts in bank base rates, and further forecast incremental uplifts over the following 12 months or so, suggest that it may be beneficial to consider taking out some external borrowing at guaranteed fixed long term rates that are still relatively low.

2.8 Table 1 above also reflects a fairly consistent level of internal borrowing forecast over the next 3 years. This largely reflects the view that forecast reserves, balances and net creditors are projected to remain reasonably consistent over the medium term.

2.9 This in part depends on the extent to which short term borrowing rates may increase from current. The relative mix of future internal and external borrowing will be considered in conjunction with advice from the Council's external treasury management advisor, noting as well that provision will be made in updated Council budget plan revenue resource assumptions to accommodate a potential increase in external borrowing.

2.10 The Service Director Finance, supports the approach that the borrowing and investment strategy for 2019-20 continues to place emphasis on the security of the Council's balances. Although credit conditions have been steadily improving, the global recovery is still fragile and regulation changes have increased local authority exposure in the event of a possible default of any financial institutions

2.11 It is recommended that balances should continue to be invested to a level which is perceived to be reasonably secure and which is needed to meet the day-to-day cash flow requirements of the Council (around £30 million). The remainder of the balances will be effectively invested internally, that is used to offset borrowing requirements.

2.12 In order to increase investment returns, alternative investment options were considered further at full Council on 12 December 2018 and as part of the Half Yearly Monitoring report on Treasury Management activities 2018/19. There was member approval to add the Local Authorities Pooled Investment Fund as an approved Council Investment, and further, for officers to continue to explore options for a potential investment of between £5m and £10m in the fund.

2.13 Average current Council cashflow balances remain consistent at about £42m, and officers consider that an investment of upto £10m will still enable sufficient remaining headroom to accommodate the £30m day-to-day cashflow requirement as noted at paragraph 2.10 above.

2.14 Given the nature of the underlying investment (UK based diversified property portfolio) and the potential for domestic economic volatility in the run up to UK's expected withdrawal from the EU on 29 March 2019, advice will be sought from the Council's external treasury advisors, as well as more detailed discussions with the LAPF's Fund Manager, CCLA. Updated Council budget plans have factored in a potential investment of upto £10m part way through 2019-20.

Borrowing Strategy

2.15 The Council is forecast to hold around £545.8m of external borrowing and other long-term liabilities as at 31 March 2019. This is analysed at Table 2 below:

Table 2 – year end estimate – 31 March 2019

	£m	**%**
PWLB loans (fixed rate)	280.4	51
LOBOs	75.0	14
Loan stock (fixed rate)	7.0	1
Other long term loans (fixed rate)	30.3	6
Temporary borrowing	50.9	9
Total external borrowing	**443.6**	
Other Long Term Liabilities (mainly PFI)	102.2	19
Total external debt liabilities	**545.8**	

2.16 The approved sources of borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- Any bank or building society authorised to operate in the UK
- Other local authorities

- Capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues
- UK public and private sector pension funds
- Salix Finance Limited

2.17 Historically, the biggest source of borrowing for local authorities has been PWLB loans. These Government loans have offered value for money and also flexibilities to restructure and make possible savings. The Council also has 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 Council has the option to either accept the new rate or to repay the loan at no additional cost. The Council will take the option to repay at no cost, if it has the opportunity to do so. The Council's current limit on LOBO borrowing is set at 30% of long-term debt.

2.18 The Local Capital Finance Company was established in 2014 by the Local Government Association as an alternative source of local authority finance. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable.

2.19 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. The Council may take advantage of this and replace some of the higher rate loans with new loans at lower interest rates where this will lead to an overall saving or reduce risk.

2.20 Salix Finance Limited provides interest free Government funding to the public sector to improve their energy efficiency, reduce carbon emissions and lower energy bills. The Council to date has taken the opportunity to secure £5.9m interest free loan to part fund the £11m approved street lighting replacement scheme in the Council's approved capital plan.

2.21 Borrowing policy and performance will be monitored throughout the year and will be reported to Members via a Half Yearly Report and also an Outturn Report in line with approved guidance.

Investment Strategy

2.22 Investment guidance issued by MHCLG requires that an investment strategy, outlining the authority's policies for managing investments in terms of risk, liquidity and yield, should be approved by full Council or equivalent level, before the start of the financial year. This strategy can then only be varied during the year by the same executive body.

2.23 The Council will not place direct investments in companies as defined by the Carbon Underground 200 on 1 February each year.

