

Taunton Deane Borough Council

Executive – 9 February 2017

Draft Treasury Management Strategy Statement, Annual Investment Strategy and Minimum Revenue Provision Policy 2017/2018

This matter is the responsibility of the Leader of the Council, Councillor John Williams

Report Author: Jo Nacey, Finance Manager

1 Executive Summary

- 1.1 The purpose of this report is to inform Members of the recommended strategy for managing the Council's cash resources including the approach to borrowing and investments. It also seeks the formal approval of the Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy which must be approved by Full Council by 31 March each year in line with regulations.
- 1.2 The Draft Strategy has been prepared taking into account professional advice and information from the Council's treasury management advisor Arlingclose.
- 1.3 The strategy continues to prioritise security and liquidity of cash over investment returns.
- 1.4 The Council currently holds £92.198m of loans, which relate solely to the HRA. This sum increased significantly in March 2012 when the Council took on £82m of loans through the introduction of HRA Self Financing and the abolition of the old Housing Subsidy system. A capital loan of £3.5m to the Somerset Waste Partnership is being considered through the budget setting process for 2017/18. This would be recognised as capital expenditure by the Council through the General Fund and could potentially require external borrowing to be taken. The Deane House Relocation Project is currently being debated through the Committee process and if approved will have implications for the TMSS in relation to capital expenditure and funding requirements.
- 1.5 The Council's investment balances, in the past 12 months, have ranged between £33 million and £52 million, this is expected to reduce in 2016/17 as more of the Capital Programme is delivered.
- 1.6 The Bank Base Rate reduced to 0.25% on 4th August 2016 and the Council's treasury management advisor, Arlingclose, has advised that their central case is for the UK Bank Rate to remain at 0.25% during 2017/18.

2 Recommendations

- 2.1 Executive recommends the Prudential Indicators included within the TMSS, which include limits for borrowing and investment, for approval by Full council.
- 2.2 Executive recommends the draft Treasury Management Strategy Statement (TMSS), Annual Investment Strategy and MRP Policy as included with this report, for approval by Full Council.
- 2.3 Executive notes that, if the project is approved, the TMSS will need to be updated to reflect the impact of the Deane House Relocation capital expenditure and funding. This will be reflected in the Final report to Executive.
- 2.4 Executive notes that, if approved, the impact of the loan to the Waste Partnership will need to be updated in the TMSS to reflect the capital expenditure and proposed funding from principal repayments. This will be reflected in the Final report to Executive.

3 Risk Assessment

Risk Matrix

Description	Likelihood	Impact	Overall
The Treasury Management Strategy and associated policies are not approved by Full Council in advance of the new financial year and become outdated.	Possible (2)	Major (4)	Medium (8)
<i>The Treasury Management Strategy is approved by Full Council in March 2017 at the latest.</i>	Rare (1)	Minor (2)	Low (2)

Risk Scoring Matrix

Likelihood	5	Very Likely	Low (5)	Medium (10)	High (15)	Very High (20)	Very High (25)	
	4	Likely	Low (4)	Medium (8)	Medium (12)	High (16)	Very High (20)	
	3	Feasible	Low (3)	Low (6)	Medium (9)	Medium (12)	High (15)	
	2	Slight	Low (2)	Low (4)	Low (6)	Medium (8)	Medium (10)	
	1	Very Unlikely	Low (1)	Low (2)	Low (3)	Low (4)	Low (5)	
			1	2	3	4	5	
		Negligible	Minor	Moderate	Major	Catastrophic		
		Impact						

Likelihood of risk occurring	Indicator	Description (chance of occurrence)
1. Very Unlikely	May occur in exceptional circumstances	< 10%
2. Slight	Is unlikely to, but could occur at some time	10 – 25%
3. Feasible	Fairly likely to occur at same time	25 – 50%
4. Likely	Likely to occur within the next 1-2 years, or occurs occasionally	50 – 75%
5. Very Likely	Regular occurrence (daily/weekly/monthly)	> 75%

