

Appendix 1 - Treasury Management Strategy 2020/21

Cabinet

Date: 5th February 2020

TREASURY MANAGEMENT STRATEGY 2020/21

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1 Current Portfolio Position

- 1.1 The capital expenditure plans set out in Annex 1 to Appendix 1 summarises the Council's current and future plans. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.
- 1.2 The Council's actual treasury portfolio position at 31 March 2019, with December 2019 actuals are summarised below.

TREASURY PORTFOLIO				
Treasury investments	actual 31.3.19 £m	actual 31.3.19 %	current 31.12.19 £m	current 31.12.19 %
UK Banks	15.0	33%	0.0	0%
Local authorities	15.5	34%	17.0	40%
Call Accounts	0.0	0%	10.0	24%
Total managed in house	30.5	67%	27.0	64%
Property funds	15.2	33%	15.0	36%
Total managed externally	15.2	33%	15.0	36%
Total treasury investments	45.7	100%	42.0	100%
Treasury long term external borrowing				
Local authorities	0.0	0%	0.0	0%
Other Financial Institutions	30.0	9%	30.0	9%
PWLB	296.3	91%	309.8	91%
Total external borrowing	326.3	100%	339.8	100%
Net treasury investments / (borrowing)	(280.6)		(297.8)	

- 1.3 The Council's Non Specified Treasury Investments are detailed below. The property fund is a non specified investment by virtue of the fact that it has a maturity profile of greater than 1 year, it is included in both the table above showing Treasury Portfolio as well as the table below.

Non Specified Treasury Investments	Sum Invested (£m)
Local Authority Property Fund	15.000
Local Charity	0.033

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Cabinet Approved Loans & Investments to wholly owned companies and joint ventures	Loan Limit (£m)	Loan Value 31.03.19 (£m)	Loan Value 31.12.19 (£m)	Share Capital (£)
Public Power Solutions Ltd.	15.0	8.9	9.7	100
Swindon Chapel Farm Solar Plc.	3.0	2.9	2.9	50,000
Swindon Common Farm Solar CIC Plc.	3.0	2.9	2.8	50,000
Swindon Housing (Rent) Co. Ltd.				100
Swindon Housing Development Co. Ltd.	15.0	0.6	5.1	1,000
Wichelstowe Joint Venture	15.0	0.3	2.4	1
Total Cabinet Approved Loans & Investments	51.0	15.6	22.9	101,201

- 1.4 The Council's actual Non-Treasury Investment portfolio position at 31 March 2019, with December 2019 actuals are summarised below.

Non-Treasury investments	actual 31.3.19 £m	current 31.12.19 £m
No of Properties	1	1
Property Acquisition Price	7.9	7.9
Amount Funded through borrowing	0.0	0.0
Average investment return before financing costs	7.5%	7.5%
Total investment income as a proportion of the Councils Net General Fund budget	0.4%	0.4%
Investment borrowing as a proportion of total external debt as measured by the Capital Financing Reserve (excl. lease liabilities and HRA)	0.0%	0.0%
Fair value of property investments as a proportion of all Council property assets (excl. HRA)	1.6%	1.6%

- 1.5 A number of investments detailed in the 2018/19 strategy have been reclassified as economic regeneration, in accordance with accounting policies and therefore have been removed from the above table.
- 1.6 The Council's forward projections for borrowing are summarised below. The table shows the actual external debt, against the underlying capital borrowing requirement, (the Capital Financing Requirement or "CFR"), highlighting any over or under borrowing.