2.24 A new regulatory update came into force from 3rd January 2018; the second Markets in Financial Instruments Directive (MiFID II), which meant that the Council had to formally apply to renew its status as a 'professional client' (also referred to as the 'opt up' option), but subject to certain criteria being met.

2.25 Following full Council approval on 13th December 2017, officers have now successfully 'opted up' the Council to professional client status, effective from 3rd January 2018. Given the size and range of the Council's treasury management activities, the Service Director Finance believes this to continue to be the most appropriate status.

2.26 It is recommended that the investment strategy for 2019-20 includes consideration of a potential investment of up to £10m in the Local Authorities Property Investment Fund (see also paragraph 2.12 earlier). The Council will continue to maintain a relatively low risk strategy giving priority to security and liquidity, and as such invest an average of around £30 million externally in relatively short-term, liquid investments through the money markets, for the purpose of managing day-to-day cash flow requirements. Any remaining balances, net of investment in the local authority property fund, will be used internally, offsetting borrowing requirements.

2.27 It is proposed to change the Council's investment criteria to increase the minimum credit rating for both UK and foreign banks in line with advice from the Treasury Management Consultants. This will raise the minimum credit rating to: A- (Fitch and S&P) and A3 (Moody's) from the previous minimum: BBB+ (Fitch and S&P) and Baa1 (Moody's). In practice this will have a minimal effect on the Council's treasury activities as all current investments meet the proposed criteria and it will bring the Council in-line with current advice from the Council's Treasury Management Consultants. The credit ratings table highlights this and is shown at Appendix B. The criteria have also been updated to reflect the potential for investment in Local Authority Pooled Investment funds. The table detailed at Appendix A reflects both of these updates and highlights the investment limits for all types of treasury investments**.**

2.28 The Council uses credit ratings from the three main rating agencies - Fitch, Moody's and Standard & Poor's to assess the risk of investment defaults (Appendix B). The lowest credit rating of an organisation will be used to help determine credit quality. Long term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade.

2.29 Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria:

- No new investments will be made;
- Any existing investments that can be recalled at no cost will be recalled;
- 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 rating is on review for possible downgrade ("negative watch") so that it is likely to fall below the required criteria, then no further investments will be made in that organisation until the outcome is announced. This policy will not apply to negative outlooks.

2.30 Full regard will be given to other available information on the credit quality of banks and building societies, including credit default swap prices, financial statements and rating agency reports. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the approved criteria.

2.31 If the UK enters into a recession in 2019-20, there is a small chance that the Bank of England could 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. This situation already exists in many other countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

2.32 Annual cash flow forecasts are prepared which are continuously updated. Investment policy and performance will be monitored continuously and will be reported to Members during the year and as part of the annual report on Treasury Management.

Statement of Policy on the Minimum Revenue Provision (MRP)

2.33 MRP is the statutory requirement for local authorities to set aside some of their revenue resources as provision for reducing the underlying need to borrow (Capital Financing Requirement – CFR), ie the borrowing taken out in order to finance capital expenditure.

2.34 Prior to the Local Authorities (Capital Finance and Accounting) (England) Regulations 2008, which came into force on 31 March 2008, the set aside was specified as a percentage of a council's CFR (2% for HRA debt, 4% for General Fund). The current Regulations are less prescriptive with a requirement to ensure the amount set aside is deemed to be **prudent**, although there is accompanying current MHCLG guidance which sets out possible methods a council might wish to follow.

2.35 Current MHCLG guidance recommends that authorities prepare a statement of policy on making MRP in respect of the forthcoming year, with approval by full council before the start of the financial year. If these proposals subsequently need to be varied, a revised statement should be put to full council. Appendix C details the Council's policy for the provision of MRP. Within the revised MRP policy approved by Council last year, the unwinding of the previous over-provision was profiled equally over 10 years (£9.1m per year).

2.36 Officers are proposing a revised profile for unwinding MRP over-provision in 2018-19 and 2019-20, that will increase the un-winding for each of the next two years. The maximum amount of un-wind in any one year cannot be more than the overall annual MRP calculation, as otherwise the Council would end up in a negative MRP position, which is not allowable under accounting rules. The maximum unwind allowable in 2018-19 is £13.5m and estimated to be similar in 2019-20. This reduction in MRP charges for these 2 years has been factored into the Council's CFR calculations set out earlier at Table 1.

2.37 Officer recommendation is that the impact of the additional unwind, will be transferred to Council financial resilience reserves as part of the Council's broader risk strategy set out in the overall annual budget report to Cabinet on 29 January and Budget Council on 13 February 2019.