4 Background Information

- 4.1 The full Draft Treasury Management Strategy Statement (TMSS), Annual Investment Strategy (AIS) and Minimum Revenue Provision (MRP) Policy are attached to this report. Due to the nature of the subject, and also in order to comply with both legislative and policy requirements, the documents contain a significant amount of technical detail and data.
- 4.2 The TMSS and related policies have been prepared taking into account the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectorial Guidance Notes (“the Code”) and CLG Guidance on Local Government Investments (“the Guidance”).
- 4.3 The key principles of the Code are as follows:
- Ensuring that public bodies put in place the necessary framework to ensure the effective management and control of treasury management activities;
 - That the framework clearly states that responsibility for treasury management lies clearly within the organisation and that the Strategy clearly states the appetite for risk;
 - That value for money and suitable performance measures should be reflected in the framework.
- 4.4 The Code also identifies four clauses to be adopted and these are as follows:
- The creation and maintenance of a policy statement and suitable treasury management practices which set out the means of achieving the policies and ensuring management and control;
 - The minimum reports (to the body that approves the budget) should be an annual strategy and plan prior to the start of the financial year, a mid-year review and an annual report after its close. A local council should ensure that

its' reporting enables those responsible for treasury management to effectively discharge their duties;

- Details of delegated responsibility for implementation and monitoring of policies and for the execution and administration of treasury management decisions. For this Council the delegated person is the Section 151 Officer;
- Details of the body responsible for the scrutiny of treasury management strategy and policies. For this Council the delegated body is the Audit Committee.

4.5 The Council's finance officers have worked closely with Arlingclose, our treasury advisor, to consider the requirements of the Code and Guidance and determine the proposed TMSS, AIS and MRP Policy that ensure compliance and provide a set of 'rules' for the Council to follow in dealing with investments, borrowing and cash flow management.

4.6 The current core principles remain in place within the proposed TMSS for 2017/18, which is to prioritise security (avoiding loss of council funds) and liquidity (quick access to cash) over return (interest costs and income).

4.7 However the TMSS for 2017/18 continues to recognise the increasing risks due to the new regulations in respect of 'bail in' for banks. In response to this risk and the wider ongoing risks in the financial sector the treasury strategy continues to build in greater "diversification" – so that we will hold surplus funds in a wider range of investments/accounts i.e. we are spreading the risk. Additionally we have removed the lowest acceptable credit rating risk from our 2016/17 strategy, as we seek to further reduce investment risk. Table 2 within the TMSS sets this out in a useful summary.

5 Treasury Management Strategy Statement

5.1 The proposed treasury strategy, investment strategy, prudential indicators are set out in the appendices to this report.

5.2 Council approves the strategy in advance of the new financial year in accordance with the Code, with annual and mid-year reports on performance presented to Audit Committee.

5.3 This Strategy is written in continuing challenging and uncertain economic times. The current economic outlook has several key treasury management implications:

- Investment returns are likely to remain relatively low during 2017/18

- With short-term borrowing 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
 - The timing of any borrowing will need to be monitored carefully; there will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.
- 5.4 This Strategy looks to reduce exposure to risk and volatility at this time of significant economic uncertainty by
- Considering security, liquidity and yield, in that order
 - Considering alternative assessments of credit strength
 - Spreading investments over a range of approved counterparties
 - Only investing for longer periods to gain higher rates of return where there are acceptable levels of counterparty risk.
- 5.5 The historically low interest rate situation has led to significant reductions in investment income in the past years which impacts directly on the Council's budget.
- 5.6 The Council's general fund capital financing requirement (CFR) for 2017/18 is £8.344m which is currently funded through internal borrowing. The timing of any borrowing must be considered as mentioned in 5.3 above.
- 5.7 The Council's Housing Revenue Account (HRA) CFR for 2017/18 is £101.063m which is currently funded through external borrowing of £89.500m plus internal borrowing of £11.563m. The Government sets a debt cap for the HRA which currently limits borrowing to £115.8m.
- 5.8 Attached to this report is the draft recommended full Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy.
- 5.9 The potential borrowing requirement of £3.5m in relation to the Waste Partnership would not compromise the council's current authorised borrowing limit of £220 million as specified in the TMSS.
- 5.10 It is important to emphasise that the operational boundary relates to controls surrounding the Council's treasury management activities, and is not in itself "approval to borrow" for capital purposes. Any plans to support capital investment through borrowing would come forwarded to Council for approval in line with the normal budget decision process, supported with appropriate business case(s).
- 5.11 Attached to this report is the draft recommended full Treasury Management Strategy Statement, Annual Investment Strategy and MRP Policy.

