Agenda Item 6.1

WARRINGTON BOROUGH COUNCIL

COUNCIL
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TITLE OF REPORT: 2018/19 TREASURY MANAGEMENT STRATEGY

1. PURPOSE OF THE REPORT

1.1 This report sets out the Council's proposed Treasury Management Strategy for 2018/19. This report was reported to the Audit and Corporate Governance Committee on 14 February 2018 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 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 2018/19 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 2017 revised CIPFA Treasury Management Code of Practice and DCLG Investment Guidance.

9. RECOMMENDATIONS

9.1 Council are recommended to approve the Treasury Management Strategy; and

9.3 With regard to borrowing from the UK Municipal Bonds Agency plc specific details have been requested to be recommended to Council to approve as detailed below:

- approve the form and content of and entry into the Certificate of Approval, the Framework Agreement (including its accompanying schedules) and the Deed of Guarantee;
- authorise each of the Director of Corporate Services as the Section 151 Officer and the Head of Legal and Democratic Services as the Monitoring Officer to execute the Certificate of Approval, the Framework Agreement, the Deed of Guarantee and any other document to be delivered pursuant to or in connection with the aforementioned documents or borrowing from the UK Municipal Bonds Agency plc subject to any amendment (whether of substance or not) which he or she may consider in his or her discretion to be necessary or desirable; and
- authorise each of the Director of Corporate Services as the Section 151 Officer and the Head of Legal and Democratic Services as the Monitoring Officer to take any other action on behalf of the Council in connection with the transactions contemplated by the Framework Agreement and the Deed of Guarantee or borrowing from the UK Municipal Bonds Agency plc.

10. BACKGROUND PAPER

10.1 Treasury Management working papers.

Contacts for Background Papers:

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APPENDIX 1

2018/19 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 2018/19 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 2017. 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 In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following:

- A high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services;
- An overview of how the associated risk is managed
- The implications for future financial sustainability

The aim of this report is to ensure that all elected members on the council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

1.8 The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

1.9 The council has completed a Capital Strategy for 2018/19 is due to be reviewed at the Executive Board on 12th February 2018.

1.10 The suggested strategy for 2018/19 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

- The current treasury position;
- Treasury indicators which limit the treasury risk and activities of the Council;
- 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.

1.11 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.

1.12 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 2018/19

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. Subject to any amendments by the Committee it will be forwarded to the Council to approve the code at its meeting of 26th February 2018.

3. CURRENT PORTFOLIO POSITION

3.1 The Council's treasury portfolio position as at 31st December 2017 comprised of:

Current Portfolio Position	Principal £m	Total £m	Average Interest Rate %
Fixed Rate Funding			
- Public Works Loans Board	411.662		2.416
- Money Market	158.512		2.857
- Temporary Borrowing	30.390	600.564	0.394
Variable Rate Funding			
- Public Works Loans Board			
- Money Market	50.000	50.000	0.846
TOTAL BORROWING		**650.564**	2.356
Council Investments			
- Fixed Rate	(79.952)		4.310
- Call Accounts	(24.621)	(104.573)	0.389
TOTAL INVESTMENTS		**(104.573)**	**3.289**
NET		**545.991**	

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 and the Council's capital strategy. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury/prudential indicators, the current and projected debt positions and the annual investment strategy. 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.

2016/17 Actual £m	2017/18 Estimate £m	Capital Expenditure	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	TOTAL 3 Years £m
115.040	385.800	Capital Expenditure	389.542	343.986	215.390	**948.918**
		Financed By:				
22.478	20.543	Capital Grants & Reserves	13.262	11.678	4.491	**29.431**
2.455	0.316	Capital Receipts	5.941	0	0	**5.941**
0.000	0.674	Council Revenue Funding	0	0	0	**0**

2.796	6.451	External Funding	18.440	16.517	0.755	**35.712**
87.312	**357.816**	**Financing need for year**	**351.899**	**315.791**	**210.144**	**877.834**

4. PROSPECTS FOR INTEREST RATES

4.1 The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

4.2 The Bank Base Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are as follows:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

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.