Policy on the Use of Financial Derivatives

2.38 Local authorities (including this Council) have in the past 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). The Localism Act 2011 includes a general power of competence that appears to remove the uncertain legal position over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). The latest CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

2.39 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where it is confident it has the powers to enter into such transactions. They will only be used for the prudent management of its financial affairs and never for speculative purposes and where it can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to.

2.40 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.

Non-Treasury Investments

2.41 The Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing, loans to local businesses and landlords, or as equity investments and loans to the Authority's subsidiaries. Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. They are however covered by the Authority's Investment Strategy (see Appendix E).

Treasury Management Indicators

2.42 The Council is asked to approve certain treasury management indicators, the purpose of which is to contain the activity of the treasury function within certain limits, thereby reducing the risk or likelihood of an adverse movement in interest rates or borrowing decision impacting negatively on the Council's overall financial position. However, if these are set to be too restrictive they will impair the opportunities to reduce costs. The proposed indicators are set out in Appendix D.

Other Matters

2.43 The CIPFA Code also requires the Council to note the following matters each year as part of the treasury management strategy:

(i) *Investment Consultants*

The Council's adviser is Arlingclose Limited. The services received include:

- Advice and guidance on relevant policies, strategies and reports;
- Advice on investment and debt management;
- Notification of credit ratings and other information on credit quality;
- Reports on treasury performance;
- Forecasts of interest rates and economic activity; and
- Training courses.

The quality of the service is monitored on a continuous basis by the Council's treasury management team.

(ii) *Investment Training*

As part of the MiFID II requirements, the needs of the Council's treasury management staff for training in investment management are assessed on a continuous basis, and formally on a 6-monthly basis as part of the staff appraisal process. Additionally training requirements are assessed when the responsibilities of individual members of staff change. Staff attend training courses and seminars as appropriate.

(iii) *Investment of money borrowed in advance of need*

The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. However, as this would involve externally investing such sums until required and thus increasing exposures to both interest rate and principal risks, it is not believed appropriate to undertake such a policy at this time.

(iv) Policy on charging interest to the Housing Revenue Account (HRA)

Following the reform of housing finance, the Council is free to adopt its own policy on sharing interest costs and income between General Fund and the HRA. The CIPFA code recommends that authorities state their policy each year in the strategy report.

On 1 April 2012, the Council notionally split each of its existing long term loans into General Fund and HRA pools. New long term loans borrowed will be assigned in their entirety to one pool or the other. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. Interest will be applied to this balance using the authority's average investment rate.

3 Implications for the Council

3.1 Working with People

N/A

3.2 Working with Partners

N/A

3.3 Placed based working

N/A

3.3 Improving Outcomes for Children

N/A

3.4 Reducing demand of services

N/A

3.5 Other (e.g. Legal/Financial or Human Resources)

The revenue implications of the strategies outlined have been reflected in the Council's annual budget report 2019-22.

4 Consultees and their opinions

Arlingclose, the treasury management advisors to the Council, have provided the economic context commentary contained in this report.

5 Next steps

Treasury management performance will be monitored and reported to members during the year.
Following consideration at Corporate Governance & Audit Committee, this report will be presented to Cabinet on 29 January 2019 and then full Council on 13 February 2019.

6 Officer recommendations and reasons

That Corporate Governance & Audit Committee recommend the following for approval by Cabinet and then Council:

(i) the borrowing strategy outlined in paragraphs 2.15 to 2.21;
(ii) the investment strategy (treasury management investments) outlined in paragraphs 2.22 to 2.32 and Appendices A and B;
(iii) the policy for provision of repayment of debt (MRP) outlined in paragraphs 2.33 to 2.37 and at Appendix C;
(iv) the treasury management indicators in Appendix D;
(v) the Investment Strategy (Non-Treasury Investments) at Appendix E.

7 Cabinet Portfolio Holder recommendation

The report and recommendations be submitted to Cabinet on 29 January 2019 and Council on 13 February 2019.

