

NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

COUNCIL – TUESDAY, 27 FEBRUARY 2018

Title of report	THE TREASURY MANAGEMENT STRATEGY STATEMENT 2018/19 AND PRUDENTIAL INDICATORS 2018/19 TO 2020/21
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Purpose of report	To seek approval of the Treasury Management Strategy Statement, the prudential indicators and the Annual Minimum Revenue Provision Statement.
Council Priorities	Value for Money
Implications:	
Financial/Staff	Interest earned on balances and interest paid on external debt, impact on the resources available to the Authority.
Link to relevant CAT	Could impact upon all CAT's.
Risk Management	Borrowing and investment both carry an element of risk. This risk is moderated through the adoption of the Treasury and Investment Strategies, compliance with the CIPFA code of Treasury Management and the retention of Treasury Management Advisors (Arlingclose) to proffer expert advice.
Equalities Impact Screening	Not applicable.
Human Rights	Not applicable.
Transformational Government	Not applicable.
Comments of Head of Paid Service	The report is satisfactory
Comments of Section 151 Officer	As author, the report is satisfactory
Comments of Deputy	The report is satisfactory

Monitoring Officer	
Consultees	The Authority's Treasury Advisor; Corporate Leadership Team;
Background papers	Treasury Management Strategy Statement 2018/19 – report and minutes of Cabinet on Tuesday, 6 February 2018
Recommendations	THAT COUNCIL APPROVES THE TREASURY MANAGEMENT STRATEGY STATEMENT 2018/19, PRUDENTIAL INDICATORS -REVISED 2017/18 AND 2018/19 TO 2020/21-AND THE ANNUAL MINIMUM REVENUE PROVISION STATEMENT

1.0 INTRODUCTION

- 1.1 Local Authorities are required to approve a treasury management strategy statement (TMSS) and an investment strategy before the start of each financial year, in line with the Chartered Institute of Public Finance and Accountancy's 'Treasury Management in the Public Services Code of Practice 2011 Edition (the CIPFA Code) and the Department for Communities and Local Government (DCLG) revised 'Guidance on Local Authority Investments' 2010.
- 1.2 CIPFA have responsibility for the Treasury Management Code of Practice and Prudential Code and have consulted on these in 2017 and revised codes were published in December 2017. The Department for Communities and Local Government is responsible for preparing the guidance on Local Authority Investments and the guidance on Minimum Revenue Provision.
- 1.3 In accordance with DCLG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this statement is based, change significantly; or if amendments to the codes and guidance arising from the consultations, require the Treasury Management Strategy Statement to be updated.
- 1.4 CIPFA has defined Treasury Management as: "the management of the organisation'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."
- 1.5 The TMSS and prudential indicators fulfil the Authority's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and DCLG Guidance.

The TMSS sets out:

- a. Background information used to determine borrowing and investment requirements (paragraphs 2.2 and 2.3).
- b. Organisational roles and responsibilities (paragraph 1.7).
- c. The role of the Authority's treasury advisor (paragraph 1.8).
- d. Reporting and monitoring of treasury management activity (paragraph 1.9).
- e. Borrowing and debt rescheduling strategies. Total Authority's interest payments on existing debt are estimated at £2,739,773 in 2018/19.
- f. Investment Strategy. Security of capital is the first and most important investment policy objective. Total investment income is estimated at £229,000 in 2018/19 (General Fund - £145,300, HRA - £83,700).

- g. Treasury Management and Prudential Indicators for 2018/19 to 2020/21. These are designed to monitor borrowing limits, debt levels and investment returns.
- h. Annual Minimum Revenue Provision Statement for 2018/19. General Fund MRP is estimated at £619,527.

All treasury activity will comply with relevant statute, guidance and accounting standards.