Link 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-17	0.50%	1.50%	2.10%	2.80%	2.50%
Mar-18	0.50%	1.60%	2.20%	2.90%	2.60%
Jun-18	0.50%	1.60%	2.30%	3.00%	2.70%
Sep-18	0.50%	1.70%	2.40%	3.00%	2.80%
Dec-18	0.75%	1.80%	2.40%	3.10%	2.90%
Mar-19	0.75%	1.80%	2.50%	3.10%	2.90%
Jun-19	0.75%	1.90%	2.60%	3.20%	3.00%
Sep-19	0.75%	1.90%	2.60%	3.20%	3.00%
Dec-19	1.00%	2.00%	2.70%	3.30%	3.10%
Mar-20	1.00%	2.10%	2.70%	3.40%	3.20%
Jun-20	1.00%	2.10%	2.80%	3.50%	3.30%
Sep-20	1.25%	2.20%	2.90%	3.50%	3.30%
Dec-20	1.25%	2.30%	2.90%	3.60%	3.40%
Mar-21	1.25%	2.30%	3.00%	3.60%	3.40%

4.3 These assumptions have been used to determine the treasury management budget projections, included as part of the 2018/19 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**
Mar-18	0.50%	1.70%	2.20%	2.60%
Jun-18	0.75%	1.90%	2.40%	2.90%
Sep-18	1.00%	2.10%	2.60%	3.10%
Dec-18	1.25%	2.40%	2.80%	3.30%
Mar-19	1.25%	2.40%	2.80%	3.30%
Jun-19	1.50%	2.40%	2.80%	3.30%
Sep-19	1.50%	2.40%	2.80%	3.35%
Dec-19	1.75%	2.40%	2.80%	3.35%
Mar-20	2.00%	2.40%	2.80%	3.35%
Jun-20	2.00%	2.65%	3.05%	3.60%
Sep-20	2.25%	2.65%	3.05%	3.60%
Dec-20	2.25%	2.90%	3.30%	3.80%

5. ECONOMIC BACKGROUND

5.1 **Global Outlook** – world growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

5.2 In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this. The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union members and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or

computers. Indeed, this is now being labelled as being the start of the fourth industrial revolution.

5.3 **Key Risks** – central bank monetary policy measures. Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

5.4 The key issue now is that the period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently, in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to reduce economic recovery by taking too rapid and too strong action, or, alternatively, let inflation increase by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks.

5.5 There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the low level of productivity growth, which may be the main driver for increases in wages; and decreasing consumer disposable income, which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

5.6 A further question that has come to the fore is whether an inflation target for central banks of 2%, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a lower inflation target of 1% to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could

ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.

- However, other economists would argue for a shift up in the inflation target to 3% in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should target financial market stability. Bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that other non-financial asset prices, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

5.7 **UK** – after the UK surprised on the upside the strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

5.8 While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee (MPC) meeting of 14/09/17 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the meeting. (Inflation actually came in at 3.1% in November so that might prove now to be the peak). This marginal revision in the Bank's forecast can hardly

justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a decrease in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

5.9 At its November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is a relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

5.10 However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increase in Bank Rate during 2018 and onwards.

5.11 It is also worth noting the contradiction within the Bank of England between action in 2016 and in 2017 by two of its committees. After the shock result of the EU referendum, the Monetary Policy Committee (MPC) voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was because the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, the Financial Policy Committee (FPC) of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit. Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages contradict wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25-34 year old band, reflecting their lower levels of real income and asset ownership.

5.12 One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increase in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right – without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

5.13 Moreover, while there is so much uncertainty around Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually work out.