8 Contact officer

James Anderson	Senior Finance Manager	01484 221000
Rachel Firth	Finance Manager	01484 221000

9 Background Papers and History of Decisions

CIPFA's Code of Practice on Treasury Management in the Public Services; CIPFA's Prudential Code for Capital Finance in Local Authorities; Guidance on Local Government Investments (MHCLG 2018); The Local Authorities (Capital Finance and Accounting) (England) Regulations 2008; Localism Act 2011.
CIPFA Treasury Management Code and Prudential Code 2017

10 Service Director responsible

Eamonn Croston 01484 221000

APPENDIX A

Investment Policy for 2019-20

Investment Limits:

- The Council is able to invest an unlimited amount with the UK Government for up to 6 months.
- The Council is able to invest up to £10 million and up to three months with UK banks and building societies with a "high to upper medium grade" credit rating.
- The Council is able to invest up to £10 million and up to two months with foreign banks with a "high to upper medium grade" credit rating.
- The Council is able to invest up to £10 million and up to two months with individual local authorities.
- The Council is able to invest up to £10 million in individual MMFs (instant access or up to 2 day notice). There will be an overall limit of £40 million for MMFs (non-government funds), plus up to £10 million invested in a fund backed by government securities.
- The Council is able to invest up to £10million in Local Authority Pooled Investment Funds.

The maximum limits apply to any one counter-party and to a banking group rather than each individual bank within a group.

Note:

The limits set out above exclude any amounts held on the Council's behalf by the Yorkshire Purchasing Organisation (YPO). The YPO (a consortium in which the Council has an interest) invest funds as part of their treasury management processes. For the avoidance of doubt, this element does not form part of the limits set above. For context, the Council's proportion of YPO's maximum investment with any given counterparty is approximately £155k.

The Council will not place direct investments in companies as defined by the Carbon Underground 200 on 1 February each year.

Liquidity management:

The Authority uses purpose-built cash flow forecasting models to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis 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.

	Short-term Credit Ratings / Long-Term Credit Ratings			Investment Limits per Counterparty		Counterparties falling into category as at Dec 2018
	Fitch	**Moody's**	**S & P**	**£m**	**Period (2)**	
UK Banks / Building Societies (Deposit accounts, fixed term deposits and REPOs)	F1	P-1	A-1	10	<3mth	HSBC, Bank of Scotland, Lloyds Group, Yorkshire BS, Santander UK, Leeds BS, Nationwide BS, Barclays, Coventry BS, Close Bros
	AAA,AA+,AA, AA-,A+,A, A-	Aaa,Aa1,Aa2, Aa3,A1,A2,A3	AAA,AA+,AA, AA-,A+,A,A-			
Foreign Banks (Deposit accounts, fixed term deposits and REPOs)	F1	P-1	A-1	10	<2mth	Svenska Handelsbanken
	AAA,AA+,AA, AA-,A+,A,A-	Aaa,Aa1,Aa2, Aa3,A1,A2,A3	AAA,AA+,AA, AA-,A+,A,A-			
MMF (1)	-	-	-	10	Instant access/ up to 2 day notice	
UK Government (Fixed term deposits)	-	-	-	Unlimited	<6mth	
UK local authorities (Fixed term deposits)	-	-	-	10	<2mth	
Local Authority Pooled Investment Funds	-	-	-	10	>6mth	

(1) Overall limit for investments in MMFs of £50 million – the assets the funds invest in are securities and structures secured on government securities
(2) The investment period begins from the commitment to invest, rather than the date on which funds are paid over.

