**Agenda Item 5.2**

**WARRINGTON BOROUGH COUNCIL**

**COUNCIL – 27 February 2017**


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| **Report of the:** | **Audit and Corporate Governance Committee** | |
| **Executive Director:** | **Lynton Green, Director of Finance & Information Services** | |
| **Report Author:** | **Danny Mather, Corporate Finance Manager** | |
| **Contact Details:** | **Email Address:**<br>**dzmather@warrington.gov.uk** | **Telephone:**<br>**01925 442344** |
| **Ward Members:** | **All** | |


Key Decision No. N/A

**Ward Members:** All

**TITLE OF REPORT: 2017/18 TREASURY MANAGEMENT STRATEGY**

## 1. PURPOSE OF THE REPORT

1.1 This report sets out the Council's proposed Treasury Management Strategy for 2017/18. The report will be considered by full Council on 27th February 2017 and any comments or recommendations of the Audit and Corporate Governance Committee on the strategy will be reported to Council at that meeting.

1.2 This report was reported to the Audit and Corporate Governance Committee on 9 February 2017 and was scrutinised by them. It is now presented to Council for approval.

## 2. BACKGROUND

2.1 The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

2.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

2.3 CIPFA defines treasury management as:

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

2.4 The Department of Communities and Local Government (DCLG) has issued guidance under the Local Government Act 2003 requiring Local Authorities to set out their policies for managing investments and for giving priority to the security and liquidity of those investments.

2.5 The Strategy is drawn from the Council's Treasury Policy Statement and covers investments, borrowing, the outlook for interest rates, the management of associated risks, prudential indicators and the policy to be adopted on the Minimum Revenue Provision (MRP).

2.6 The Council's 2017/18 Treasury Management Strategy is attached at Appendix 1. Although, every attempt has been made to reduce the technical content of this report, by its very nature the report is technical in parts and the glossary of terms in Annexe A to the Strategy should aid members understanding of some technical terms used in the report.

**3. CONFIDENTIAL OR EXEMPT**

Not confidential.

4. **FINANCIAL CONSIDERATIONS**

N/A

**5. RISK ASSESSMENT**

5.1 The Council would be putting its financial standing at risk, as well as failing to meet the requirements of the Local Government Act 2003, if it failed to follow the revised Treasury Management Code and the associated guidance. Acceptance of the recommendations in this report would not only avoid this risk, but would ensure that the Council's financial matters continue to be managed prudently.

5.2 The Treasury Management Strategy and Prudential and Treasury Indicators reflect various assumptions of future interest rate movements and Government support for capital expenditure. These will be continually monitored and any necessary amendments will be made in accordance with the Strategy.

**6. EQUALITY AND DIVERSITY/EQUALITY IMPACT ASSESSMENT**

6.1 The Finance Service undertakes an Equality Impact Assessment (EIA) in its wider functions. Service changes that emerge from proposals contained in the treasury management strategy are subject to EI Assessments.

## 7. CONSULTATION

Not applicable.

## 8. REASONS FOR RECOMMENDATIONS

8.1 To ensure the Council complies with the 2011 revised CIPFA Treasury Management Code of Practice and DCLG Investment Guidance.

## 9. RECOMMENDATIONS

9.1 The Council approves the Treasury Management Strategy for 2017/18.

## 10. BACKGROUND PAPER

10.1 Treasury Management working papers.

**Contacts for Background Papers**:

| Name | E-mail | Telephone |
|---|---|---|
| Danny Mather<br>Corporate Finance Manager | dzmather@warrington.gov.uk | 01925<br>442344 |

**APPENDIX 1**

## 2017/18 COUNCIL'S TREASURY MANAGEMENT STRATEGY

## 1. INTRODUCTION

1.1 The Local Government Act 2003 (the Act) and supporting regulations requires the Council to 'have regard to' the Chartered Institute of Public Finance and Accountancy's (CIPFA) Prudential Code and the CIPFA Treasury Management Code of Practice to set prudential indicators for the next three years to ensure that its capital investment plans are affordable, prudent and sustainable.

1.2 The Act therefore requires the Council to set out its Treasury Management Strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance issued subsequent to the Act). This sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

1.3 The Council's strategy has regard to the Department of Communities and Local Government (CLG) Guidance on Local Government Investments ("the Guidance"), which came into effect from 1 April 2010.

1.4 The strategy also includes the Council's 2017/18 Minimum Revenue Provision strategy.

1.5 The CIPFA Code of Practice on Treasury Management (revised November 2009) was adopted by this Council on 1st March 2010. CIPFA issued revisions to the Prudential Code, Treasury Management Code and Treasury Guidance Notes in mid-November 2011. The CIPFA Code of Practice has been amended and is detailed in section 9 of this report.

1.6 The primary requirements of the Code are as follows:

(i) Creation and maintenance of a Treasury Management Policy Statement, which set out the policies and objectives of the Council's treasury management activities.

(ii) Creation and maintenance of Treasury Management Practices, which set out the manner in which the Council will seek to achieve those policies and objectives:

- Reporting Requirements – the Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.
    - **Prudential and treasury indicators and treasury strategy** – the first, and most important report covers:
      1. The capital plans (including prudential indictors);
      2. A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

3. The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
4. An investment strategy (the parameters on how investments are to be managed).

- **A mid-year treasury management report** – this will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. In addition, this Council will receive quarterly update reports.

- **An annual treasury report** – this provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

(iii) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

(iv) Delegation by the Council of the role of scrutiny of the Treasury Management Strategy and policies to a specific named body. For this Council, the delegated body is the Audit and Corporate Governance Committee.

1.7 The suggested strategy for 2017/18 in respect of the following aspects of the treasury management function is based upon treasury officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury advisor (Capita). The strategy covers two main areas:

**Capital Issues**
- The capital plans and the prudential indicators;
- The minimum revenue provision (MRP) policy.

**Treasury management issues**
- Prudential and Treasury Indicators in force that will limit the treasury risk and activities of the Council;
- the current treasury position;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling opportunities;
- the investment strategy;
- creditworthiness policy;
- policy on use of external service providers;
- the minimum revenue provision strategy; and
- future developments.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, the DCLG MRP Guidance, the CIPFA Treasury Management Code and the DCLG Investment Guidance.

1.8 In particular, Section 32 of that Act requires the Authority to calculate its budget requirement for each financial year to include the revenue costs which flow from capital financing decisions. This means that increases in capital expenditure must be limited to a level where any increases in charges to revenue are from:

- Increases in interest charges caused by increased borrowing to finance additional capital expenditure, or
- Any increases in running costs from new capital projects are limited to a level, which is affordable within the projected income of the Council for the foreseeable future.

1.9 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been undertaken by members in November 2016 and further training will be arranged as required.