5.14 **Eurozone** – economic growth in the Eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

5.15 **USA** – growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again in quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25-1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

5.16 **China** – economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

5.17 **Japan** – GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However it is still struggling to get inflation up to its target of 2%,

despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

5.18 **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: initial two-year negotiation period on the terms of exit. In the Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- 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 could also exit without any such agreements in the event of a breakdown of negotiations.
- 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 full 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.

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 2018, 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 £357.816m in 2017/18, £351.788m in 2018/19, £315.791m in 2019/20 and £210.144m 2020/21. There is a large requirement in the early years. This is due to the impact of new capital schemes in the programme and the need to replace existing debt as the council has taken some short term loans to take advantage of existing market conditions.

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 2.35%, which has been 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 approved sources of long-term and short-term borrowing will be:

- Public Works Loan Board
- UK Local Authorities
- Municipal Bond Agency (see section 6.7 and 6.8 for further details)
- Any institution approved for investments including high quality supranational banks
- UK public and private sector pension funds
- Any other financial institution approved by the Prudential Regulation Authority, which is part of the Bank of England and is responsible for the regulation and supervision of banks, building societies, credit unions, insurers and major investment firms
- Capital market bond investors either over the counter or through electronic trading platforms

6.7 The Council has limited sources of capital finance available to it. As reported to this committee in February 2016 the Municipal Bond Agency has introduced a Framework Agreement which sets out he arrangements for borrowing from the Agency and incorporates a joint and several guarantee that requires all local authorities borrowing from the Agency to guarantee the money owed by the Agency to those who have lent it money to fund its loans. The Framework Agreement incorporates a mechanism to prevent a call under the guarantee by requiring borrowers to lend the Agency money to cover a default by another local authority, referred to as "contributions".

6.8 The risks associated with the joint and several guarantees are mitigated by the contribution arrangement. Therefore, from a practical perspective, the real risk to the Council is the requirement to make contributions in the event of a default by

another borrower and this exposure is proportional because it is calculated by reference to the amount borrowed by the Council as a proportion of all non-defaulting loans made by the Agency. If the Council has no borrowings via the Agency, it will not be called upon under the Framework Agreement.

6.9 The 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-18	1.60%	2.20%	2.90%	2.60%
Jun-18	1.60%	2.30%	3.00%	2.70%
Sep-18	1.70%	2.40%	3.00%	2.80%
Dec-18	1.80%	2.40%	3.10%	2.90%
Mar-19	1.80%	2.50%	3.10%	2.90%
Jun-19	1.90%	2.60%	3.20%	3.00%
Sep-19	1.90%	2.60%	3.20%	3.00%
Dec-19	2.00%	2.70%	3.30%	3.10%
Mar-20	2.10%	2.70%	3.40%	3.20%
Jun-20	2.10%	2.80%	3.50%	3.30%
Sep-20	2.20%	2.90%	3.50%	3.30%
Dec-20	2.30%	2.90%	3.60%	3.40%
Mar-21	2.30%	3.00%	3.60%	3.40%

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 the 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 increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases. Since then, borrowing rates have eased back. There has been little general trend in rates during the current financial year. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

6.9 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Director of Corporate Services 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 that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

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 2018/19 will be to balance investments to obtain returns within the council's risk appetite. 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 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"). This Code has been reviewed and updated following recent developments in the marketplace and the introduction of the Localism Act 2011 for English local authorities.

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 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."

9.4 'Investments' in the definition above covers all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code.

9.5 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. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

9.6 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 value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

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

- a Treasury policy statement, stating the policies, objectives and approach to risk management of its Treasury Management activities
- suitable Treasury Management Practices (TMPs) setting out the manner in which the Council will seek to achieve those policies and objectives, and

prescribing how it will manage and control those activities (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 6 and 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 Corporate Services (Section 151 Officer), who will act in accordance with the Council's Treasury Management Strategy and the TM Code, who is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

2018/19 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 Corporate 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") and the CIPFA Treasury Management in Public Services Code of Practice and cross Sectoral Guidance Notes 27 ("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 The Council has reviewed its classification with financial institutions under MIFID II requirements. A schedule has been included with the Treasury Management Practices document of those organisations with which it is registered as a professional client and those with which it has an application outstanding to register as a professional client.