1.6 The Authority is responsible for its treasury decisions and activity. No treasury management activity is without risk. The successful identification, monitoring and control of risk are important and integral elements of treasury management activities. The main risks to the Authority's treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (inadequate cash resources)
- Market or Interest Rate Risk (fluctuations in interest rate levels)
- Inflation Risk (exposure to inflation)
- Refinancing Risk (impact of refinancing on suitable terms)
- Legal & Regulatory Risk (failure to act in accordance with powers or regulatory requirements)

1.7 Organisational Roles and Responsibilities

In accordance with CIPFA guidance, the roles and responsibilities of the Authority's Treasury Management function are divided between several responsible officers and are summarised below:

Section 151 Officer – overall responsibility for the treasury management function to include:

Ensuring the organisation of the treasury management function is adequate to meet current requirements:

- Investment, borrowing and debt rescheduling decisions.
- Monitoring adherence to approved Treasury Management Strategy Statement.
- Regular reporting to Members on treasury management activity.

Finance Team Manager (Deputy Section 151 Officer) – ensuring that day to day treasury activities comply with the approved Treasury Management Strategy Statement.

Technical Accountant – identification of investment opportunities and borrowing requirements and acts as the Authority's interface with brokers and counterparties.

The needs of the Authority's treasury management staff for training in investment management, are assessed through the 'BEE Valued' staff appraisal process and additionally when the responsibilities of individual members of staff change.

Training courses, seminars and conferences provided by the Authority's treasury advisor or CIPFA, are regularly attended to refresh and enhance the knowledge of treasury management staff.

1.8 The Role of the Authority's Treasury Advisor

The Authority currently employs Arlingclose Ltd as treasury advisor to provide the following services; strategic treasury management advice, advice relating to Housing & Capital finance, leasing advice, economic advice and interest rate forecasting, debt

restructuring and portfolio review (structure and volatility), counterparty credit ratings and other creditworthiness indicators and training, particularly investment training, for Members and officers.

Arlingclose Ltd is authorised and regulated by the Financial Conduct Authority (FCA). Arlingclose Ltd is to provide the Authority with timely, clear and regular information about the financial sector to enable the Authority to take pro-active decisions which in turn, helps to minimise risk.

The quality of this service is monitored by officers on a regular basis, focusing on the supply of relevant, accurate and timely information across the services provided.

1.9 Reporting and Monitoring of Treasury Management Activity

The Treasury Management Stewardship Report for 2017/18 will be presented to the Audit and Governance Committee for scrutiny and then Cabinet as soon as possible after the end of the financial year. As in previous years, the Treasury Management Strategy Statement will be supplemented by in-year reporting of treasury management activity and monitoring of prudential indicators, to the Audit and Governance Committee during 2018/19.

This report, together with all other reports to Council, Cabinet and the Audit and Governance Committee are a public record and can be viewed on the Authority's website. This demonstrates compliance with DCLG Guidance on local government investments, which recommends that the initial strategy, and any revised strategy, should, when approved, be made available to the public free of charge, in print or online.

2.0 THE TREASURY MANAGEMENT STRATEGY STATEMENT 2018/19

2.1 The purpose of this Treasury Management Strategy Statement is to set out for approval

- The Borrowing Strategy 2018/19 (APPENDIX A)
- The Debt Rescheduling Strategy 2018/19 (APPENDIX B)
- The Annual Investment Strategy 2018/19 (APPENDIX C)
- The Apportionment of Interest Strategy 2018/19 (APPENDIX D)
- The Treasury Management and Prudential Indicators 2018/19 to 2020/21 (APPENDIX E)
- The Annual Minimum Revenue Provision (APPENDIX F)

2.2 External Factors. (Background Information provided by Treasury Advisors)

Economic background: The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee

raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

Credit outlook: High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

Interest rate forecast: The Authority’s treasury adviser Arlingclose’s central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose’s forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government’s seemingly deteriorating fiscal stance is an upside risk.

2.3 Outlook for UK Interest Rates:

The Authority’s treasury advisor’s current central case forecast for the UK Bank Rate is set out below.

Bank Rate %	March 2018	June 2018	Sept. 2018	Dec. 2018	March 2019	June 2019	Sept. 2019	Dec. 2019
Upside Risk	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25
Arlingclose Central Case	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50
Downside Risk	0.00	0.00	0.00	0.00	-0.25	-0.25	-0.25	-0.25

The Authority’s treasury advisor has forecast the Bank Rate to remain at 0.50% over the medium term.