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CAPITAL FINANCING REQUIREMENT						
	2019/20 (£m)	2020/21 (£m)	2021/22 (£m)	2022/23 (£m)	2023/24 (£m)	2024/25 (£m)
CFR excl. PFI b/fwd. 1 April	428.2	451.3	473.4	497.4	532.1	532.8
PFI liabilities	49.6	47.6	45.5	43.1	40.5	37.6
CFR incl. PFI	477.8	498.9	518.9	540.5	572.6	570.4
Add Capital Expenditure funded through borrowing	29.9	29.5	32.3	44.8	11.3	1.9
Less MRP (debt repayment)	(6.8)	(7.4)	(8.3)	(10.1)	(10.6)	(10.8)
Underlying Borrowing Requirement	451.3	473.4	497.4	532.1	532.8	523.9
PFI Liabilities	47.6	45.5	43.1	40.5	37.6	34.3
CFR c/fwd. 31 March	498.9	518.9	540.5	572.6	570.4	558.2
External Borrowing b/fwd. 1 April	(326.2)	(336.8)	(363.3)	(379.3)	(433.9)	(449.5)
Loan Maturities	1.5	11.9	11.8	13.2	14.9	15.6
New Loans	(12.1)	(38.4)	(27.8)	(67.8)	(30.5)	(31.2)
External Borrowing c/fwd. 31 March	(336.8)	(363.3)	(379.3)	(433.9)	(449.5)	(465.1)
Under / (Over) Borrowing	114.5	110.1	118.1	98.2	83.3	58.8
<i>Under borrowing as a % of Underlying Borrowing Requirement (excludes PFI)</i>	25%	23%	24%	18%	16%	11%
Net Investments c/fwd.	(45.0)	(40.0)	(40.0)	(40.0)	(40.0)	(40.0)

- 1.7 Within the range of prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2020/21 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue or speculative purposes.
- 1.8 The Corporate Director of Finance and Assets reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

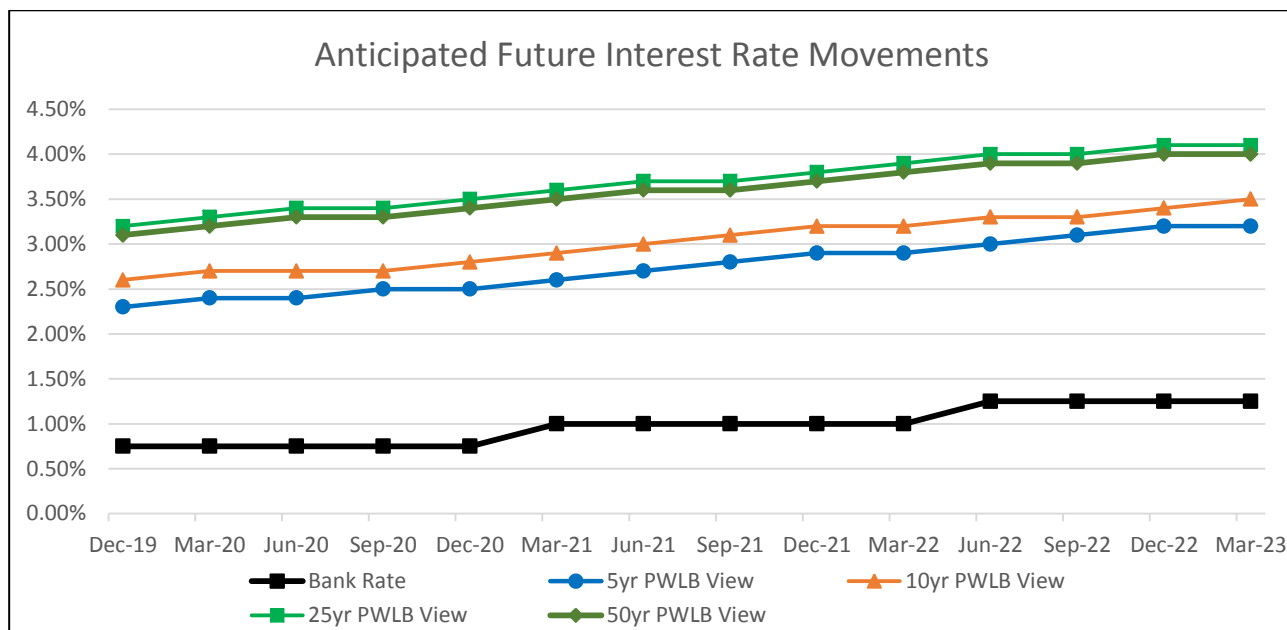
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2 Prospects for Interest Rates

- 2.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the Link view on interest rate movements.