Credit ratings

<table>
<tr><th colspan="2">Moody's</th><th colspan="2">S&P</th><th colspan="2">Fitch</th><th></th></tr>
<tr><th>Long-term</th><th>Short-term</th><th>Long-term</th><th>Short-term</th><th>Long-term</th><th>Short-term</th><th></th></tr>
<tr><td>Aaa</td><td rowspan="6">P-1</td><td>AAA</td><td rowspan="4">A-1+</td><td>AAA</td><td rowspan="4">F1+</td><td>Prime</td></tr>
<tr><td>Aa1</td><td>AA+</td><td>AA+</td><td rowspan="3">High grade</td></tr>
<tr><td>Aa2</td><td>AA</td><td>AA</td></tr>
<tr><td>Aa3</td><td>AA-</td><td>AA-</td></tr>
<tr><td>A1</td><td>A+</td><td rowspan="2">A-1</td><td>A+</td><td rowspan="2">F1</td><td rowspan="3">Upper medium grade</td></tr>
<tr><td>A2</td><td>A</td><td>A</td></tr>
<tr><td>A3</td><td rowspan="2">P-2</td><td>A-</td><td rowspan="2">A-2</td><td>A-</td><td rowspan="2">F2</td></tr>
<tr><td>Baa1</td><td>BBB+</td><td>BBB+</td><td rowspan="3">Lower medium grade</td></tr>
<tr><td>Baa2</td><td rowspan="2">P-3</td><td>BBB</td><td rowspan="2">A-3</td><td>BBB</td><td rowspan="2">F3</td></tr>
<tr><td>Baa3</td><td>BBB-</td><td>BBB-</td></tr>
<tr><td>Ba1</td><td rowspan="14">Not prime</td><td>BB+</td><td rowspan="6">B</td><td>BB+</td><td rowspan="6">B</td><td rowspan="3">Non-investment grade speculative</td></tr>
<tr><td>Ba2</td><td>BB</td><td>BB</td></tr>
<tr><td>Ba3</td><td>BB-</td><td>BB-</td></tr>
<tr><td>B1</td><td>B+</td><td>B+</td><td rowspan="3">Highly speculative</td></tr>
<tr><td>B2</td><td>B</td><td>B</td></tr>
<tr><td>B3</td><td>B-</td><td>B-</td></tr>
<tr><td>Caa1</td><td>CCC+</td><td rowspan="5">C</td><td rowspan="5">CCC</td><td rowspan="5">C</td><td>Substantial risks</td></tr>
<tr><td>Caa2</td><td>CCC</td><td>Extremely speculative</td></tr>
<tr><td>Caa3</td><td>CCC-</td><td rowspan="3">In default with little prospect for recovery</td></tr>
<tr><td rowspan="2">Ca</td><td>CC</td></tr>
<tr><td>C</td></tr>
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APPENDIX C

STATEMENT OF POLICY ON THE MINIMUM REVENUE PROVISION (REPAYMENT OF DEBT)

1. Background

1.1 The Local Authorities (Capital Finance and Accounting) (England) Regulations 2008 requires authorities to make an amount of MRP which the authority considers "prudent".

1.1 The regulation does not itself define "prudent provision". However, guidance issued alongside the regulations makes recommendations on the interpretation of that term.

2 Policy for 2018-19 onwards

2.1 The Service Director Finance recommends the following policy for making prudent provision for MRP:

(i) General Fund Borrowing (pre 1st April 2008) - Provision to be made over the estimated average life of the asset (as at 1 April 2008) for which borrowing was taken - deemed to be 50 years (annuity calculation).

(ii) Calculations to compare this to the previous MRP charge indicated that between 2007-08 and 2015-16 the Council provided an additional £91.2m with which it will "un-wind" over 9 years from 2017-18.

(iii) General Fund Prudential Borrowing – Provision to be made over the estimated life of the asset for which borrowing is undertaken. Provision to commence in the year following purchase (annuity calculation). Where large loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

(iv) HRA Borrowing - Provision to be made for debt repayments equal to its share of any scheduled external debt repayments.

(v) PFI schemes - Provision to equal the part of the unitary payment that writes down the balance sheet liability, together with amounts relating to lifecycle costs incurred in the year.

TREASURY MANAGEMENT INDICATORS

Gross Debt and the Capital Financing Requirement (CFR)
The Code requires that where gross debt is greater than the CFR, the reasons for this should be clearly stated in the annual strategy. This does not apply to this Council as its gross debt will not exceed the CFR over the forecast period (see the 'Gross Debt and the Capital Financing Requirement table within the Capital Strategy).

Interest Rate Exposures
While fixed rate borrowing can contribute significantly to reducing the uncertainty surrounding future interest rate scenarios, the pursuit of optimum performance justifies retaining a degree of flexibility through the use of variable interest rates on at least part of the treasury management portfolio.

It is recommended that the Council sets an upper limit on its fixed interest rate exposures for 2019-20, 2020-21 and 2021-22 of £680m, £720m, £754m of its net principal. It is further recommended that the Council sets an upper limit on its variable interest rate exposures for 2019-20, 2020-21 and 2021-22 of £100m of its net principal.

Maturity Structure of Borrowing
This indicator is designed to prevent the Council having large concentrations of fixed rate debt* needing to be replaced at times of uncertainty over interest rates. It is recommended that the Council sets upper and lower limits for the maturity structure of its borrowings as follows:

Amount of projected borrowing that is fixed rate maturing in each period as percentage of total projected borrowing that is fixed rate		
	Upper Limit (%)	**Lower Limit (%)**
Under 12 months	20	0
Between 1 and 2 years	20	0
Between 2 and 5 years	60	0
Between 5 and 10 years	80	0
More than 10 years	100	20

*LOBOs are classed as fixed rate debt unless it is considered probable that the loan option will be exercised.