3.0 IMPLICATIONS FOR TREASURY ACTIVITY

3.1 The economic outlook, the financial health of sovereign states, major banks and investment counterparties, still provide major challenges and risk for treasury activity, particularly investment activity, during the financial year.

3.2 The principles in the proposed suite of treasury policies remain broadly unchanged from previous years - borrowing will be prudent, minimize borrowing costs and maintain the stability of the debt maturity portfolio. Debt rescheduling should achieve interest savings, carry minimal risk and maintain the stability of the debt maturity portfolio.

Investments will be prioritised and based upon the principles of security, liquidity and yield.

4.0 MARKETS IN FINANCIAL INSTRUMENTS DIRECTIVE (MIFID)

4.1 The Markets in Financial Instruments Directive is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded.

4.2 MiFID originally introduced three categories for clients of financial services firms, when dealing with regulated investments. These categories reflected the level of understanding of Financial Instruments required for: Retail Clients; Professional Clients and eligible counterparties. New rules come into effect from 3 January 2018 which mean that the Authority will be re-classified to 'Retail Client' from 'Professional Client' status.

4.3 This re-categorisation seeks to provide additional protections for retail clients by ensuring that financial services firms provide investments that are suitable for the client but will also limit the investment options available to the authority. With the agreement of the firm, a client can elect to move to a different category if it meets specified criteria.

4.2 The Authority has elected to 'opt-up' to Professional status so that it can continue to access the range of investment options that it currently has access to.

5.0 FUTURE SIGNIFICANT EVENTS

5.1 In November 2017, the Council decided to conduct a lawful procurement and subsequently [award a contract for the outsourced management of the Council's Hermitage and Hood Park leisure centre facilities and creation of a new £20m facility](#). At the time of writing this report, a procurement exercise is underway to secure an operator. The Council will retain ownership of both the existing and new assets, however from inception of the contract (anticipated April 2019), the new operator will be responsible for all capital improvement works. The maximum capital value of the new facility will be £19.475m and will be funded through a mixture of internal and external borrowing and capital receipts arising on the disposal of a Cropston Drive, one of the Council's remaining significant land holdings.

5.2 From time to time the authority will consider other service delivery models (for example shared service) and these will potentially affect the authority's balance sheet and treasury position. As at such time that these alternative delivery models are agreed and implemented, in line with paragraph 1.3 above which outlines that this strategy should be updated should the assumptions on which this statement is based alter significantly.

6.0 THE AUTHORITY'S CURRENT BALANCE SHEET AND TREASURY POSITION

6.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Usable reserves and working capital are the underlying resources available for investment. The CFR, balances and reserves are the core drivers of Treasury Management Activity. The estimates, based on the current Revenue Budget and Capital Programmes, are set out below:

	31.03.17 Actual £m	31.03.18 Estimate £m	31.03.19 Forecast £m	31.03.20 Forecast £m	31.03.21 Forecast £m
General Fund CFR	14.4	16.1	17.8	27.8	35.7
HRA CFR	75.1	74.0	72.9	71.8	70.6
Total CFR	89.5	90.1	90.7	99.6	106.3
Less: External Borrowing	(83.4)	(82.3)	(81.2)	(80.1)	(79.0)
Internal Borrowing	6.1	7.8	9.5	19.5	27.3
Less: Usable Reserves	(21.3)	(23.4)	(22.7)	(22.7)	(20.7)
Less: Working Capital Estimate	0.3	0.3	0.3	0.3	0.3
Investments (or New Borrowing)	14.9	15.3	12.9	2.9	(6.9)

- 6.2 The Authority has an increasing General Fund CFR due to the use of borrowing to fund the Capital Programme, which includes the Leisure Services Project which was agreed at Council 21 November 2017.
- 6.3 The Leisure Project is scheduled for 2019/20 to 2020/21. In 2019/20 the Authority will be utilising internal borrowing. The effect of this is that there is less cash available for investment by 31 March 2020. By 31 March 2021, there is no availability for investment but there will be a requirement for borrowing.
- 6.4 The Authority's level of physical debt and investments is linked to the components of the Balance Sheet. Market conditions, interest rate expectations and credit risk considerations will influence the Authority's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position. The Authority's short term strategy is to maintain borrowing and investments below their underlying levels (internal borrowing).