## 2. TREASURY LIMITS FOR 2017/18

2.1 It is a statutory duty, under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

2.2 The Council must have regard to the Prudential Code when setting the Authorised Limit. This essentially requires it to ensure that total capital investment remains within sustainable limits and in particular, that the impact upon its future council tax and council rent levels is 'acceptable'.

2.3 Whilst termed an "Affordable Borrowing Limit", capital plans to be considered for inclusion in corporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4 Prudential and Treasury Indicators identified at Annexe 2 are relevant for the purposes of setting an integrated Treasury Management Strategy.

2.5 The Council is also required to indicate if it has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA) Code of Practice on Treasury Management in Local Authorities (the Treasury Management Code). The original Treasury Management Code was adopted in 2004 at a full meeting of the Council, and the 2009 revised Treasury Management Code was adopted at a full meeting of the Council on 1 March 2010. Amendments to the Code have been detailed in section 9 of this report.

## 3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position as at 31st December 2016 comprised of:

| Current Portfolio Position | Principal £m | Total £m | Average Interest Rate % |
|---|---|---|---|
| **Fixed Rate Funding** | | | |
| - Public Works Loans Board | 75.191 | | 3.173 |
| - Money Market | 143.512 | | 2.866 |
| - Temporary Borrowing | 87.340 | 306.044 | 0.572 |
| **Variable Rate Funding** | | | |
| - Public Works Loans Board | | | |
| - Money Market | 50.000 | 50.000 | 0.846 |
| **TOTAL BORROWING** | | **356.044** | 2.521 |
| **Council Investments** | | | |
| - Fixed Rate | (45.157) | | 5.482 |
| - Call Accounts | (36.103) | (81.259) | 0.430 |
| **TOTAL INVESTMENTS** | | **(81.259)** | **4.053** |
| **NET** | | **274.784** | |

### BORROWING REQUIREMENT

3.2 The capital expenditure plans provide details of the service activity of the Council. 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. 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. The Council's capital expenditure plans are the key driver of treasury management activity.

3.2 The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist member's overview and confirm capital expenditure plans.

3.3 The table below sets out the Council's future borrowing requirement (current and previous years are shown for comparison) based on current commitments and plans.

| 2015/16 Actual £m | 2016/17 Estimate £m | Capital Expenditure | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m | TOTAL 3 Years £m |
|---|---|---|---|---|---|---|
| 84.465 | 166.176 | Capital Expenditure | 617.694 | 279.533 | 285.705 | **1182.932** |
| | | **Financed By:** | | | | |
| 21.774 | 24.726 | Capital Grants & Reserves | 16.855 | 6.711 | 4.357 | **27.923** |
| 0.190 | 1.515 | Capital Receipts | 1.339 | 0.000 | 0.000 | **1.339** |
| 0.000 | 0.000 | Council Revenue Funding | 0.000 | 0.000 | 0.000 | **0.000** |
| 2.471 | 1.605 | External Funding | 12.938 | 6.566 | 10.617 | **30.121** |
| **60.03** | **138.330** | **Financing need for year** | **586.562** | **266.256** | **270.731** | **1123.549** |

## 4. PROSPECTS FOR INTEREST RATES

4.1 The Council has appointed Capita Asset Services to assist and advise the Council to formulate a view on interest rates.

4.2 The Bank Base Rate is forecast to remain unchanged at 0.25%, before starting to rise from quarter 2 of 2019. Capita's central view for bank rate forecasts for financial year ends (March) are as follows:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.75%

There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs later) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

### Capita Asset Services' interest rate forecast

The following table gives their central view:

| | **Bank Rate** | **PWLB Borrowing Rates** | | | |
|---|---|---|---|---|---|
| | | **5 year** | **10 year** | **25 year** | **50 year** |
| Dec-16 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Mar-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Jun-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Sep-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Dec-17 | 0.25% | 1.60% | 2.30% | 3.00% | 2.80% |
| Mar-18 | 0.25% | 1.70% | 2.30% | 3.00% | 2.80% |
| Jun-18 | 0.25% | 1.70% | 2.40% | 3.00% | 2.80% |
| Sep-18 | 0.25% | 1.70% | 2.40% | 3.10% | 2.90% |
| Dec-18 | 0.25% | 1.80% | 2.40% | 3.10% | 2.90% |
| Mar-19 | 0.25% | 1.80% | 2.50% | 3.20% | 3.00% |
| Jun-19 | 0.50% | 1.90% | 2.50% | 3.20% | 3.00% |
| Sep-19 | 0.50% | 1.90% | 2.60% | 3.30% | 3.10% |
| Dec-19 | 0.75% | 2.00% | 2.60% | 3.30% | 3.10% |
| Mar-20 | 0.75% | 2.00% | 2.70% | 3.40% | 3.20% |

4.3 These assumptions have been used to determine the treasury management budget projections, included as part of the 2017/18 revenue budget and future year projections.

### Other forecasts

4.4 The data below shows a variety of forecasts published by a number of institutions. The forecast includes Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources.

### Capital Economics interest rate forecast

| | Bank Rate | PWLB Borrowing Rates | | | |
|---|---|---|---|---|---|
| | | 5 year | 10 year | 25 year | 50 year |
| Mar-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Jun-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Sep-17 | 0.25% | 1.60% | 2.30% | 2.90% | 2.70% |
| Dec-17 | 0.25% | 1.60% | 2.30% | 3.00% | 2.80% |
| Mar-18 | 0.25% | 1.70% | 2.30% | 3.00% | 2.80% |
| Jun-18 | 0.25% | 1.70% | 2.40% | 3.00% | 2.80% |
| Sep-18 | 0.25% | 1.70% | 2.40% | 3.10% | 2.90% |
| Dec-18 | 0.25% | 1.80% | 2.40% | 3.10% | 2.90% |
| Mar-19 | 0.25% | 1.80% | 2.50% | 3.20% | 3.00% |
| Jun-19 | 0.50% | 1.90% | 2.50% | 3.20% | 3.00% |
| Sep-19 | 0.50% | 1.90% | 2.60% | 3.30% | 3.10% |
| Dec-19 | 0.75% | 2.00% | 2.60% | 3.30% | 3.10% |
| Mar-20 | 0.75% | 2.00% | 2.70% | 3.40% | 3.20% |

## 5. ECONOMIC BACKGROUND

5.1 **The UK economy** – UK Gross Domestic Product (GDP) growth rates in 2013, 2014 and 2015 of 2.2%, 2.90% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the European Union (EU), China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

5.2 The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which was interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

5.3 The Monetary Policy Committee (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing (QE), with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

5.4 The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

5.5 The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, consideration to a further cut in Bank Rate can not be discounted if economic growth were to take a significant dip downwards, though it is thought unlikely. Forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

5.6 The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

5.7 The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a ‘business as usual’ mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the Gesellschaft für Konsumforschung (GfK) consumer confidence index recovered quite strongly to -3 in October after an initial sharp lunge in July to -12 with regard to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

5.8 Bank of England GDP forecasts in the November quarterly Inflation Report were as follows: (August forecasts in brackets) 2016 +2.2% (+2.0%), 2017 +1.4% (+0.8%), 2018+1.5% (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

5.9 The Chancellor has said he will do ‘whatever is needed’ i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the public sector borrowing requirement (PSBR) deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor or the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure any by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, after the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was confirmed in the Statement which also included some increases in infrastructure spending.