6 Minimum Revenue Provision

- 6.1 The proposed Minimum Revenue Provision continues the policy approved for 2016/17, with an addition to set out a policy in respect of capital loans provided to third parties. This takes into account the Council is considering a loan to the Somerset Waste Partnership. For such loans it is proposed to link MRP to the life of the asset(s) for which a loan is provided. This is included at the end of Appendix E.

7 Links to Corporate Aims / Priorities

- 7.1 The Council must approve and maintain appropriate treasury management arrangements to ensure good governance and stewardship of public resources, and to comply with relevant regulations and guidance.

8 Finance / Resource Implications

- 8.1 The estimated costs and income of projected investment and borrowing requirements have been reflected in the Council's MTFP forecasts. The Council procures specialist treasury management advice to assist finance officers with advice and support to ensure robust treasury management arrangements are delivered. Additionally, appropriate training is undertaken by staff. These costs are incorporated within existing budgets.

9 Legal Implications

- 9.1 This report fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the CLG Guidance.
- 9.2 In March 2012 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.
- 9.3 In addition, the Department for Communities and Local Government (CLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

10 Environmental Impact Implications

- 10.1 None.

11 Safeguarding and/or Community Safety Implications

- 11.1 None.

12 Equalities and Diversity Implications

12.1 None.

13 Social Value Implications

13.1 None.

14 Partnership Implications

14.1 None.

15 Health & Wellbeing Implications

15.1 None.

16 Asset Management Implications

16.1 None.

17 Consultation Implications

17.1 None.

18 Scrutiny Comments

18.1 Corporate Scrutiny Committee noted the report including the Treasury Management Strategy Statement and Prudential Indicators which incorporates borrowing and investment limits. Committee also noted that the TMSS presented to Executive and Council will be updated to reflect Deane House accommodation and SWP loan capital financing requirements.

18.2 The following salient comments and questions were raised:

- Clarification was sought on 'bail in' risk. *The Finance Manager clarified that due to the relatively new "bail-in legislation" we have been advised that the credit risk associated with unsecured bank deposits has increased. We have amended our counterparty levels accordingly and have removed the inclusion of BBB- from the approved list of counterparties, thus reducing risk to our investments.*
- Clarification was sought on the arrangements with Arlingclose and how often we can access professional treasury advice? *It was clarified that there is an annual fixed price for the Council's contract with Arlingclose, and we have regular daily access to their services.*

Democratic Path:

- **Corporate Scrutiny – 26 January 2017**
- **Executive – 9 February 2017**

- **Full Council – 23 February 2017**

Reporting Frequency: Annual

List of Appendices

Appendix A	Treasury Management Strategy Statement and Annual Investment Strategy 2017/18
Appendix B	Arlingclose Economic and Interest Rate Forecast – November 2016
Appendix C	Existing Investment and Debt Portfolio Position
Appendix D	Prudential Indicators 2017/18
Appendix E	Annual Minimum Revenue Provision Statement 2017/18

Contact Officers

Name	Jo Nacey	Name	Sue Williamson
Direct Dial	01823 356537	Direct Dial	01823 358685
Email	j.nacey@tauntondeane.gov.uk	Email	s.williamson@tauntondeane.gov.uk

Taunton Deane Borough Council

Draft Treasury Management Strategy Statement and Annual Investment Strategy 2017/2018

Introduction

In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services Code of Practice 2011 Edition (the "CIPFA Code") which requires the Council to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the CLG Guidance.

The Council has borrowed and invested substantial sums of money and is, therefore, 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 risk are, therefore, central to the Council's treasury management strategy.