The following table shows the Investment and debt portfolio position:

	Portfolio as at 31 March 2017 £m	Portfolio as at 5 Jan 2018 £m	Average Rate as at 5 Jan 2018 %
External Borrowing:			
PWLB	74.987	74.451	3.340
Local Authorities	1.000	1.000	6.875
Banking Sector	3.940	3.940	4.740
LOBO Loans	3.500	3.500	4.800
<i>Total External Borrowing</i>	<i>83.427</i>	<i>82.891</i>	
Other Long Term Liabilities	0.112	0.112	3.140
TOTAL GROSS EXTERNAL DEBT	83.539	83.003	
Investments:			
Short Term - Managed in-house	24.349	31.325	0.374
Long Term - Managed in-house	12.000	12.000	0.900
Fund Managers-Managed Externally	0	0	
Pooled Funds-Managed Externally	3.100	10.200	0.170
<i>Total Investments</i>	<i>39.449</i>	<i>53.525</i>	
NET DEBT	44.090	29.478	

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

7.0 THE COUNCIL'S APPROACH TO BEING COMMERCIAL

7.1 The Investment Strategy included in Appendix C provides the strategic framework in which it's investment activity is undertaken.

7.2 In line with the Medium Term Financial Strategy 2018 – 2023, the Investment Strategy has been revised and updated to allow the flexibility required in adopting a commercial approach.

7.3 The Strategy provides Members with the flexibility to undertake differing forms of investments for the Council, including, but not limited to investment in property funds and investment in a Council owned company for the purposes of trading (such as a Local Housing Company). The strategy has been updated to reflect how the Authority may purchase property for non-treasury investments eg. the purchase of property for income generating activities. These key amendments provide members with the flexibility to undertake new forms of longer term investment.

7.4 It is important for members to note however, that at a time when the Council is due to invest some £19.5m into a new leisure facility for Coalville under the Sports and Leisure project, it is unlikely that any new significant investments will be undertaken utilising the Council's internal reserves.

BORROWING STRATEGY 2018/19

At the 31st March 2018, the Authority will hold loans totalling £82.3m (£73.9m HRA and £8.4m General Fund). This is a decrease of £1.1m on the previous year (£75m HRA and £8.4m General Fund) and is part of the Authority's strategy for funding previous years' Capital Programmes and for the self-financing of the HRA, which was presented to Cabinet on 13th March 2012 in the "Housing Revenue Account (HRA) Business Plan".

The balance sheet forecast in paragraph 6.1 shows that the authority does not expect to need to borrow in 2017/18. Borrowing will be required by 2020/21 and this strategy sets out the methodology and approach that will be taken into consideration at that time.

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

Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources or to borrow short term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

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

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

- Internal Borrowing
- Public Works Loan Board (PWLB) and any successor body
- UK Local Authorities
- any institution approved for investments
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Local Government Pension Scheme administered by Leicestershire County Council)
- Capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

UK Municipal Bonds Agency Plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the Capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee to refund their investment in the event that the Agency is unable to for any reason; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to the Council.

The Authority holds one LOBO (Lender's Option Borrower's Option) loan of £3.5m as part of its total borrowing of £82.3m, where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. This LOBO has options during 2018/19 and although the Authority understands that the lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the opportunity to repay LOBO loans at no cost if it has the opportunity to do so.

The total amount borrowed will not exceed the authorised borrowing limit of £115 million.

Borrowing activity will be reported in the annual Treasury Management Stewardship Report and supplemented with in-year Treasury Activity Reports to the Audit and Governance Committee.

DEBT RESCHEDULING STRATEGY 2018/19

The Authority will continue to maintain a flexible policy for debt rescheduling.

The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. However, the lower interest rate environment has adversely affected the scope to undertake meaningful debt restructuring although occasional opportunities arise.

The rationale for rescheduling will be one or more of the following:

- Savings in interest costs with minimal risk.
- Balancing the volatility profile (i.e. the ratio of fixed to variable rate debt) of the debt portfolio.
- Amending the profile of maturing debt to reduce any inherent refinancing risks.