5.10 The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of approximately 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as the MPC meeting date of 15.12.16). This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

5.11 What is clear is that consumer disposable income will come under pressure, as the latest employers’ survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The consumer price index (CPI) figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

5.12 Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has been also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and peaked again at 1.55% in November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC’s new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

5.13 Employment had been growing steadily during 2016 but encountered a first fall in over a year (of 6,000) over the three months to October. The latest employment data in December (for November) was distinctly weak with an increase in unemployment benefits claimants of 2.400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

5.14 **The US economy** – the American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth. The Federal Reserve (Fed.) embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed, therefore, also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

5.15 The result of the presidential election In November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

5.16 Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

5.17 In the first week since the US election, there was a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

5.18 **Eurozone economy** – in the Eurozone, the European Central Bank (ECB) commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

5.19 **Eurozone (EZ) GDP growth** – in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

5.20 There are also significant specific political and other risks within the EZ:

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.

- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- The under capitalisation of Italian banks poses a major risk. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk while at the same time those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- Italian constitutional referendum on reforming the Senate and reducing its powers; this was a confidence vote on the Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.

- Dutch general election in March – a far right party is currently polling closely with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU/Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU/Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.

- French presidential election – first round April and second round May 2017.

- French National Assembly election June 2017.

- German Federal election August to October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

- The core European Union (note not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

5.21 Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

5.22 **Asia economy** – economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which, both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

5.23 **Japan economy** – economic growth is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

5.24 **Emerging countries** – there have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a arise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due to repayment in the final two months of 2016 and 2017 – a 40% increase on the figure for the last three years.

5.25 Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

5.26 **Brexit timetable and process**

- March 2017 – UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50.
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.

- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU – but this is not certain.
- On exit from the EU the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.
- It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

## 6. BORROWING STRATEGY

6.1 The capital expenditure plans provide details of the service activity of the Council. 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. 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.

6.2 In general, the Council will borrow for one of two purposes – to finance cash flow in the short-term or to fund capital investment over the longer term. The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

6.3 The Council's treasury portfolio position at 31 March 2017, with forward projections is summarised below and detailed in table 3.3. The actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlights an underlying need to borrow £138.330m in 2016/17, £586.562m in 2017/18, £266.256m in 2018/19 and £270.731m 2019/20.

6.4 A key aim of the Treasury Management Strategy is to minimise the cost of the Council's loan portfolio whilst ensuring that the obligation to repay the loan is spread over a period of time. This reduces the impact on the revenue budget of interest payments.

6.5 Currently the average rate of interest on the Council's loan portfolio is 2.52%, which is one of the lowest rates of the CIPFA group of authorities that we compare ourselves to. The achievement of such low rates ensures the Council benefits from the best value for money in terms of its borrowing. This is the result of a number of years proactively managing the portfolio on loans through restructuring and taking advantage of the best possible interest rates available. The proposed treasury management strategy aims to continue this successful approach.

6.6 The Council forecasts it will borrow from either, the Public Works Loans Board (PWLB), the bond market or other Local Authorities during the strategy period. PWLB rate forecasts are given in the table below. The Council will also evaluate the option of borrowing further from the bond markets during 2017/18. Borrowing from the bond market will take place if it offers greater value for money than borrowing from the PWLB.

| | **PWLB Borrowing Rates** | | | |
|---|---|---|---|---|
| | **5 year** | **10 year** | **25 year** | **50 year** |
| Mar-17 | 1.60% | 2.30% | 2.90% | 2.70% |
| Jun-17 | 1.60% | 2.30% | 2.90% | 2.70% |
| Sep-17 | 1.60% | 2.30% | 2.90% | 2.70% |
| Dec-17 | 1.60% | 2.30% | 3.00% | 2.80% |
| Mar-18 | 1.70% | 2.30% | 3.00% | 2.80% |
| Jun-18 | 1.70% | 2.40% | 3.00% | 2.80% |
| Sep-18 | 1.70% | 2.40% | 3.10% | 2.90% |
| Dec-18 | 1.80% | 2.40% | 3.10% | 2.90% |
| Mar-19 | 1.80% | 2.50% | 3.20% | 3.00% |

6.7 These forecasts are based around an expectation that there will normally be variations of +/-25bp during each quarter around these average forecasts in normal economic and political circumstances. However, greater variations can occur should there be any unexpected shocks to financial and/or political systems.

6.8 Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4$^{th}$ August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a ‘hard Brexit’, the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served will over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

6.9 Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Director of Finance 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 start date and 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 still lower than they are projected to be in the next few years.

6.10 There will remain a cost of carry to any new long-term borrowing. If borrowing causes a temporary increase in cash balances this will incur a revenue cost, that is, the difference between borrowing costs and investment returns.

6.11 Any decisions will be reported to the Audit and Corporate Governance Committee at the next available opportunity.

6.12 The Council's policy for 2017/18 will be to run down investments to maximise returns and minimise risks. However, an assessment of the opportunity for borrowing will be made on the cost of borrowing long-term dependent on the interest rate movements.

## 7. POLICY ON BORROWING IN ADVANCE OF NEED

7.1 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 value for money can be demonstrated and that the Council can ensure the security of such funds.

7.2 In determining whether borrowing will be undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio, which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use;
- consider the impact of borrowing in advance (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk and the level of such risks given the controls in place to minimise them. Any risks will be reported through the mid-year or annual reporting mechanism.

## 8. DEBT RESCHEDULING

8.1 The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt (which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates) has meant that PWLB to PWLB debt restructuring is now much less attractive than before these events. In particular, consideration would have to be given to the large premiums, which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings may still be achievable through using other local authority loans and market loans in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

8.2 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

8.3 The reasons for any rescheduling to take place will include:

(a) The generation of cash savings and / or discounted cash flow savings;

(b) Help fulfil the borrowing strategy outlined above;

(c) Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

8.4 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.

8.5 All rescheduling will be reported to the Audit and Corporate Governance Committee at the earliest meeting following this action.

8.6 It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority intends to make use of this new source of borrowing as and when appropriate.