11.4 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.

11.5 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, Link Asset Services in producing its colour coding which show the varying degrees of suggested creditworthiness.

11.6 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.

11.7 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.

11.8 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.)

1. Specified Investments (limit per counterparty)	Maximum Individual Investment	Maximum Group Limit
UK Government	£50.0m	Unlimited
Local Authorities	£50.0m	Unlimited
Money Market Funds CNAV	£50.0m	£100.0m
Money Market Funds LVNAV	£25.0m	£75.0m
Money Market Funds VNAV	£15.0m	£50.0m
Pooled Fund Institution with a min rating of AAA/A1	£10.0m	£50.0m
Institutions with a minimum rating of AAA/A1	£50.0m	£100.0m
Institutions with a minimum rating of AA-/A2	£10.0m	£20.0m
Institutions with a minimum rating of A-/A3	£5.0m	£15.0m
Institutions with a minimum rating of BBB/A3	£1.0m	£10.0m
Building Societies – assets greater than £5,000 million	£1.0m	£5.0m
Building Societies – assets greater than £1,000 million	£0.5m	£2.5m
Building Societies – assets greater than £ 250 million	£0.2m	£1.0m
Building Societies – for Local Authority Mortgage Scheme	£0.2m	£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	Sovereign rating A	£10m	1 year

*The countries approved for investing with their banks: UK, 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	Max Individual Investment	Maximum Total Investment	Max Maturity Period
Collateralised deposit	UK sovereign rating	£5m	£5m	1 year
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	1 year
UK Government Gilts	UK sovereign rating	£10m	£50m	1 year
Bonds issued by multilateral development banks	Long term AA	£10m	£20m	1 year
Treasury Bills	UK sovereign rating	£5m	£20m	1 year

Collective Investment Schemes structures as Open Ended Investment Companies (OEICs)			
Government Liquidity Funds	Long term AA	£10m	1 year
Money Market Funds	Variable CNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable LVNAV Long Term AAA	£50m per fund	1 year
Money Market Funds	Stable VNAV 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 90% 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 Individual Investment**	**Maximum Group Limit**	**Maximum Maturity Period**
Structured deposits	In accordance with Link's Credit Worthiness Criteria	£1m	£5m	5 years
Banks and 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	£1m	£5m	5 years
	Non rated	£0.5m	£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	£20m	1 year
Municipal Bonds	UK sovereign rating	£10m	£10m	10 years
Commercial paper	Short-term F2, Long term A	£5m	£5m	5 years
Corporate Bonds Corporate Bond Funds / Gilt Funds	Short-term F2, Long term A	£20m	£20m	10 years
Floating Rate Notes	Long term A	£1m	£5m	5 years
Covered Bonds	Long term AA-	£1m	£5m	10 years
Un-rated bonds	Long term B-	20m	£50m	10 years
Churches, Charities and Local Authorities (CCLA) Property Fund		£20m	£20m	10 years

13.3 Maturities in excess of 1 year

	Minimum 'High' Credit Criteria	Maximum Individual Limit	Maximum Group Limit	Maximum Maturity Period
Term deposits – local authorities and other public institutions		£5m	£50m	5 years
Term deposits – banks and building societies		£1m	£5m	5 years
Certificates of deposits issued by banks and building societies	UK sovereign rating	£5m	£20m	5 years
UK Government Gilts	UK sovereign rating	£5m	£50m	5 years
Bonds issued by multilateral development banks	AA	£5m	£20m	5 years
Corporate bonds	Short term F2 Long Term A-	£10m	£20m	10 years
Green Energy Bonds	Internal Due Diligence	£100m	£200m	10 years
Collateralised Term Deposit	Local Authority	£5m	£20m	5 years
Sovereign bond issues (i.e. other than the UK government)	AA	£5m	£20m	5 years
Property Bonds		£20m	£50m	5 years
LiveWire Community Energy		£1m	£1m	20 years
Funding Circle		£10m	£10m	5 years
Asset Backed Securities	Internal Due Diligence	£20m	£100m	10 years
Asset Backed Pooled Funds	Internal Due Diligence	£10m	£50m	10 years
Collective Investment Schemes structured as Open Ended Investment Companies (OEICs)				
Bond Funds	AA	£5m	£10m	10 years
Gilt Funds	AA	£5m	£10m	5 years
Forest Financial Institute		£20m	£50m	30 years