Any rescheduling activity will be undertaken within the Authority's Treasury Management Policy and Strategy. The Authority will agree in advance with its treasury advisor, the strategy and framework within which debt will be repaid / rescheduled, should opportunities arise. Thereafter, the Authority's debt portfolio will be monitored against equivalent interest rates and available refinancing options on a regular basis. As opportunities arise, they will be identified by the Authority's treasury advisor and discussed with the Authority's officers.

All rescheduling activity will comply with accounting and regulatory requirements and will be reported in the annual Treasury Management Stewardship Report and supplemented with in-year Treasury Activity Reports to the Audit and Governance Committee.

ANNUAL INVESTMENT STRATEGY 2018/19

The Authority holds invested funds which represent income received in advance of expenditure plus balances and reserves held as reflected in the balance sheet forecast in paragraph 6.1. Similar levels are expected to be maintained in 2018/19.

Investment Policy

Guidance from DCLG on Local Governments in England requires that an Annual Investment Strategy (AIS) be approved by Full Council. Both the CIPFA Code and the DCLG Guidance require the Authority to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

The Authority's investment priorities are:

- security of the invested capital;
- liquidity of the invested capital;
- An optimum yield which is commensurate with security and liquidity.

If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero. This would be likely to feed through to negative interest rates on all low risk, short term investment options. This situation already exists in many other European Countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Investment Strategy

Given the increasing risk and lower returns from short-term unsecured bank investments, the Authority aims to continue to invest in more secure asset classes during 2018/19. This is especially the case for the estimated £12m that is available for longer-term investment. The Authority's surplus cash is currently invested in; short-term unsecured bank or building society deposits, money market funds and short and long term investments with other Local Authorities.

The Authority's investments are made with reference to the Authority's cash flow, the outlook for the UK Bank Rate, money market rates, the economic outlook and advice from the Authority's treasury adviser.

The Authority compiles its cash flow forecast on a pessimistic basis, with receipts underestimated and payments over-estimated to minimise the risk of the Authority having to borrow on unfavourable terms. Limits on investments are set with reference to the Authority's Medium Term Financial Plan and cash flow forecast. This also determines the maximum period for which funds may prudently be committed.

The Section 151 Officer, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators.

The DCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt.

All Investment activity will be reported in the annual Treasury Management Stewardship Report and supplemented with in-year Treasury Activity Reports to the Audit and Governance Committee.

Investment of money borrowed in advance of need

The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. Any risks generated by borrowing in advance of need will be managed as part of the Authority's overall management of its treasury risks.

Approved Counterparties

The Authority may invest its surplus funds with any of the counterparty types in the table below, subject to the cash and time limits shown:

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 Years	n/a	n/a
AAA	£2m 5 years	£5m 20 years	£5m 50 years	£2m 20 years	£3m 20 years
AA+	£2m 5 years	£5m 10 years	£5m 25 years	£2m 10 years	£3m 10 years
AA	£2m 4 years	£5m 5 years	£5m 15 years	£2m 5 years	£3m 10 years
AA-	£2m 3 years	£5m 4 years	£5m 10 years	£2m 4 years	£3m 10 years
A+	£2m 2 years	£5m 3 years	£5m 5 years	£2m 3 years	£3m 5 years
A	£2m 13 months	£5m 2 years	£5m 5 years	£2m 2 years	£3m 5 years
A-	£2m 6 months	£5m 13 months	£5m 5 years	£2m 13 months	£3m 5 years
None	£1m 6 months	n/a	£5m 25 years	£1m 6 months	£1m 2 years
Banking Provider - Lloyds	£3m 13 months		n/a	n/a	n/a
Pooled Funds	£6m per fund				

This table must be read in conjunction with the notes below:

Credit Rating: Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings and all other relevant factors, including external advice, will be taken into account.

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks.

These investments are subject to the risk of credit loss via a bail-in, should the regulator determine that the bank is failing or likely to fail.

Operational Bank Accounts: The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank. These are not classed as investments but are still subject to the risk of a bank bail-in. The Bank of England has stated that in the event of a failure, banks with assets greater than £25 billion are more likely to be bailed-in rather than be made insolvent, increasing the chance of the Authority maintaining operational continuity.