## 9. TREASURY POLICY STATEMENT

9.1 Treasury management within this Council is undertaken in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services ("the TM Code").

9.2 The Council has been compliant with the requirements of the TM Code and has formally adopted the key recommendations as described within Section 4 of the TM Code.

9.3 In accordance with the TM Code, the Council defines treasury management activities as:

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

9.4 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured.

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

9.6 The Council will create and maintain, as the cornerstone for effective treasury management:

- a Treasury policy statement, stating the objectives of its Treasury Management activities
- suitable Treasury Management Practices (TMPs) setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (reported to the Audit & Corporate Governance Committee annually)
- Treasury management Prudential Indicators as determined by the requirements of the CIPFA Prudential Code; and
- The content of the policy statement and TMPs will follow the recommendations contained in Sections 7 of the TM Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the TM Code's key principles.
- The Council will receive reports on its treasury management policies, practices and activities, including as a minimum, an annual strategy and plan in advance of the year, an annual report after its close and an half year review report.

- The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit & Corporate Governance Committee, and for the execution and administration of treasury management decisions to the Director of Finance and Information Services, who will act in accordance with the Council's Treasury Management Strategy and the TM Code.

## 2017/18 COUNCIL'S ANNUAL INVESTMENT STRATEGY

### 10. INTRODUCTION

10.1 The aim of our investment strategy is to:

- Maintain capital security;
- Maintain policy flexibility.

10.2 The Council's Director of Finance and Information Services, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the risks shown in the forecast above.

10.3 The Council invests surplus cash balances only with certain approved organisations, as security of funds is of primary importance. All investments will be made in accordance with the Council's investment policies and prevailing legislation and regulations.

### 11. INVESTMENT POLICY

11.1 The Council will have regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 and revised 2011 CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

(a) The security of capital and;

(b) The liquidity of its investments.

11.2 The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

11.3 In accordance with guidance from DCLG and CIPFA, and in order to minimise the risk to investments, the Council has stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list, which also enable diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

11.4 Furthermore, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that 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 this end the Council will engage with its advisors to maintain and monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings. This is integrated into the credit methodology provided by the advisors, Capita Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

11.5 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.

11.6 The aim of the strategy is to generate a list of highly creditworthy counterparties, which will also enable diversification and thus avoidance of concentration risk. The intention of the strategy is to provide security of investment and minimisation of risk.

11.7 Investment instruments identified for use in the financial year are listed below under the 'Specified' and 'Non-Specified' investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices Statement.

## 12. SPECIFIED INVESTMENTS (MATURITIES UP TO ONE YEAR) AND COUNTERPARTY LIMITS

12.1 All such investments will be sterling denominated, with maturities up to maximum of 1 year, meeting the minimum 'high' rating criteria where applicable. The maximum limit will be applied to each account (i.e. bank, local authority, bond, etc.)

| | **Maximum Limit** |
|---|---|
| **1. Specified Investments (limit per counterparty)** | |
| UK Government | Unlimited |
| Local Authorities | £50.0m |
| Money Market Funds with a minimum rating AAA | £50.0m |
| Pooled Fund Institution with a minimum rating of AAA/A1 | £50.0m |
| Institutions with a minimum rating of AAA/A1 | £50.0m |
| Institutions with a minimum rating of AA-/A2 | £20.0m |
| Institutions with a minimum rating of A-/A3 | £15.0m |
| Institutions with a minimum rating of BBB/A3 | £10.0m |
| Building Societies – assets greater than £5,000 million | £5.0m |
| Building Societies – assets greater than £1,000 million | £2.5m |
| Building Societies – assets greater than £ 250 million | £1.0m |
| Building Societies – for Local Authority Mortgage Scheme | £1.0m |

| All investments with maturities up to maximum 1 year, high credit criteria: | | | |
|---|---|---|---|
| | **Minimum ‘High’ Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
| Debt Management Agency Deposit Facility | UK sovereign rating | £50m | 1 year |
| Term deposits – local authorities and other public institutions | UK sovereign rating | £20m | 1 year |
| Term deposits – banks and building societies* | UK sovereign rating | £20m | 1 year |

12.2 Term deposits with nationalised banks, banks and building societies

| | **Minimum ‘High’ Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
|---|---|---|---|
| UK part nationalised banks | UK sovereign rating | £20m | 1 year |
| Banks part nationalised by high credit rated (sovereign rating) countries – non UK* | Sovereign rating A | £10m | 1 year |

*The countries approved for investing with their banks: Canada, Denmark, Finland, France, Germany, Luxembourg, Netherlands, Norway, Singapore, Sweden, Switzerland, UK, Australia, Belgium, Hong Kong, USA.

12.3 Other instruments

| | **Minimum ‘High’ Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
|---|---|---|---|
| Collateralised deposit | UK sovereign rating | £5m | 1 year |
| Certificates of deposits issued by banks and building societies | UK sovereign rating | £5m | 1 year |
| UK Government Gilts | UK sovereign rating | £5m | 1 year |
| Bonds issued by multilateral development banks | Long term AA | £5m | 1 year |
| Treasury Bills | UK sovereign rating | £5m | 1 year |

| **Collective Investment Schemes structures as Open Ended Investment Companies (OEICs)** | | | |
|---|---|---|---|
| Government Liquidity Funds | Long term AA | £5m | 1 year |
| Money Market Funds | Variable NAV<br>Long Term AAA | £50m per fund | 1 year |
| Money Market Funds | Stable NAV<br>Long Term AAA | £50m per fund | 1 year |
| Enhanced Cash Funds | Long Term AA | £5m | 1 year |
| Bonds Funds | Long Term AA | £5m | 1 year |
| Gilt Funds | Long Term AA | £5m | 1 year |

## 13. NON-SPECIFIED INVESTMENTS (MATURITIES OVER ONE YEAR)

13.1 These are any investments which do not meet the specified investment criteria. A maximum of 80% may be held in aggregate in non-specified investments. A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories. The criteria, time limits and monetary limits applying to institutions or investment vehicles are:

| **Term deposits with nationalised banks and building societies:** | | | |
|---|---|---|---|
| | **Minimum 'High' Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
| UK part nationalised banks | UK sovereign rating | £20m | 5 year |
| Banks part nationalised by high credit rated (sovereign rating) countries UK and non UK* | Sovereign rating A | £20m | 5 year |