Total principal sums invested for periods longer than 364 days
The Council is not intending to invest sums for periods longer than 364 days.

Appendix E

Investment Strategy 2019/20

Introduction

The Authority invests its money for three broad purposes:

- because it has surplus cash as a result of its day-to-day activities, for example when income is received in advance of expenditure (known as **treasury management investments**),
- to support local public services by lending to or buying shares in other organisations (**service investments**), and
- to earn investment income (known as **commercial investments** where this is the main purpose).

This investment strategy is a new report for 2019/20, meeting the requirements of statutory guidance issued by the government in January 2018, and focuses on the second and third of these categories.

Treasury Management Investments

The Authority typically receives its income in cash (e.g. from taxes and grants) before it pays for its expenditure in cash (e.g. through payroll and invoices). It also holds reserves for future expenditure. These activities, plus the timing of borrowing decisions, lead to a cash surplus which is invested in accordance with Treasury Management guidance both from the Chartered Institute of Public Finance and Accountancy and MHCLG. Average cash balances in 2019/20 for the purpose of treasury management investment are expected to average £40m plus, with fluctuations between £25m and £65m.

Contribution: The contribution that these investments make to the objectives of the Authority is to support effective treasury management activities.

Further details: Full details of the Authority's policies and its plan for 2019/20 for treasury management investments are covered in the treasury management strategy report 2019/20 to which this Investment Strategy is appended.

Service Investments: Loans

Contribution: The Council makes investments to assist local public services, including making loans to a variety of organisations, mainly local businesses, the local education college and local residents to support local public services and stimulate local economic growth.

The Council provided a significant loan to Kirklees College to help facilitate a new campus in Huddersfield and the delivery of a successful further education provision for post 16 students and adults across the District.

Smaller loans have also been provided to local residents to be able to provide energy efficient heating within their own homes. The Council is part of the Leeds City Region Investment Fund where all local authorities contribute to the fund which provides individual loans to support infrastructure and construction projects which help deliver economic growth and job creation.

From 19/20 the Council is planning on providing significant development finance loans to support major town centre regeneration and economic growth, up to a Council approved £38m (per the 5 year Capital Plan 2019-20 to 2023-24), through a combination of Property Investment Fund (£25m) and HD-One Fund at £13m. Amounts have been set aside in the capital plan for this type of investment.

Security: The main risk when making loans is that the borrower will be unable to repay the principal lent and/or the interest due. Investment Strategy guidance states that in order to limit this risk, and ensure that total Council exposure to loans remains proportionate to the size of the Authority, upper limits on the outstanding loans to each category of borrower have to be set, and approved annually by Council. The proposed upper limits for Council loans are set out at Table 1 below:

Table 1: Loans for service purposes in £ millions

Category of borrower	**31.3.2018 actual**			**2019/20**
	Balance owing	**Loss allowance**	**Net figure in accounts**	**Approved Limit**
Further education college	16.4	0.0	16.4	**16.4**
Leeds City Region revolving investment fund	2.3	0.0	2.3	**3.9**
Local businesses and charities	0.8*	0.0	0.8*	**38.8**
Local residents	2.1	0.0	2.1	**2.1**
TOTAL	**21.6**	**0.0**	**21.6**	**61.2**

* This is made up of numerous small investments, the largest of which are £0.2m for the Media Centre and £0.2m for KSDL.

Accounting standards require the Authority to set aside a loss allowance for loans, reflecting the likelihood of non-payment. The figures for loans in the Authority's statement of accounts from 2018-19 onwards will be shown net of this loss allowance. However, the Authority makes every reasonable effort to collect the full sum lent and has appropriate credit control arrangements in place to recover overdue repayments.

Risk assessment:

The Authority assesses the risk of loss before entering into and whilst holding service loans. This will include the nature of the market/sector to which the loan relates, and loan security against business/sector assets. The single largest current loan relates to Kirklees College which is a public sector entity and considered to be a viable going concern. The strength of the Council's partnership with key anchor organisations in the district like the College, and ability to influence, support and monitor the College's ongoing financial position, are also key factors, including Council senior finance representation on the College's finance committee.

Development finance loans such as Property Investment Fund (PIF) and HD-One will allow the Council to offer loans to development projects which offer significant economic benefits to the Council and the wider Kirklees district.

Any funding offers made will be on the basis that the loan repayments made by the recipient will cover the Council's financing costs and allow for an appropriate margin on cost of funds reflecting the level of risk involved and consistent with State Aid principles. All funding offers made will be subject to appropriate due diligence, including external specialist advice where appropriate, availability of credit ratings in respect of any potential loanee where appropriate, and loan security arrangements. Each individual loan offer will be the subject of a further Cabinet report.