Banks Secured: Covered Bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency and means that they are exempt from bail-in. Where there is no investment specific credit rating but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank, will not exceed the cash limit for secured investments.

Government: Loans, Bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

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

Registered Providers: Loans or bonds issued by, guaranteed by or secured on the assets of the Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving Government support if needed.

Pooled Funds: Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term money market funds that offer same day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term but are more volatile in the short-term. These allow the Authority to diversify into asset classes, other than cash, without the need to own and manage the underlying investments. Because these funds have no defined maturity date but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made
- any existing investments that can be recalled or sold at no cost will be, and
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

The Authority understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations, in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Authority will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Authority’s cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

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

- Denominated in pound sterling
- Due to be repaid within 12 months of arrangement
- not defined as capital expenditure by Legislation
- invested with one of:
 - the UK Government
 - a UK local authority, parish council, community Council
 - a body or investment scheme of ‘high credit quality’

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

Non-Specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality.

To minimise the risk of investment losses in the case of a default, the maximum that will be lent to any one organisation (other than the UK Government) will be £5 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts (*e.g. King & Shaxson*), foreign countries and industry sectors as below:

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£10m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£5m per country
Registered Providers	£5m in total
Unsecured Investments with Building Societies	£5m in total
Loans to unrated corporates	£5m in total
Money Market Funds	£20m in total (max £6m per fund)
Long-Term (Non-Specified) Investments	£12m in total
Other Non-Specified Investments (not meeting the definition of 'high credit quality')	£5m in total

Policy on use of Financial Derivatives

Local Authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (*e.g.* interest rate collars and forward deals) and to reduce costs of increase income at the expense of greater risk (*e.g.* LOBO loans and callable deposits). The general power of competence in section 1 of the Localism Act 2011, removes much of the uncertainty over local authorities' use of standalone financial derivatives (*i.e.* those that are not embedded into a loan or investment).

The Authority will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty limit and the relevant foreign country limit.

Non-Treasury Investments

The Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example in shared ownership housing or as equity investments and loans to the Authority's subsidiaries.

Such purchases, loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure.

The Authority's existing non-treasury investments relate to the investment properties held, the fair value of which was £13.554m as at 31 March 2017.

APPORTIONMENT OF INTEREST STRATEGY 2018/19

The Localism Act 2011 required Local Authorities to allocate existing and future borrowing costs between the Housing Revenue Account and the General Fund.

Accordingly, on 1st April 2012, the Authority notionally split its existing debt into General Fund and Housing Revenue Account as detailed in the 'Borrowing Strategy'. Any future borrowing will be assigned in its entirety to the appropriate revenue account.

Interest payable and any other costs arising from long-term loans (for example, premiums and discounts on early redemption) will be charged to the appropriate revenue account.

Interest received on investment income is budgeted to be apportioned between General Fund and the Housing Revenue Account based on an estimated cash flow position and balance sheet forecast. For 2018/19, the budgeted investment income is £229,000 and is apportioned as follows: £145,300 General Fund and £83,700 Housing Revenue Account. Any over or under achievement of investment income is apportioned on this basis, at the end of the financial year.

PRUDENTIAL INDICATORS

1 Background

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

2. Estimates of Capital Expenditure

The Authority's planned capital expenditure and financing is summarised in the table below. Further detail is provided in the Capital Programmes report taken to Cabinet on 6 February 2018.