External Context

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the Federal Reserve has increased its interest rate in December 2016 by 0.25%. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall

Interest rate forecast: The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

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 investments will be made at an average rate of 0.91%, and that new long-term loans will be borrowed at an average rate of 2.80%.

Local Context

The Council currently has £92.198m of borrowing and £46.822m of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.03.16 Actual £'000	31.03.17 Estimate £'000	31.03.18 Forecast £'000	31.03.19 Forecast £'000	31.03.20 Forecast £'000
General Fund CFR	8,524	8,344	8,164	7,984	7,804
HRA CFR	101,088	101,063	101,411	99,590	97,769
Total CFR	109,612	109,407	109,575	107,574	105,573
Less: External borrowing	(92,198)	(89,500)	(89,874)	(82,500)	(89,509)
Internal borrowing	17,414	19,907	19,701	25,074	16,064
Less: Usable reserves	41,396	41,787	43,117	46,141	49,081
(Investments) or New borrowing	(23,982)	(21,880)	(23,416)	(21,067)	(33,017)

* shows only loans to which the Council is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Council expects to comply with this recommendation during 2017/18.

Borrowing Strategy

The Council currently holds £92.198m of loans, as part of its strategy for funding previous years' capital programmes. This sum increased significantly in March 2012 when the Council took on £82m of loans through the introduction of HRA Self Financing and the abolition of the old Housing Subsidy system. The balance sheet forecast in table 1 shows that the Council does not expect to borrow in 2017/18. The Council may, however, borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £220 million.

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

Given the significant cuts to public expenditure and in particular to local government funding, the Council'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 Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. 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. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

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

- Public Works Loan Board (PWLB) and its successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Somerset Pension Fund)
- capital market bond investors
- special purpose companies created to enable joint local authority bond issues
- UK local authorities

The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

LGA Bond Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. 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. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

The Council holds £3m 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 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 LOBO loans at no cost if it has the opportunity to do so.

Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

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 Council 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.

Investment Strategy

The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's average investment balance has ranged between £33 million and £52 million, this is expected to reduce in 2017/18 as more of the Capital Programme is delivered.

Both the CIPFA Code and the CLG Guidance require the Council 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 Council'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.

Given the increasing risk and continued low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2017/18. This is especially the case for the estimated £20m that is available for longer-term investment. Less of the Council's surplus cash is now invested in short-term unsecured bank deposits, certificates of deposit and money market funds but has been moved to more secure covered bonds. This diversification represents a continuation of our current investment strategy over the coming year.

The Council may invest its surplus funds with any of the counterparties in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ unlimited 50 years	n/a	n/a
AAA	£3m 5 years	£6m 20 years	£6m 50 years	£3m 20 years	£3m 20 years
AA+	£3m 5 years	£6m 10 years	£6m 25 years	£3m 10 years	£3m 10 years
AA	£3m 4 years	£6m 5 years	£6m 15 years	£3m 5 years	£3m 10 years
AA-	£3m 3 years	£6m 4 years	£3m 10 years	£3m 4 years	£3m 10 years
A+	£3m 2 years	£6m 2 years	£3m 10 years	£3m 3 years	£3m 5 years
A	£3m 13 months	£6m 13 months	£3m 10 years	£3m 2 years	£3m 5 years
A-	£3m 6 months	£6m 6 months	£3m 10 years	£3m 13 months	£3m 5 years
BBB+	£1m 100 days	£3m 100 days	£1m 2 years	£1m 6 months	£1m 2 years
BBB	£1m	£3m	n/a	n/a	n/a

	Next day only	100 days			
None	£1m 6 months	n/a	£6m 25 Years	£50k 5 Years	£3m 5 Years
Pooled funds	Up to 50% of total investments limited to £6m each fund				

This table must be read in conjunction with the notes below

Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standards and Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

In addition, the Council may invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management advisor.

Banks 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. Unsecured investment with banks rated BBB are restricted to overnight deposits at the Council's current account bank Nat West.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they 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 highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Government: Loans, 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 an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed. The Council will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the

advantage of providing wide diversification of investment risks, coupled with the services of a fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council 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 Council's investment objectives will be monitored regularly.