13 OTHER NON-SPECIFIED INVESTMENTS

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

- Forest Financial Instruments

14 CREDITWORTHINESS POLICY

14.1 This Council uses the creditworthiness service provided by Link 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 Link Asset Services 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 Ultra-Short Dated Bond Funds with a credit score of 1.25
Light Pink	5 years for Ultra-Short Dated Bond Funds 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 Link Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system; it does not give undue preponderance to just one agency's ratings.

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 Link 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 any external 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 2018/19 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 0.50% until quarter four 2018 and not to rise above 1.25% by quarter one 2021. Bank Rate forecasts for financial year ends (March) are as follows:-

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%

- 2020/21 1.25%

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:

- 2017/18 0.40%
- 2018/19 0.60%
- 2019/20 0.90%
- 2020/21 1.25%
- 2021/23 1.50%
- 2022/23 1.75%
- 2023/24 2.00%
- Later years 2.75%

17.4 The overall balance of risks to these forecasts is currently probably slightly skewed to the upside and dependent on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

17.5 For 2018/19 the Council will budget for an investment return of 0.40% on investments placed during the financial year.

18. LIQUIDITY OF INVESTMENTS

18.1 The maximum period of investment of treasury balance 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 Link Asset Services (previously named 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 pay off an element of the accumulated General Fund capital spend (CFR) each year through a revenue charge (MRP). 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 Local Authority Mortgage Scheme (LAMS), Local Authority Partnership Purchase Scheme (LAPP) and Custom Build and Self Build Scheme (CSB) using the cash backed option; the mortgage lenders require a 5 year cash advance from the local authority to match the 5 year life of the indemnity. The cash advance placed with the mortgage lender provides an integral part of the mortgage lending, and should therefore be treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The cash advance is due to be returned in full at maturity, with interest paid annually. Once the cash advance matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The position should be reviewed on an annual basis.

21.19 **Redwood Bank** - The Council will charge no MRP on its investment in Redwood Bank for a period of 5 years. This is because the Council wants to build up a sustainable profitable bank before taking any dividends per the business case agreed by the Executive Board on 12th January 2017. After year 5 MRP will be charged over 50 years by applying the annuity method. The major reason for forming the bank was for economic regeneration purposes and the Council sees it as a long term 50+ years investment that all generations of tax payers can benefit from.

21.20 **Strategic Asset Investment Programme** - The properties in this portfolio are held for investment and economic regeneration purposes and are managed on a fully commercial basis.

21.21 The purchase of these properties will be treated as capital expenditure and will increase the Capital Financing Requirement. The Council is holding these properties solely for investment and economic regeneration purposes and they are leased to

business tenants on commercial lease terms. This includes a range from small local growth SME's to global businesses.

21.22 The Council has the ability to sell this asset or a number of varied approaches to an exit strategy that could raise capital – for example joint venture, equity share, partial sale or additional lease. By sale or raising capital through an alternative route, this can be used to repay any outstanding debt liabilities related to the purchase. As such, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

21.23 The assets will be reviewed annually and if the asset value significantly decreases, a prudent MRP policy will commence on the amount of the fall in value of the asset.

21.24 The Council's borrowing in the Strategic Asset Investment programme is prudent and within the Council's affordable borrowing limit. The Council's Section 151 Officer is satisfied that the borrowing is prudent and that the risks relating to the repayment of loans or the value of the investment are deemed to be low thus there are no resource implications in following this approach.