Capital Expenditure	2017/18 Approved £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Non-HRA	3.071	3.837	3.187	14.280	9.612
HRA	10.152	6.003	10.085	7.268	4.909
Total	13.223	9.840	13.272	21.548	14.521

Capital expenditure will be financed or funded as follows:

Capital Financing	2017/18 Approved £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital receipts	1.679	4.346	1.684	4.369	1.534
Government Grants	0.525	0.573	0.573	0.573	0.573
Major Repairs Allowance	3.139	3.139	3.127	3.164	3.132
Reserves	3.332	(4.778)	5.548	2.309	0.043
Other Contribution-S106	0.000	1.291	0.000	0.381	0.200
Grants - Other	0.000	0.000	0.000	0.000	0.000
Revenue contributions	3.123	3.007	0.050	0.050	0.050
Total Financing	11.798	7.578	10.982	10.846	5.532
Supported borrowing	0.000	0.000	0.000	0.000	0.000
Unsupported borrowing	1.425	2.262	2.290	10.702	8.989
Total Funding	1.425	2.262	2.290	10.702	8.989
Total Financing and Funding	13.223	9.840	13.272	21.548	14.521

3. Capital Financing Requirement

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

Capital Financing Requirement	2016/17 Actual £m	2017/18 Estimate £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Non-HRA	14.383	15.465	16.094	17.765	27.780	35.683
HRA	75.072	73.993	73.993	72.890	71.762	70.608
Total CFR	89.455	89.458	90.087	90.655	99.542	106.291

The General Fund CFR is forecast to rise over the medium term. This is in line with the Capital programme schemes that are financed by debt. The detail of these schemes can be seen in more detail in the capital report presented to Cabinet on 6 February 2018.

4. Gross Debt and the Capital Financing Requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that the debt does not (except in the short term) exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

Debt – as at 31 st March	2017 Actual £m	2018 Estimate £m	2019 Estimate £m	2020 Estimate £m	2021 Estimate £m
Borrowing	83.427	82.348	81.245	80.117	78.963
Finance Leases	0.000	0.000	0.000	0.000	0.000
Transferred Debt	0.111	0.104	0.097	0.090	0.082
Total Debt	83.538	82.452	81.342	80.207	79.045

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

5. Authorised Limit and Operational Boundary for External Debt

The **Operational Boundary** is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of capital expenditure, the capital financing requirement and cash flow requirements and is a key management tool for in-year monitoring. Other long-term liabilities may comprise of finance leases, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

The Section 151 Officer has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council.

Operational Boundary for External Debt	2017/18 Approved £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	93.462	94.929	112.255	130.682	136.872
Other Long-term Liabilities	0.500	0.500	0.500	0.500	0.500
Total	93.962	95.429	112.755	131.182	137.372

The **Authorised Limit** sets the maximum level of external debt on a gross basis (i.e. excluding investments) for the Authority. It is measured on a daily basis against all external debt items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Authority's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

The Authorised Limit is the affordable borrowing limit determined in compliance under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit). It is the maximum amount of debt that the Authority can legally owe. The Authorised Limit provides headroom over and above the operational boundary to allow for unusual cash movements

Authorised Limit for External Debt	2017/18 Approved £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	95.462	96.929	114.255	132.682	138.872
Other Long-term Liabilities	0.700	0.700	0.700	0.700	0.700
Total	96.162	97.629	114.955	133.382	139.572

The Authority has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Authority and not just those arising from capital spending reflected in the CFR.

6. Ratio of Financing Costs to Net Revenue Stream

This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Approved %	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Non-HRA	8.17	6.20	6.97	7.91	14.00
HRA	12.74	12.54	12.45	12.52	12.38
Total (Average)	10.94	9.73	10.08	10.54	13.03

The Authority has an increasing ratio of Non-HRA financing costs due to forecast increases of interest on loans and MRP contributions and reducing revenue income streams.

7. Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2017/18 Approved £	2017/18 Revised £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
Increase in Band D	2.66	2.72	3.36	5.27	8.45

Council Tax					
Increase/(Decrease) in Average Weekly Housing Rents *	(0.83)	(0.83)	(0.82)	(0.81)	2.41

* Government Policy requires an actual decrease in Housing Rents of 1% per year until 2019/20. This is reflected in the estimates above.

Whilst this is a notional indicator as Band D Council Tax has not been increased, it represents the impact of the increased costs from capital decisions on the Band D Council Tax. The increasing impact is in line with the Estimates of Capital Expenditure as shown in table 2 above.

8. Adoption of the CIPFA Treasury Management Code

The Authority re-affirmed adoption of the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition at Cabinet on 9 February 2016. It complies with the Codes recommendations.