- 2.2 The Monetary Policy Committee (MPC) left Bank Rate unchanged at 0.75% during 2019. There is still some residual risk that the MPC could cut Bank Rate as the UK economy is still likely to only grow weakly in 2020. Until that uncertainty is removed, it is unlikely that the MPC would raise Bank Rate.
- 2.3 The overall longer run future trend is for gilt yields, and consequently PWLB rates, to rise, albeit gently. From time to time, gilt yields, and therefore PWLB rates, can be subject to exceptional levels of volatility due to geopolitical, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period.
- 2.4 In addition, PWLB rates are subject to decisions by H.M. Treasury to change the margin over gilt yields charged in PWLB rates: such changes could be up or down. It is not clear that if gilt yields were to rise back up again by over 100bps within the next year or so, whether H M Treasury would remove the extra 100 bps margin implemented on 9.10.19.
- 2.5 Economic and interest rate forecasting remains difficult with so many influences weighing on UK gilt yields and PWLB rates. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

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2.6 In summary:

- Investment returns are likely to remain low during 2020/21 with little increase in the following two years. However, if major progress was made with an agreed future relationship with the EU, then there is upside potential for earnings.
- Borrowing interest rates were on a major falling trend during the first half of 2019-20 but then jumped up by 100 bps on 9.10.19. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, the unexpected increase of 100 bps in PWLB rates requires a major rethink of local authority treasury management strategy and risk management.
- While this authority will not be able to avoid borrowing to finance new capital expenditure, to replace maturing debt and the rundown of reserves, there will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

3 Minimum Revenue Provision Policy Statement

- 3.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).
- 3.2 MHCLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement:
- *For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP will be based on the CFR as per the regulatory method in the MRP guidance. This option provides for an approximate 4% reduction in the borrowing need (CFR) each year.*
 - *From 1 April 2008 for all unsupported borrowing the MRP will be based on the estimated life of the assets, on an annuity basis, in accordance with the regulations. Annuity method charges will be calculated using the relevant PWLB annuity rates for the estimated asset lives as at 31 March in the year of expenditure. MRP charges commence the year after the asset becomes operational.*
 - *MRP will be deferred in relation to capital expenditure funded through borrowing where there is an intention to repay the borrowing from future receipts and where there is a strong likelihood that this will happen. Should*

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there be a shortfall between the debt and eventual receipts, the balance will incur an annual MRP charge.

- MRP Overpayments - A change introduced by the revised MHCLG MRP Guidance was the allowance that any charges made over the statutory minimum revenue provision (MRP), voluntary revenue provision (VRP) or overpayments, can, if needed, be reclaimed in later years if deemed necessary or prudent. In order for these sums to be reclaimed for use in the budget, this policy must disclose the cumulative overpayment made each year. Up until the 31 March 2020 it is not anticipated that any VRP overpayments will be made, the Council will apply this policy as required in future years.*
- For PFI contracts MRP will be based on the estimated life of the assets, on an annuity basis, in accordance with the regulations. Annuity method charges will be calculated based on the PWLB annuity rates at 31st March in the year that the assets became operational.*
- Where non-ring-fenced capital receipts are available, these can be applied to meet the cost of PFI liability repayment (or part thereof). Where capital receipts are applied in this manner, the MRP charge for the PFI would be reduced by an equal amount in that year.*
- For any future finance leases the MRP requirement would be met by a charge equal to the element of the charge applied to write down the liability.*

- 3.3 No revenue charge is currently required for the HRA, although the existing voluntary policy is to repay £5m per annum.

4 Borrowing Strategy

- 4.1 The Council is currently maintaining an under-borrowed position. This means that the amount of long-term loans required exceeds the actual level of long term loans taken out. Long term loans are required to fund capital expenditure which Council has approved as “funded through borrowing”, but there is a timing difference between when the expenditure is made and when the long term loan is taken out. The timing of the taking of long term loans is part of the wider cash management strategy.
- 4.2 The difference between long term borrowing required and what has actually been taken out is known as “Internal Borrowing” and represents the temporary use of cash reserves and working capital to bridge the timing difference. As cash from reserves and working capital is currently invested at historically low rates, then the policy of delaying long-term borrowing and using existing cash balances as an interim measure is currently a cheaper option for the Council.

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- 4.3 While the council will maintain an under borrowed position on the General Fund (the HRA is fully borrowed up to the CFR), future movements in interest rates will dictate the future policy and the timing of taking out long-term loans, and will be kept under careful review.
- 4.4 Against this background and the risks within the economic forecast, caution will continue to be adopted with the 2020/21 treasury operations. The Corporate Director of Finance and Assets will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:
- If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
 - If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.
- 4.5 Any borrowing decisions will be reported to the Audit Committee as part of the annual cycle of reports.