Other Organisations: The Council may also invest cash with other organisations, for example by making loans to small businesses. Because of the higher perceived risk of unrated businesses, such investments may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management advisors.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council's treasury advisors, who will notify changes in ratings as they occur. When 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 Council 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 and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council 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 Council'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.

Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".

The Council defines "high credit quality" organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. The Council does, on occasion, grant loans to small organisations for the purpose of furthering service provision within the Council's area but these loans fall outside of the scope of the Council's treasury management activities. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below BBB+	£10m
Total non-specified investments	£30m

Investment Limits: The Council's General Fund revenue reserves available to cover investment losses are forecast to be £21,878 million on 31st March 2016. In order that no more than 25% of available reserves 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 £6 million. 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 as below. 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.

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Government	£6m each
UK Government	unlimited
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£15m per manager
Negotiable instruments held in a broker's nominee account	£20m per broker
Foreign countries	£6m per country
Registered Providers	£14m in total
Loans to unrated corporates	£6m in total
Money Market Funds	£28m in total

Approved Instruments: The Council 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 Council may demand repayment at any time (with or without notice),
- callable deposits and loans where the borrower may repay before maturity, but subject to a maximum of £6 million in total,
- certificates of deposit,
- covered bonds, 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 Council uses a spreadsheet which details the Council's cash flow on a daily basis to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a pessimistic basis, with receipts under-estimated and payments over-estimated to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

Treasury Management Indicators

The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating 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.

	Target
Portfolio average credit rating	A-

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments within a rolling three month period, without additional borrowing.

	Target
Total cash available within 3 months	£6m

Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of net principal borrowed will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	100%	100%	100%

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

Maturity Structure of Borrowing: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	100%	0%
20 years and within 30 years	100%	0%
30 years and within 40 years	100%	0%
40 years and within 50 years	100%	0%
50 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

Principal Sums Invested for Periods Longer than 364 days: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking

early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2016/17	2017/18	2018/19
Limit on principal invested beyond year end	£30m	£30m	£30m

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

Policy on Use of 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 Council 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 Council 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 including those present in pooled funds and forward starting transactions, 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.

Policy on Apportioning Interest to the HRA: On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/credited to the respective revenue account. 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. This balance will be measured at the end of the year and interest transferred between the General Fund and HRA at the Council's average interest rate on investments, adjusted for credit risk.

Investment Training: The needs of the Council's treasury management staff for training in investment management are assessed every six months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

Investment Advisors: The Council has appointed Arlingclose Limited as treasury management advisors and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled by holding quarterly meetings and tendering periodically. The last tender was completed in March 2013.

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. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £220 million. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure.

Financial Implications

The budget for investment income in 2017/18 is £366,800 (General Fund = £314,000, HRA = £52,800). The budget for debt interest paid in 2017/18 is £2.838 million (All HRA). If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

Other Options Considered

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Operations (S151 Officer), believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults but any such losses will be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults but any such losses will be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however, long-term interest costs will be more

		certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however, long-term interest costs will be less certain

Arlingclose Economic and Interest Rate Forecast November 2016

Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.
- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.
- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.
- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.
- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.
- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.
- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.
- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.
- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely..

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.

Appendix B**Existing Investment and Debt Portfolio Position**

	31/12/2016 Actual Portfolio £m	31/12/2016 Average Rate %
External Borrowing:		
PWLB - Fixed Rate	84,198	3.35%
PWLB – Variable Rate	5,000	0.67%
LOBO Fixed Rate Loans	3,000	4.25%
Total External Borrowing	92,198	2.76%
Investments		
Short Term	44,873	0.83%
Net Debt	47,325	

Prudential Indicators 2017/2018

1. Background

- 1.1 The Local Government Act 2003 requires the Council to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

2. Estimates of Capital Expenditure

- 2.1 The Council's planned capital expenditure and financing may be summarised as follows:

Capital Expenditure	2016/17 Predicted £'000	2017/18 Estimate £'000	2018/19 Estimate £'000	2019/20 Estimate £'000
Non-HRA	11,805	5,809	7,059	4,101
HRA	12,830	11,165	9,397	9,534
Total Capital Expenditure	24,635	16,974	16,456	13,635