TREASURY MANAGEMENT INDICATORS

9. Upper Limits for Fixed and Variable Interest Rate Exposure

These indicators allow the Authority to manage the extent to which it is exposed to changes in interest rates. The Authority calculates these limits on net principal outstanding sums (i.e. fixed rate debt net of fixed rate investments).

The upper limit for variable rate exposure has been set to ensure that the Authority is not exposed to interest rate rises which could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

	Existing (Benchmark) level 31/03/17 %	2017/18 Approved %	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Upper Limit - Fixed Interest Rate Exposure	100	100	100	100	100	100
Upper Limit - Variable Interest Rate Exposure	50	50	50	50	50	50

The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Authority's treasury management strategy.

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the transaction year or the transaction date if later. All other instruments are classed as variable rate.

10. Maturity Structure of Fixed Rate borrowing

This indicator highlights the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates and is designed to

protect against excessive exposures to interest rate changes in any one period, in particular in the course of the next ten years.

It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

Maturity structure of fixed rate borrowing	Lower Limit for 2018/19 %	Upper Limit for 2018/19 %
under 12 months	0	60
12 months and within 24 months	0	40
24 months and within 5 years	0	50
5 years and within 10 years	0	40
10 years and within 20 years	0	50
20 years and within 30 years	0	70
30 years and within 40 years	0	40

11. Upper Limit for total principal sums invested over 364 days

The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Authority having to seek early repayment of the sums invested.

	2017/18 Approved £m	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Upper Limit	12	12	12	5	5

The reduction of the Upper Limit from 2019/20 onwards is in line with the capital expenditure expected on the leisure project and to ensure liquidity is maintained.

ANNUAL MINIMUM REVENUE PROVISION STATEMENT**Background**

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

The DCLG Guidance requires the Authority to approve an Annual MRP Statement each year. The broad aim of the DCLG guidance is to ensure that debt is repaid over a period that is reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

MRP is not required to be charged to the Housing Revenue Account and where a local authority's overall CFR is £nil or a negative amount there is no requirement to charge MRP.

Following the payment made to exit the Housing Revenue Account subsidy system for the new self-financing arrangements from April 2012, MRP will be determined as being equal to the principal amount repaid on the loans borrowed to finance that payment. The structure of the debt that was incurred to fund the self-financing was based on the principal being repaid over the life of the HRA business plan, which also takes into account the 'old' HRA debt. For 2018/19, the MRP for HRA is determined by the amounts of principal repaid on the loans that were taken out on an annuity basis.

MRP Options:

Four options for prudent MRP are set out in the DCLG Guidance. Details of each are set out below:

Option 1 – Regulatory Method.

For Capital expenditure incurred before 1st April 2008, MRP under this option, is the amount determined in accordance with the 2003 regulations. In effect, this is 4% of the total Capital Financing Requirement (CFR) excluding HRA borrowing and Adjustment A. Adjustment A is an accounting adjustment to ensure consistency with previous capital regulations. Once calculated this figure is fixed. For this Authority, Adjustment A is fixed at £606,250.49.

Option 2 – CFR Method.

MRP under this option is the same as option 1 but ignores Adjustment A. In effect, this is 4% of the CFR less HRA borrowing.

Option 3 – Asset Life Method.

Where capital expenditure on an asset is financed either wholly or in part by borrowing or credit arrangements, MRP is determined by the life of the asset. For example, if the asset life is 5 years, then the MRP for that asset will be based on 20% of the capital expenditure (unsupported borrowing), per year for 5 years.

Option 4 - Depreciation Method.

Under this option, MRP would be based on the provision required under depreciation accounting. It would also take into account any residual value at the end of the life of the asset. For example, if the asset life was 5 years and the residual value was anticipated to be 10% of the asset value, then the MRP for that asset would be based on 20% of the capital expenditure (unsupported borrowing) less 10% residual value per year for 5 years.

MRP Policy for 2018/19:

The Authority will apply Option 1 in respect of supported capital expenditure.

The Authority will apply Option 2 in respect of unsupported capital expenditure.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2018, the 2018/19 budget for General Fund MRP is £619,527. The HRA Subsidy Reform payment for 2017/18 is £1,103,275.