Borrowing in Advance of Need

- 4.6 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

Loan Re-scheduling

- 4.7 Opportunities from rescheduling loans to generate savings will be monitored through the year but need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).
- 4.8 The reasons for any rescheduling to take place will include:
- The generation of cash savings and / or discounted cash flow savings;
 - Helping to fulfil the treasury strategy;
 - Amending the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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- 4.9 Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.
- 4.10 All rescheduling will be reported to the Cabinet at the earliest meeting following its action.

New financial institutions as a source of borrowing and / or types of borrowing

- 4.11 Following the decision by the PWLB on 9 October 2019 to increase their margin over gilt yields by 100 bps to 180 basis points on loans lent to local authorities, consideration will also need to be given to sourcing funding at cheaper rates from the following:
 - Local authorities (primarily shorter dated maturities)
 - Financial institutions (primarily insurance companies and pension funds but also some banks, out of spot or forward dates)
 - Municipal Bonds Agency
- 4.12 The degree which any of these options proves cheaper than PWLB Certainty Rate is still evolving at the time of writing and will be kept under review.

5 Investment Policy, Creditworthiness Policy and Investment Strategy

Investment Policy

- 5.1 The MHCLG and CIPFA have extended the meaning of ‘investments’ to include both financial and non-financial investments. This report deals solely with financial investments, (as managed by the treasury management team). Non-financial investments, essentially the purchase of income yielding assets, are covered in the Capital Strategy, (this forms part of the Capital Report elsewhere on this agenda).
- 5.2 The Council’s investment policy has regard to the following: -
 - MHCLG’s Guidance on Local Government Investments (“the Guidance”)
 - CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the Code”)
 - CIPFA Treasury Management Guidance Notes 2018
- 5.3 The Council’s investment priorities will be security first, portfolio liquidity second and then yield, (return).
- 5.4 The above guidance from the MHCLG and CIPFA place a high priority on the management of risk. This authority has adopted a prudent approach to managing risk and defines its risk appetite by the following means: -

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- Minimum acceptable credit criteria are applied in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the short term and long-term ratings.
 - **Other information:** ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as “**credit default swaps**” and overlay that information on top of the credit ratings.
 - **Other information sources** used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.
- 5.5 This authority has defined the list of **types of investment instruments** that the treasury management team are authorised to use. There are two lists in Annex 2 under the categories of ‘specified’ and ‘non-specified’ investments.
- **Specified investments** are those with a high level of credit quality and subject to a maturity limit of one year.
 - **Non-specified investments** are those with less high credit quality, may be for periods in excess of one year, and/or are more complex instruments which require greater consideration by members and officers before being authorised for use. Once an investment is classed as non-specified, it remains non-specified all the way through to maturity i.e. an 18 month deposit would still be non-specified even if it has only 11 months left until maturity.
- 5.6 This authority has engaged **external consultants**, (see section 7), to provide expert advice on how to optimise an appropriate balance of security, liquidity and yield, given the risk appetite of this authority in the context of the expected level of cash balances and need for liquidity throughout the year.
- 5.7 All investments will be denominated in **sterling**.
- 5.8 As a result of the change in accounting standards for 2019/20 under IFRS 9, this authority will consider the implications of investment instruments which could result in an adverse movement in the value of the amount invested and resultant charges at the end of the year to the General Fund. (In November 2018, the Ministry of Housing, Communities and Local Government, [MHCLG], concluded a consultation for a temporary override to allow English local authorities time to adjust their portfolio of all pooled investments by announcing a statutory override to delay implementation of IFRS 9 for five years commencing from 1.4.18).

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- 5.9 Investment instruments identified for use in the financial year are listed in Annex 2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.
- 5.10 However, this authority will also pursue value for money in treasury management and will monitor the yield from investment income against appropriate benchmarks for investment performance. Regular monitoring of investment performance will be carried out during the year.