13.2 Maturities of any period:

| **Fixed term deposits with variable rate and variable maturities**: | | | |
|---|---|---|---|
| | **Minimum 'High' Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
| Structured deposits | In accordance with Capita's Credit Worthiness Criteria | £5m | 5 years |
| Building Societies term deposits with unrated counterparties : any maturity | The top twenty building societies by total assets with a minimum asset size of £1bn and the following credit rating Fitch (or its equivalent): | | |
| | Long term rating AA-, short term rating F1 | £5m | 5 years |
| | Non rated | £1m | 1 year |
| Challenger Banks term deposits with unrated counterparties : any maturity | The non-rated bank must have a minimum asset level of £200m, | £5m | 1 year |
| Municipal Bonds | UK sovereign rating | £5m | 10 years |
| Commercial paper | Short-term F2, Long term A | £5m | 5 years |
| Corporate Bonds Corporate Bond Funds / Gilt Funds | Short-term F2, Long term A | £5m | 10 years |
| Floating Rate Notes | Long term A | £5m | 5 years |
| Covered Bonds | Long term AA- | £5m | 10 years |
| Un-rated bonds | Long term B- | £5m | 10 years |
| Churches, Charities and Local Authorities (CCLA) Property Fund | | £20m | 10 years |

13.3 Maturities in excess of 1 year

| | **Minimum 'High' Credit Criteria** | **Maximum Limit** | **Maximum Maturity Period** |
|---|---|---|---|
| Term deposits – local authorities and other public institutions | | £5m | 5 years |
| Term deposits – banks and building societies | | £5m | 5 years |
| Certificates of deposits issued by banks and building societies | UK sovereign rating | £5m | 5 years |
| UK Government Gilts | UK sovereign rating | £5m | 5 years |
| Bonds issued by multilateral development banks | AA | £5m | 5 years |
| Corporate bonds | Short term F2<br>Long Term A- | £5m | 10 years |
| Green Energy Bonds | Internal Due Diligence | £20m per bond | 10 years |
| Collateralised Term Deposit | Local Authority | £5m | 5 years |
| Sovereign bond issues (i.e. other than the UK government) | AA | £5m | 5 years |
| Property Bonds | | £5m per bond | 5 years |
| LiveWire Community Energy | | £5m | 20 years |
| Funding Circle | | £1.0m | 5 years |
| Asset Backed Securities | Internal Due Diligence | £10m | 10 years |
| Asset Backed Pooled Funds | Internal Due Diligence | £10m | 10 years |
| **Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)** | | | |
| Bond Funds | AA | £5m | 10 years |
| Gilt Funds | AA | £5m | 5 years |

## 13 OTHER NON-SPECIFIED INVESTMENTS

- Fixed term deposits with variable rate and variable maturities
- Local Authority Mortgage Scheme (LAMS)
- Pooled Funds

## 14 CREDITWORTHINESS POLICY

14.1 This Council uses the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;

- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;
- Sovereign ratings to select counterparties from only the most creditworthy countries.

14.2 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 on some occasions.

14.3 The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Capita's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands:

| **Colour** | **Suggested Duration** |
|---|---|
| Yellow | 5 years * |
| Dark Pink | 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25 |
| Light Pink | 5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5 |
| Purple | 2 years |
| Blue | 1 year (only applies to nationalised or semi nationalised UK Banks) |
| Orange | 1 year |
| Red | 6 months |
| Green | 100 days |
| No colour | Not to be used |

**The yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt.*

14.4 The Capita 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.

14.5 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.

14.6 All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita 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;

- In addition to the use of Credit Ratings the Council will be advised of information in movements in Credit Default Swap (CDS) against the iTraxx (CDS product brand name) benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Councils lending list.

14.7 Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and information, information on government support for banks and the credit ratings of that government support.

## 15. COUNTRY LIMITS

15.1 The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide them). The list will be added to, or deducted from by officers should ratings change in accordance with this policy.

## 16. INVESTMENT STRATEGY

16.1 Prudence will drive the Council's investment strategy in 2017/18 due to the volatility and uncertainty that exists in the world's financial markets. Lending will only take place to institutions at the higher end of the credit rating spectrum. Due to interest rates being historically low and to maximise liquidity investments will be of a short term nature. In order to minimise risk, the Council will look to diversify its investment portfolio by investing in other investment vehicles such as money market funds and property funds. The driving force of our strategy will be maintaining the security of capital and investment liquidity. The Council will use a combination of credit ratings, sovereign ratings and guarantees to assess the credit quality of financial institutions before placing investments.

## 17. INTEREST RATE OUTLOOK

17.1 The Bank Rate is forecast to remain unchanged at 0.25% until quarter two 2019 and not to rise above 0.75% by quarter one 2020. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

17.2 There are downside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth weakens. However, should the pace of growth quicken, there could be upside risk.

17.3 The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next few years are as follows:

- 2016/17 0.25%

- 2017/18  0.25%
- 2018/19  0.25%
- 2019/20  0.50%
- 2020/21  0.75%
- 2021/23  1.00%
- 2022/23  1.50%
- 2023/24  1.75%
- Later years 2.75%

17.4 The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increase in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

17.5 For 2017/18 the Council will budget for an investment return of 0.25% on investments placed during the financial year.

## 18. LIQUIDITY OF INVESTMENTS

18.1 The maximum period of investment of Council money will be ten years.

18.2 There will be no more than £100m committed for a period over 5 years.

## 19. POLICY ON THE USE OF EXTERNAL SERVICE PROVIDERS

19.1 The Council uses Capita Asset Services as its external treasury management advisers.

19.2 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 our external service providers.

19.3 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. The Council tendered for the service in 2015 for a three year period.

## 20. TREASURY MANAGEMENT SCHEME OF DELEGATION

20.1 The scheme of delegation is in the Council's Treasury Management Practices statement which will be reported to the Audit and Corporate Governance Committee on an annual basis.

## 21. MINIMUM REVENUE PROVISION (MRP) STRATEGY

21.1 The Council is required to make an annual provision from revenue to contribute towards the repayment of borrowing. This requirement arises under the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008, which simplifies earlier MRP requirements by placing a duty on the Authority to determine each year an amount of minimum revenue provision, which it considers to be prudent. In order to assist the Council with this determination, guidance for assessing what would represent a prudent provision has been issued under S.21 (1A) of the Local Government Act 2003 (The Guidance). The Council is required to have regard to the Guidance when considering the amount of their annual "prudent" MRP.

21.2 The Council has resolved to have regard to the Guidance when determining the amount of its annual MRP.

21.3 The major proportion of MRP for 2009/10 related to the more historic debt liability that was outstanding at the time the Guidance was adopted. This will be charged over a 50 year period.

21.4 New capital expenditure for each subsequent year will in general be charged in accordance with Option 3 of the Guidance, which recommends that the annual charge should broadly equate to the anticipated life, or period of benefit, which is reflective of the nature of the expenditure. The annual charge will represent an equal annual instalment relative to the assessed life period.

21.5 The determination of which expenditure should be charged under Option 3, and the life periods considered to be applicable to these, will be carried out under delegated powers.