21.25 **Housing Companies** - The Council has established two wholly owned housing companies which will be provided with loans from the Council on a commercial basis. Under these arrangements, the cash advances will be used by the companies to fund capital expenditure by the building of new houses and should therefore be treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the loans advanced and under the terms of the contractual loan agreements are due to be returned in full with interest paid. Once funds are returned to the Council, the returned funds are classed as a capital receipt, offset against the CFR, which will reduce accordingly. As this is a temporary arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The outstanding loan will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence. The loans also will be used to build houses which will be sold during the business plan period and the resulting sale proceeds can also be used to pay down the CFR. With housing historically being an appreciating asset and the strong demand for houses that exists in the borough the risk of default is low.

21.26 The DCLG consulted on changes to its MRP Guidance in late 2017. Their new guidance is yet to be published. This policy will be updated if required when the new DCLG MRP Guidance is published and reported to members for approval.

22. CAPITAL PROGRAMME

22.1 The Council is proposing an ambitious capital programme of £389.542m in 2018/19 which contains £351.899m of prudential borrowing. A few 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 region. It will require borrowing of £200m. The second theme is with regard to regeneration and growth, such as Times Square which will require borrowing of £38m and also the theme of investment in Strategic Property Programme (£17m), Green Energy Programme (£17.9m) and a Housing Company (£15m).

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. DCLG CONSULTATION ON LOCAL GOVERNMENT INVESTMENT

23.1 DCLG have issued a consultation paper on investments which proposes an effective date of 1 April 2018. This includes a new definition of investments, providing that investments "cover all the financial assets of the organisation, as well as other non-financial assets which the organisation holds primarily for financial returns, such as investment property portfolios. This may therefore include investments which are not managed as part of normal treasury management or under treasury management delegations. All investments require an appropriate investment management and risk management framework under this Code".

23.2 In practice, this means that any loans given or investment in assets wholly for income generation purposes are covered by the Code. Under the proposed Code, loans for economic development purposes can be made even if they do not meet the strict criteria for security and liquidity. However, the Code will expect the loans to be proportionate to the overall portfolio and limits to be set on the maximum that can be loaned.

23.3 Similarly, council can hold non-financial investments, which will normally involve a physical asset that can be realised to recoup the capital invested. The Code requires details on the assessment of risk and the action to be taken if the value of the asset no longer covers the investment.

23.4 If there are any required actions, including the setting of limits, they will be undertaken once the outcomes of the consultation paper are finalised.

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
Phillips curve	A model equation describing a historical inverse relationship between rates of unemployment and corresponding rates of rises in wages that result within an economy. Stated simply, decreased unemployment, (i.e. increased levels of employment) in an economy will correlate with higher rates of wages rises.
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 2016/17, the revised estimate for the current year and estimates for the future years are as follows:

2016/17 Actual £m	2017/18 Forecast £m	Capital Expenditure	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
10.236	9.924	Families & Wellbeing	10.202	6.790	2.575
10.904	2.101	Resources & Strategic Commissioning	7.491	0.924	0.120
28.673	44.827	Economic Regeneration Growth & Environment	60.556	53.171	10.280
65.228	328.948	Invest to Save Programme	311.293	283.101	202.415
115.040	**385.800**	**Total Capital Expenditure**	**389.542**	**343.986**	**215.390**

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:

2016/17 Actual £m	2017/18 Forecast £m	Capital Financing	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
87.312	357.816	Unsupported Borrowing	351.899	315.791	210.144
22.478	20.543	Capital Grants and Reserves	13.262	11.678	4.491
2.455	0.316	Capital Receipts	5.941	0	0
0.000	0.674	Revenue Funding	0	0	0
2.796	6.451	External Funding	18.440	16.517	0.755
115.040	**385.800**	**Total Capital Financing**	**389.542**	**343.986**	**215.390**

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 2018/19, 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.