It would not be the intention for the Council to directly compete with existing providers of investment funding. The Council would only look to invest, at its discretion, when there was a clear and demonstrable added value case to be made in terms of local economic benefits for development finance involvement. In many instances the Council investment would be short term to cover the construction phase of development which is the most critical period for schemes to locate finance that is timely and on reasonable terms.

Once out of the development phase there is sufficient liquidity at an appropriate risk margin in the existing investment markets for schemes to be refinanced at which point the Council investment would be repaid. Any investment from the PIF would be on terms that allowed the Council to fully cover its costs, including the costs of borrowing to fund any advance, and creation of an appropriate risk contingency.

Service Investments: Shares

Contribution: The Council invests in the shares of local businesses to support local public services and stimulate local economic growth. The main share investment (£0.9m) is a 9.9% holding in Kirklees School Services Ltd which operates 20 schools on our behalf on a 32 year contract under PFI. The council also has a 40% shareholding in KSDL, a 14% holding in in QED KMC Holdings Ltd (£0.3m) and a 100% shareholding in KHBP Ltd (£0.1m).

A further £2.5m has been approved for a potential 50% shareholding in Bridge Homes currently in the Capital Plan. This is a partnership project for the building of new homes in the region.

Security: One of the risks of investing in shares is that they fall in value meaning that the initial outlay may not be recovered. In order to limit this risk, upper limits on the sum invested in each category of shares have been set as follows:

Table 2: Shares held for service purposes in £ millions

Category of company	**31.3.2018 actual**			**2019/20**
	Amounts invested	**Gains or losses**	**Value in accounts**	**Approved Limit**
Local businesses	1.3	0.0	1.3	3.8

Risk assessment: The Authority entered into these shareholdings for the purposes of participating in the governance and control of organisations that it considered to be important for the purposes of securing economic benefits to the borough. The Council is also the sole client in respect of one of these investments. The Council assessed the risk of participation taking account of the financial and public benefits, including the opportunity to make a potential gain in the event of the business being successful, although this was not the core purpose for initial participation. The Council assesses the risk of losses whilst holding shares by continued oversight and involvement in the strategic and operational aspects of the business, and participation in decision making, although the financial risk of the investment is perhaps lower than the operational and or reputational impacts of any failure by the companies in which the Council holds share based investments.

Liquidity: The Council has entered into these shareholdings for the purposes of delivery of its public service and community leadership obligations and the investments are considered to be long term. Viability of the investments in the long term is an important part of the strategy, but as the Councils share ownership and participation is strategic rather than financial the daily or periodic value is of less concern than the overall long term health of the organisation in which the investment is held.

Non-specified Investments: Shares are the only investment type that the Authority has identified that meets the definition of a non-specified investment in the government guidance. The limits above on share investments are therefore also the Authority's upper limits on non-specified investments. The Authority has not adopted any procedures for determining further categories of non-specified investment since none are likely to meet the definition.

Commercial Investments: Property

Contribution: The Council invests in local commercial property such as retail town centre shops and buildings.

These assets fall under the definition of Investment Properties in the CIPFA Accounting Code and are valued at fair value in the accounts in accordance with IFRS13. Fair value is when an asset is valued at its highest and best use.

Table 3: Property held for investment purposes in £ millions

Property type	Actual	31.3.2018 actual		31.3.2019 expected	
	Purchase cost	Gains or (losses)	Fair value in accounts	Gains or (losses)	Value in accounts
Commercial Property	*See below	2.2	20.8	2.0	22.8

*The purchase cost cannot be ascertained as the majority of these assets have been owned by Kirklees for many years and purchased by Huddersfield Corporation during the 1920's from Ramsdens Estate. There is a signed legal document and also a 'book of acquisition' which is a hard backed ledger held in legal services.

Security: In accordance with government guidance, the Authority considers a property investment to be secure if its accounting valuation is at or higher than its purchase cost including taxes and transaction costs.

A fair value assessment of the Authority's investment property portfolio has been made within the past twelve months, and the underlying assets provide security for capital investment. Should the 2018/19 year end accounts preparation and audit process value these properties below their purchase cost, then an updated investment strategy will be presented to full council detailing the impact of the loss on the security of investments and any revenue consequences arising there from.