21.6 The use of this option for certain schemes/expenditures will also result in there being no MRP charge until the year after that in which all expenditures on a scheme, project or other item of capital expenditure have been fully accrued under proper practices, regardless of the extent of such expenditure that has not been accrued at the end of the previous financial year.

21.7 Items of capital expenditure will only be considered to represent separate amounts in cases where two or more major components have substantially different useful economic lives. Assets will not be transferred into the asset register and fixed assets account until complete, in accordance with Accounting Code principles.

21.8 To the extent that expenditure does not create an asset, and is of a type that is subject to estimated life periods that are referred to in the Guidance, these recommended periods will generally be adopted by the Council. However, in the case of long term debtors arising from loans or other types of capital expenditure made by the Council which will be repaid under separate arrangements, there will be no minimum revenue provision made. The Council are satisfied that a prudent provision will be achieved after exclusion of these capital expenditures.

21.9 A similar type of policy will apply in the case of the Golden Square Shopping Centre. However, instead of relying solely upon principal element of repayments to satisfy the MRP liability, the annual MRP charge that will in effect be made will equate to the principal amount that has been assessed by the Council's advisers, Price Waterhouse Coopers, to be included each year within the repayments received by the Authority under the lease. Rather than resulting in a fixed annual MRP charge over the period of the lease, the nominal amount of MRP charge each year will be regarded as met by the element of the lease rental which serves to write down the outstanding long term debtor created as a consequence of the lease having been granted. The deferred capital receipt created under this arrangement will be earmarked on a yearly basis to pay off the debt liability over 200 years and will equate to the MRP charge. This approach mirrors that which is recommended within paragraph 20 of the MRP Guidance with regard to leases where the authority is a lessee.

21.10 Other finance leases and Private Finance Initiative (PFI) assets will have their MRP liability determined according to the life of the financial instrument, which will act as a proxy for asset life. MRP on these instruments will be accounted for with reference to IFRS accounting principles.

21.11 The Council, if it considers it prudent for a particular financial year, will set aside capital receipts to be offset by the matching MRP liability amount.

21.12 For those types of capital expenditure incurred by the Council which are not capable of being related to an individual asset (e.g. capitalising revenue items), asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure, and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

21.13 With regards to loans granted by the Council no MRP will be charged on them. The MRP will be equated to the principal repayment of the individual loans. No MRP will be charged on the Local Authority Mortgage Scheme. The Council will annually review the validity of all loans advanced and if it is assessed that the loan is not to be fully repaid then MRP will be calculated on the amount of shortfall over the remaining life of the loan.

21.14 The policy will be reviewed on an annual basis. Any changes to the MRP policy will retrospectively be applied to previous years if assessed to be prudent. If it is proposed to vary the terms of the original Policy Statement during any year, a revised statement should be put to members at that time.

21.15 Per the decision of the Council's Audit & Corporate Governance Committee in

December 2015 a new item 8 figure will be adopted for the calculation of the 2015/16 MRP charge and beyond.

21.16 Retrospective reductions in MRP will be made when over payment of MRP in past years is identified.

21.17 Option 2 & 4 will be used for economic regeneration and investment schemes if thought to be prudent.

21.18 For expenditure in shares classed as capital expenditure a 50 year life will be applied to the calculation of MRP.

## 22. CAPITAL PROGRAMME

22.1 The Council is proposing an ambitious capital programme of £617.213m in 2017/18 which contains £586.562m of prudential borrowing. A few of themes predominately drive this borrowing figure. Firstly expanding the Council's loans to Registered Social Landlords, this is an Invest to Save Scheme that generates income to the Council and results in having additional investment in the borough. It will require borrowing of £200m. The second theme is relating to investment in Strategic Property Programme and will require borrowing of £266m and the third theme is with regard to regeneration and growth, such as Times Square which will require borrowing of £36m.

22.2 The Council's Invest to Save Programme is an ambitious one. The level of borrowing will be determined by the delivery of capital schemes.

## 23. 2017/2018 DEVELOPMENTS

23.1 **Business Bank** – In line with the decision of Executive Board of 16 January 2017 the Council will mobilise the bank and put in place the agreed financing.

23.2 **Housing Company** – the Council plan to form a housing company in 2017/18 and will finance it via Council issued loans.

23.3 **Investment Fund Joint Venture** – the Council plan to form a joint venture investment fund incorporating an energy company in 2017/18 that other Councils can invest in.

23.4 **Strategic Property Investment Programme** – the Council plan to expand their Strategic Property Investment Programme during 2017/18.

23.5 **Lenders Option Borrowers Option (LOBO)** – the Council will explore options to re-finance its LOBO portfolio and previous Barclays LOBO's in 2017/18.

23.6 **Treasury Trading Company** – it is planned to set up a treasury trading company in 2017 to enable the Council to generate extra income from consultancy and joint venture working.

**ANNEXE A**

## GLOSSARY OF TERMS

| | |
|---|---|
| **Basis Point (BP)** | 1/100th of 1%, i.e. 0.01% |
| **Base Rate** | Minimum lending rate of a bank or financial institution in the UK |
| **Benchmark** | A measure against which the investment policy or performance of a fund manager can be compared. |
| **Bill of Exchange** | A financial instrument financing trade. |
| **Callable Deposit** | A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower. |
| **Cash Fund Management** | Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio. |
| **Certificate of Deposit** | Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD. |
| **Commercial Paper** | Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing. |
| **Corporate Bond** | Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies. |
| **Counterparty** | Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.) |
| **CDS** | Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap. |
| **CFR** | Capital Financing Requirement |
| **CIPFA** | Chartered Institute of Public Finance and Accountancy |
| **CLG** | Department for Communities and Local Government |
| **CPI** | Consumer Price Index – calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees. |
| **DCLG** | Department of Communities and Local Government |
| **Derivative** | A contract whose value is based on the performance of an |

| | |
|---|---|
| | underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock. |
| **DMADF** | Deposit Account offered by the Debt Management Office, guaranteed by the UK government. |
| **ECB** | European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle. |
| **EMU** | European Monetary Union |
| **Equity** | A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain. |
| **EU** | European Union |
| **Fed.** | Federal Reserve Bank of America – sets the central rates in the USA |
| **Floating Rate Notes** | Bonds on which the rate of interest is established periodically with reference to short-term interest rates |
| **Forward Deal** | The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate. |
| **Forward Deposits** | Same as forward dealing (above). |
| **FSA** | Financial Services Authority – body responsible for overseeing financial services. |
| **Fiscal Policy** | The Government policy on taxation and welfare payments. |
| **GDP** | Gross Domestic Product |
| **GF** | General Fund |
| **Gilt** | Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent. |
| **Gilt Funds** | Pooled fund investing in bonds guaranteed by the UK government. |
| **Government MMF** | MMFs that invest solely in government securities, or reverse repurchase agreements backed by Government Securities. |
| **HM Treasury** | Her Majesty's Treasury |
| **HRA** | Housing Revenue Account |
| **IFRS** | International Financial Reporting Standards |
| **IMF** | International Monetary Fund |
| **iTraxx** | The brand name for the group of credit default swaps index products. |
| **LOBO's** | Lenders Option Borrowers Option loans |
| **Money Market Fund** | A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments. It is very similar to a unit trust, however in a MMF. |
| **Monetary Policy committee (MPC)** | Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two year's time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable |

| | |
|---|---|
| | levels of growth and employment. |
| **MRP** | Minimum Revenue Provision |
| **MTFP** | Medium Term Financial Plan |
| **Open Ended Investment Companies** | A diversified pooled investment vehicle, with a single purchase price, rather than a bid/offer spread. |
| **Other Bond Funds** | Pooled funds investing in a wide range of bonds. |
| **PFI** | Private Finance Initiative |
| **PWLB** | Public Works Loan Board |
| **QE** | Quantitative Easing |
| **Reverse Gilt Repo** | This is a transaction as seen from the point of view of the party which is buying the gilts. In this case, one party buys gilts from the other and, at the same time and as part of the same transaction, commits to resell equivalent gilts on a specified future date, or at call, at a specified price. |
| **Retail Price Index (RPI)** | Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person. |
| **RPIX** | As RPI but excluding mortgage interest rate movements. |
| **RPIY** | As RPI but excluding mortgage interest rate movements and changes in prices caused by changes in taxation. |
| **Sovereign Issues (Ex UK Gilts)** | Bonds issued or guaranteed by nation states, but excluding UK government bonds. |
| **Supranational Bonds** | Bonds issued by supranational bodies, e.g. European investment bank. These bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts. |
| **SORP** | Statement of Recommended Practice |
| **S151** | Section 151 Officer |
| **Term Deposit** | A deposit held in a financial institution for a fixed term at a fixed rate. |
| **Treasury Bill** | Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value. |
| **UBS** | Union Bank of Switzerland |
| **US** | United States |
| **WARoR** | Weighted Average Rate of Return is the average annualised rate of return weighted by the principal amount in each rate. |
| **WAM** | Weighted Average Time to Maturity is the average time, in days, till the portfolio matures, weighted by principal amount. |
| **WATT** | Weighted Average Total Time is the average time, in days, that deposits are lent out for, weighted by principal amount. |
| **WA Risk** | Weighted Average Credit Risk Number. Each institution is assigned a colour corresponding to a suggested duration using Sector's Suggested Credit Methodology. |
| **Model WARoR** | Model Weighted Average Rate of Return is the WARoR that the model produces by taking into account the risks inherent in the portfolio. |

## PRUDENTIAL INDICATORS

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within defined limits.

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

## A Capital Expenditure

The Council has to make a reasonable estimate of the capital expenditure that it plans to incur in the following three years and after the year-end must record the actual capital expenditure incurred in that year.

The Council's capital programme informs the requirements of these indicators. The actual capital expenditure that was incurred by the authority in 2015/16, the revised estimate for the current year and estimates for the future years are as follows:

| 2015/16 Actual £m | 2016/17 Estimate £m | Capital Expenditure | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|---|
| 14.417 | 13.785 | Families & Wellbeing | 8.839 | 0.153 | 0.000 |
| 2.934 | 7.888 | Resources & Strategic Commissioning | 2.256 | 2.498 | 1.000 |
| 24.014 | 35.262 | Economic Regeneration Growth & Environment | 66.083 | 29.279 | 19.137 |
| 53.209 | 109.241 | Invest to Save Programme | 540.516 | 247.603 | 265.568 |
| **94.574** | **166.176** | **Total Capital Expenditure** | **617.694** | **279.533** | **285.705** |

The table below summarises the above capital expenditure plans and how these plans are being finance by capital or revenue resources. Any shortfall of resources results in a funding borrowing need:

| 2015/16 Actual £m | 2016/17 Estimate £m | Capital Financing | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|---|
| 75.683 | 138.330 | Unsupported Borrowing | 586.562 | 266.256 | 270.731 |
| 16.884 | 24.726 | Capital Grants and Reserves | 16.855 | 6.711 | 4.357 |
| 0.090 | 1.515 | Capital Receipts | 1.339 | 0.000 | 0.000 |
| 1.867 | 0.000 | Revenue Funding | 0.000 | 0.000 | 0.000 |
| 0.050 | 1.605 | External Funding | 12.938 | 6.566 | 10.617 |
| **94.574** | **166.176** | **Total Capital Financing** | **617.694** | **279.533** | **285.705** |

## B Capital financing cost indicators

One of the indicators of affordability is the estimated ratio of the Council's general fund capital financing costs to its net revenue stream in percentage terms. This indicator shows the proportion of the revenue budget spent on capital financing costs; if the ratio is increasing rapidly over time then a larger proportion of revenue resources is being taken up by capital financing costs, which could be used for other elements of the authority's budget.

For 2016/17, net revenue streams are based on the MTFP draft general fund (GF). For future years, the GF net revenue stream is projected in the Council's MTFP.

| 2015/16 Actual % | 2016/17 Estimate % | Ratio of financing costs to net revenue stream | 2017/18 Estimate % | 2018/19 Estimate % | 2019/20 Estimate % |
|---|---|---|---|---|---|
| 5.02 | 3.47 | Non-HRA | 4.70 | 4.48 | 4.68 |

## C Capital Financing Requirement

The Capital Financing Requirement (CFR) indicator is a notional figure which shows the authority's theoretical need to borrow to fund capital expenditure. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

| 2015/16 Actual £m | 2016/17 Forecast £m | Capital Financing Requirement (CFR) | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|---|
| **304.830** | **438.051** | **Total CFR** | **1023.115** | **1287.597** | **1556.502** |
| | | **Movement in CFR represented by** | | | |
| 60.029 | 138.330 | Net financing need for the year | 586.562 | 266.256 | 270.731 |
| (5.079) | (5.109) | Less MRP, other financing movements | (1.498) | (1.775) | (1.827) |
| **54.950** | **133.221** | **Movement in CFR** | **585.064** | **264.481** | **267.366** |