Creditworthiness Policy

- 5.11 This Council applies the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:
- Credit watches and credit outlooks from credit rating agencies;
 - CDS spreads to give early warning of likely changes in credit ratings;
 - Sovereign ratings to select counterparties from only the most creditworthy countries.
- 5.12 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.
- 5.13 The Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.
- 5.14 Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.
- 5.15 All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' creditworthiness service.
- If a downgrade results in the counterparty / investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

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- In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx European Financials benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Link Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

UK banks – ring fencing

5.17 The largest UK banks, (those with more than £25bn of retail / Small and Medium-sized Enterprise (SME) deposits), are required, by UK law, to separate core retail banking services from their investment and international banking activities by 1st January 2019. This is known as “ring-fencing”. Whilst smaller banks with less than £25bn in deposits are exempt, they can choose to opt up. Several banks are very close to the threshold already and so may come into scope in the future regardless.

5.18 Ring-fencing is a regulatory initiative created in response to the global financial crisis. It mandates the separation of retail and SME deposits from investment banking, in order to improve the resilience and resolvability of banks by changing their structure. In general, simpler, activities offered from within a ring-fenced bank, (RFB), will be focused on lower risk, day-to-day core transactions, whilst more complex and “riskier” activities are required to be housed in a separate entity, a non-ring-fenced bank, (NRFB). This is intended to ensure that an entity's core activities are not adversely affected by the acts or omissions of other members of its group.

5.19 While the structure of the banks included within this process may have changed, the fundamentals of credit assessment have not. The Council will continue to assess the new-formed entities in the same way that it does others and those with sufficiently high ratings, (and any other metrics considered), will be considered for investment purposes.

Country limits

5.20 The Council has determined that it will only use approved counterparties from the UK and countries with a minimum sovereign credit rating of AA- from Fitch (or equivalent). This list will be amended by officers should ratings change in accordance with this policy.

Investment Strategy

5.21 **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months). Greater returns are usually obtainable by investing for longer periods. While most cash balances

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are required in order to manage the ups and downs of cash flow, where cash sums can be identified that could be invested for longer periods, the value to be obtained from longer term investments will be carefully assessed.

Investment returns expectations

- 5.22 On the assumption that the UK and EU agree a Brexit deal including the terms of trade by the end of 2020 or soon after, then Bank Rate is forecast to increase only slowly over the next few years to reach 1.00% by quarter 1 2023. Bank Rate forecasts for financial year ends (March) are:

Q1 2021	0.75%
Q1 2022	1.00%
Q1 2023	1.00%

- 5.23 The suggested budgeted investment earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

2019/20	0.75%
2020/21	0.75%
2021/22	1.00%
2022/23	1.25%
2023/24	1.50%
2024/25	1.75%
Later years	2.25%

Investment Periods

- 5.24 **Specified Investment** periods are currently restricted to no longer than 24 months. Lending to counterparties is in line with the creditworthiness policy detailed above and recommended by Link and these are limited to a total of £20m. Any investments to banks and building societies for a period in excess of 365 days would be classed as a “non-specified investment” as detailed in Annex 2 to this strategy.
- 5.25 **Non Specified Investments** are limited to a maximum of £10m for any one counterparty, however investments in the Local Authority Property Fund or any similar multi asset fund may exceed this limit. These investments will be subject to a specific Cabinet approval before they are undertaken.
- 5.26 The Council balances held in our current account and outside the list of treasury investments are simply for transactional purposes and not active investments. These will be kept as close to a minimum as Council cash flow allows.” These balances will fluctuate on a daily basis and this fluctuation is

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managed by the use of short term deposit / instant access accounts. These balances will be will not exceed £20m.

- 5.27 There may be occasions where the Council has investments with Lloyds which, in addition to the operational bank account, will exceed the £20m threshold per counterparty. The overall deposits with Lloyds will therefore be limited to a maximum of £40m.
- 5.28 The maximum amount the council will invest for more than 1 year is set out in the table below;

Maximum principal sums invested > 365 days					
2019/20	2020/21	2021/22	2022/23	2023/24	2024/25
£20m	£20m	£20m	£20m	£20m	£20m

Investment risk benchmarking

- 5.29 This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 3 month LIBOR. At the end of the financial year, the Council will report on its investment performance as part of its Annual Treasury Report.

6 Policy on the use of external service providers

- 6.1 The Council uses Link Asset Services, Treasury solutions as its external treasury management advisors.
- 6.2 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the services of our external service providers. All decisions will be undertaken with regards to all available information, including, but not solely, our treasury advisers.
- 6.3 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

Annexes

- Annex 1 - Prudential Indicators.
- Annex 2 - Credit and Counterparty Risk Management, Specified and Non-Specified Investments