Risk assessment: The Authority's current commercial asset portfolio held for investment purposes is largely a historical portfolio. It is monitored and reviewed annually as part of the Council's wider asset strategy including potential future appreciation and potential receipt value.

It is not the Council's intention to invest in any new commercial portfolio investments at this time. If any new investments are identified a risk assessment would be performed.

Liquidity: Compared with other investment types, property is relatively difficult to sell and convert to cash at short notice, and can take a considerable period to sell in certain market conditions. To ensure that the invested funds can be accessed when they are needed, for example to repay capital borrowed, the Council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to which are necessary for the achievement of its business/service objectives. Cash flow projections are prepared on a regular and timely basis.

Loan Commitments and Financial Guarantees

Although not strictly counted as investments, since no money has exchanged hands yet, loan commitments and financial guarantees carry similar risks to the Authority and are included here for completeness. The Council does not have any loan commitments, however there are some guarantees that the Council holds which are identified in the Statement of Account under Contingent Liabilities. Mainly guarantees on outstanding contributions to Pension Fund in the event of a default by certain bodies. A guarantee to the Homes & Communities Agency (HCA) in the event of a default by Kirklees Community Association (KCA) on the redevelopment of the Fieldhead Estate. The Council also act as a guarantor to a loan of £1.3m that KSDL hold in the event of default.

Capacity, Skills and Culture

The Council employs professionally qualified and experienced staff in senior positions with responsibility for making capital expenditure, borrowing and investment decisions. For example, the Service Director Finance is a qualified accountant with extensive local government experience, the Strategic Director – Economy and Infrastructure has extensive experience of major Council regeneration schemes and partnerships with major business and 3rd party partners, as do key Service Directors. The Council pays for staff to study towards relevant professional qualifications including CIPFA and AAT.

Where Council staff do not have the knowledge and skills required, use is made of external advisers and consultants that are specialists in their field. The Council currently employs Arlingclose Limited as treasury management advisers. This approach is more cost effective than employing such staff directly, and ensures that the Council has access to knowledge and skills commensurate with its risk appetite.

Cabinet is responsible for the implementation and monitoring of any Investment policy. The Corporate Governance and Audit Committee undertake a scrutiny role with regard to Investment. Regular training for members of the Committee is provided by our treasury advisors to enable them to make decisions to ensure accountability and responsibility on investment decisions within the context of the Council's corporate values. Any new investment decisions are also approved at full Council.

Investment Indicators

The Authority has set the following quantitative indicators to allow elected members and the public to assess the Authority's total risk exposure as a result of its investment decisions.

Total risk exposure: The first indicator shows the Authority's total exposure to potential investment losses. This includes amounts the Authority is contractually committed to lend but have yet to be drawn down and guarantees the Authority has issued over third party loans.

Table 5: Total investment exposure in £millions

Total investment exposure	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Treasury management investments	36.1	34.1	30.0
Service investments: Loans	21.6	22.7	39.2
Service investments: Shares	1.3	1.3	2.6
Commercial investments: Property	20.8	22.8	24.9
TOTAL INVESTMENTS	**79.8**	**80.9**	**96.7**
Commitments to lend	0.0	0.0	0.0
Guarantees issued on loans	1.3	1.3	1.3
TOTAL EXPOSURE	**81.1**	**82.2**	**98.0**

How investments are funded: Government guidance is that these indicators should include how investments are funded. Since the Authority does not normally associate particular assets with particular liabilities, this guidance is difficult to comply with. However, the following investments could be described as being funded by borrowing. The remainder of the Authority's investments are funded by usable reserves and income received in advance of expenditure

Table 6: Investments funded by borrowing in £m

Investments funded by borrowing	31.03.2018 Actual	31.03.2019 Forecast	31.03.2020 Forecast
Service investments: Loans	**18.7**	**19.8**	**36.3**

Rate of return received: This indicator shows the investment income received less the associated costs, including the cost of borrowing where appropriate, as a proportion of the sum initially invested. Note that due to the complex local government accounting framework, not all recorded gains and losses affect the revenue account in the year they are incurred.

Table 7: Investment rate of return (net of all costs)

Investments net rate of return	**2017/18 Actual**	**2018/19 Forecast**	**2019/20 Forecast**
Treasury management investments	0.3%	0.7%	0.8%
Service investments: Loans	0.6%	0.6%	0.6%
Service investments: Shares	None	None	None
Commercial investments	10.7%	10.0%	10.0%
ALL INVESTMENTS	**11.6%**	**11.3%**	**11.4%**