## D Gross Borrowing Requirement

There is a clear linkage between the authority's capital financing requirement indicators and its gross external borrowing. Within the code there is a key indicator of prudence that ensures that, over the medium term, gross borrowing is only for a capital purpose. This can be demonstrated by comparing gross external borrowing shown in the table below to the total CFR in the preceding year plus the estimates of any additional CFR for the current and next two financial years. Gross external borrowing should not exceed this limit except in the short term. There is some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operation), against the underlying capital borrowing need (the Capital Financing Requirement (CFR)), highlighting any over or under borrowing:

| **2015/16 Actual £m** | **2016/17 Estimate £m** | **Current Portfolio Position** | **2017/18 Estimate £m** | **2018/19 Estimate £m** | **2019/20 Estimate £m** |
|---|---|---|---|---|---|
| | | **External Debt** | | | |
| 196.597 | 263.840 | Debt at 1 April | 414.874 | 981.436 | 1189.186 |
| 67.243 | 151.034 | Expected change in Debt | 566.562 | 207.751 | 267.485 |
| 263.840 | 414.874 | External Debt at 31 March | 981.436 | 1189.186 | 1456.671 |
| 4.328 | 4.232 | Other LT Liabilities (OLTL) | 4.129 | 4.019 | 3.901 |
| 0 | 0 | Expected change in OLTL | 0 | 0 | 0 |
| 268.168 | 419.106 | Actual Gross Debt at 31 March | 985.565 | 1193.205 | 1460.572 |
| 304.831 | 438.051 | Capital Financing Requirement | 1023.115 | 1287.597 | 1556.502 |
| **36.663** | **18.945** | **Under / (over) borrowing** | **37.55** | **94.392** | **95.930** |

The Director of Finance 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.

## E Impact of Capital Investment Decisions on Council Tax

The other indicator of affordability is the estimate of the incremental impact on Council Tax, over and above capital investment decisions that have previously been taken by the Council. This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period. The indicator is intended to show the effect on Council Tax of approving new capital expenditure in the capital programme.

| 2015/16 Actual £ | 2016/17 Estimate £ | Impact of capital investment decisions for band D Council Tax | 2017/18 Estimate £ | 2018/19 Estimate £ | 2019/20 Estimate £ |
|---|---|---|---|---|---|
| 12.92 | 8.93 | Unsupported Borrowing | 13.84 | 5.61 | 1.55 |

## F Authorised Limit for External Debt

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

The authority has to set an Authorised Limit, which is the statutory maximum borrowing permitted, and an operational boundary, which is the normal level of borrowing expected, for external debt.

The Authorised Limits set out below are consistent with the authority's current commitments, existing plans and the proposals set out in this report for the capital expenditure and financing, and with its approved treasury policy statement and practices. They are based on the most likely, prudent, but not worse case scenario, with sufficient headroom over and above this to allow for operational management recognising that during the year it may be necessary to exceed the operational boundary in order to take advantage of interest rate movements or to accommodate unusual cash flow movements.

| 2015/16 Actual £m | 2016/17 Estimate £m | Authorised Limit for External Debt | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|---|
| 263.840 | 414.874 | Borrowing | 1125.427 | 1416.357 | 1712.152 |
| 4.328 | 4.232 | Other Long Term Liabilities | 4.129 | 4.019 | 3.901 |
| **268.168** | **419.106** | **Total Authorised Limit** | **1129.556** | **1420.376** | **1716.053** |

In agreeing these limits, it should be noted that the Authorised Limit for 2017/18 will be the statutory limit determined under Section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised. This indicator being the maximum limit the Council may borrow at any point in time in the year. If borrowing above this level were needed a report would go to Executive Board for authorisation to increase the limit.

## G Operational Boundary for External Debt

The operational boundary is a key management tool for in-year monitoring. Temporary breach of the operational boundary will not in itself be a cause for concern, although a sustained breach might indicate an underlying issue that would need investigation and action.

The operational boundaries below are based on the Authorised Limit, estimating the authority's most likely level of borrowing and leasing each year. It includes long term borrowing to fund capital and short term borrowing to meet day to day variations in cash flow but without the additional headroom.

This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

| 2015/16 Actual £m | 2016/17 Estimate £m | Operational Boundary | 2017/18 Estimate £m | 2018/19 Estimate £m | 2019/20 Estimate £m |
|---|---|---|---|---|---|
| 263.840 | 414.874 | Debt | 1203.205 | 1470.572 | 1388.600 |
| 4.328 | 4.232 | Other long term liabilities | 4.129 | 4.019 | 3.901 |
| **268.168** | **419.106** | **Total** | **1207.334** | **1474.591** | **1392.501** |

**Treasury management limits on activity**

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

## H Maturity structure of debt

It is recommended that the Council sets upper and lower limits for the maturity structure of its debt for the forthcoming year as follows:

| Maturity Structure of Council Borrowing | Lower Limit % | Upper Limit % |
|---|---|---|
| Under 12 months | 0% | 30% |
| 12 months to 2 years | 0% | 30% |
| 2 years to 5 years | 0% | 35% |
| 5 years to 10 years | 0% | 30% |
| 10 years to 20 years | 40% | 100% |
| 20 years to 30 years | 40% | 100% |
| 30 years and above | 40% | 100% |

The above percentages are the ranges for the projected borrowing maturing in each year out of the total projected borrowing. The indicator is designed to be a control over the Council having large concentrations of fixed interest rate debt needing to be replaced at any one time and thus being at risk of having to borrow large amounts when interest rates may be unfavourable.

## I Fixed interest rate exposure

The table below shows the Council's upper limit for fixed interest rate exposure for the next three years. This indicator shows the percentage of borrowing that can be undertaken at fixed interest rates. Up to 100% of borrowing can be at fixed interest rates. Again, this indicator is set at levels to reduce the risk from interest rate movements.

| **Upper Limit – Fixed Interest Rate Exposure** | **2017/18 %** | **2018/19 %** | **2019/20 %** |
|---|---|---|---|
| Fixed Interest Rates | 100 | 100 | 100 |

## J Variable interest rate exposure

The following indicator shows the percentage of borrowing that can be undertaken at variable interest rates. The purpose of the indicator is to restrict variable rate borrowing in order to reduce the risk from sudden movements in interest rates. The Council sets its upper limit for borrowing, reflecting variable interest rates less investments that are variable rate investments at 40%.

| **Upper Limit – Variable Interest Rate Exposure** | **2017/18 %** | **2018/19 %** | **2019/20 %** |
|---|---|---|---|
| Variable Interest Rates | 40 | 40 | 40 |

Currently 100% of the borrowing is fixed rate, which is within these limits.

## K Investment periods

It is recommended that the Council sets a limit on the amount invested for periods longer than one year of **£100m** in total for 2017/18, with the maximum period for any one loan being ten years. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment and are based on the availability of funds after each year-end.

| **Upper Limit for Total Principal Sums Invested for over 364 days** | **2017/18 Estimate £m** | **2018/19 Estimate £m** | **2019/20 Estimate £m** |
|---|---|---|---|
| External Debt | 100.000 | 100.000 | 100.000 |