2016/17 Actual %	2017/18 Forecast %	Ratio of financing costs to net revenue stream	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
1.15	1.53	Non-HRA	1.33	7.69	6.35

C Capital Financing Requirement

The prudential indicator for the Council's Capital Financing Requirement (CFR) is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's indebtedness and so its underlying borrowing need. 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 does not include any other long term liabilities (e.g. PFI schemes, finance leases). The CFR can be increased and, therefore, the Council's borrowing requirement but these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

2016/17 Actual £m	2017/18 Forecast £m	Capital Financing Requirement (CFR)	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
387.884	**744.197**	**Total CFR**	**1094.583**	**1400.269**	**1600.812**
		Movement in CFR represented by			
87.312	357.816	Net financing need for the year	351.899	315.791	210.144
(4.258)	(1.504)	Less MRP, other financing movements	(1.513)	(10.105)	(9.601)
83.054	**356.312**	**Movement in CFR**	**350.386**	**305.686**	**200.543**

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:

2016/17 Actual £m	2017/18 Forecast £m	Current Portfolio Position	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
		External Debt			
263.840	400.878	Debt at 1 April	744.195	1094.581	1400.267
137.038	343.317	Expected change in Debt	350.386	305.686	200.543
400.878	744.195	External Debt at 31 March	1094.581	1400.267	1600.810
4.129	4.019	Other LT Liabilities (OLTL)	3.901	3.775	3.640
0	0	Expected change in OLTL	0	0	0
405.007	748.214	Actual Gross Debt at 31 March	1098.482	1404.042	1604.450
387.884	744.197	Capital Financing Requirement	1094.583	1400.269	1600.812
(17.123)	**(4.018)**	**Under / (over) borrowing**	**(3.899)**	**(3.773)**	**(3.638)**

Please note: over borrowing in the table above relates to the OLTL

The Director of Corporate Services 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.

2016/17 Actual £	2017/18 Forecast £	Impact of capital investment decisions for band D Council Tax	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
8.63	8.01	Unsupported Borrowing	15.82	10.68	2.26

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.

2016/17 Actual £m	2017/18 Forecast £m	Authorised Limit for External Debt	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
400.878	818.616	Borrowing	1204.041	1540.296	1760.894
4.129	4.019	Other Long Term Liabilities	3.901	3.775	3.640
405.007	**822.635**	**Total Authorised Limit**	**1207.942**	**1544.071**	**1764.534**

In agreeing these limits, it should be noted that the Authorised Limit for 2018/19 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.

2016/17 Actual £m	2017/18 Forecast £m	Operational Boundary	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
400.878	765.699	Debt	1117.598	1433.389	1643.533
4.129	4.019	Other long term liabilities	3.901	3.775	3.640
405.007	**769.718**	**Total**	**1121.499**	**1437.164**	**1647.173**

Treasury management indicators for debt

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	Lower Limit		Upper Limit	
	Fixed	Variable	Fixed	Variable
Under 12 months	0%	0%	30%	40%
12 months to 2 years	0%	0%	30%	0%
2 years to 5 years	0%	0%	35%	0%
5 years to 10 years	0%	0%	30%	0%
10 years to 20 years	40%	0%	100%	0%
20 years to 30 years	40%	0%	100%	0%
30 years to 40 years	40%	0%	100%	0%
40 years and above	40%	0%	100%	0%

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.

Please note that the maturity structure guidance for lobo loans deems the maturity date to be the next call date which would account for £68.5m and 10.5% of the current loan portfolio. The loans have remained as the expected maturity date, however, these loans could potentially be called by the lender within the next six month period but they are unlikely to do so due to the current low interest rate environment.

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	2018/19 %	2019/20 %	2020/21 %
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	**2018/19 %**	**2019/20 %**	**2020/21 %**
Variable Interest Rates	40	40	40

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 2018/19, 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 365 days	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Investment	100.000	100.000	100.000