- 2.2 Capital expenditure will be financed as follows:

Capital Financing	2016/17 Predicted £'000	2017/18 Estimate £'000	2018/19 Estimate £'001	2017/20 Estimate £'002
Capital Receipts	5,230	877	812	820
Capital Grants	1,828	5,408	660	660
Revenue Contributions	7,557	1,494	7,616	4,691
Borrowing	2,295	1,874	0	0
Major Repairs Reserve	7,725	7,321	7,368	7,464
Total Capital Financing	24,635	16,974	16,456	13,635

3. Capital Financing Requirement

- 3.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.16 Actual £'000	31.03.17 Revised £'000	31.03.18 Estimate £'000	31.03.19 Estimate £'000	31.03.20 Estimate £'000
General Fund	8,524	8,344	8,164	7,984	7,804
HRA	101,088	101,063	101,411	99,590	97,769
Total CFR	109,612	109,407	109,575	107,574	105,573

3.2 The CFR is forecast to increase during 2017/18 as the Council supports significant capital investment in the HRA, and then decrease in 2017/18 decreasing again in 2018/19 as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

4. Gross Debt and the Capital Financing Requirement

4.1 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 Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years.

4.2 The S151 officer reports that the Council had no difficulty meeting this requirement in 2015/16, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Debt	31.03.17 Revised £'000	31.03.18 Estimate £'000	31.03.19 Estimate £'000	31.03.20 Estimate £'000
Total CFR	109,407	109,575	107,574	105,573
Borrowing	-89,500	-85,500	-82,500	-89,509
Difference	19,907	24,075	25,074	16,064

4.3 Total debt is expected to remain below the CFR during the forecast period.

5. Operational Boundary for External Debt

5.1 The Operational Boundary is based on the Council's estimate of the most likely, i.e. prudent but not worst case scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring.

	2015/16 Revised £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Operational Boundary for External Debt	200,000	200,000	200,000	200,000

6. Authorised Limit for External Debt

- 6.1 The Authorised Limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements. The HRA has a debt cap of £115.8m which is a figure set by Central Government.

	2015/16 Revised £'000	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Authorised Limit for External Debt	220,000	220,000	220,000	220,000

7. Ratio of Financing Costs to Net Revenue Stream

- 7.1 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, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Revised %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
General Fund	-2.16%	-2.54%	-2.43%	-2.34%
HRA	10.92%	10.02%	10.42%	11.46%
Total	8.76%	7.48%	7.99%	9.12%

8. Incremental Impact of Capital Investment Decisions

- 8.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £
Increase in annual Band D Council Tax	4.51	5.38	3.10
Increase in Average Weekly Housing Rents	1.21	1.01	1.04

9. Adoption of the CIPFA Treasury Management Code:

- 9.1 This indicator demonstrates that the Council has adopted the principles of best practice. The Council adopted the CIPFA Treasury Management in the Public Services: Code of Practice 2011 Edition in February 2011. The Council

has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices.

Annual Minimum Revenue Provision (MRP) Statement 2017/18

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* most recently issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. Amendment regulation 4(1) of the 2008 Capital Financing and Accounting Regulations which details the MRP rules, revised the former regulations and replaced them with a basic duty for a council each year to make an amount of MRP which it considers to be "**prudent**". The regulation does not in itself define "prudent provision", however, the MRP guidance makes recommendations to authorities on the interpretation of that term.

The MRP methodology was reviewed in the current year (2016/17) to ensure that our approach was appropriate for our financial stability and was robust and prudent for future capital expenditure.

The weighted average useful life approach was deemed to be the most prudent approach and took into consideration the materiality of each asset and its recorded remaining useful life. The weighted average was then applied to the class of asset then applied across the whole fixed asset base. That gave a robust basis to support the asset life applied to MRP calculations and be appropriate for audit scrutiny.

In forthcoming years this base calculation will stay the same but any additional CFR will be calculated separately and added to the MRP as a distinct calculation thus protecting the original calculation and adding to it where appropriate.