

NORTH WEST LEICESTERSHIRE DISTRICT COUNCIL

CABINET – 9 FEBRUARY 2016

Title of report	THE TREASURY MANAGEMENT STRATEGY STATEMENT 2016/17 AND PRUDENTIAL INDICATORS 2016/17 TO 2018/19
Key Decision	a) Financial Yes b) Community Yes
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Purpose of report	<p>This report outlines the expected treasury operations for the forthcoming financial year and sets out the Authority's prudential indicators for 2016/17 to 2018/19. It fulfils key requirements of the Local Government Act 2003:</p> <ul style="list-style-type: none"> • The Treasury Management Strategy Statement in accordance with the CIPFA Code of Practice for Treasury Management in the Public Services ; • The Annual Investment Strategy in accordance with the CLG Investment Guidance; • The reporting of the prudential indicators as required by the CIPFA Prudential Code for Capital Finance in Local Authorities. • The Policy for the Annual Minimum Revenue Provision.
Reason for Decision	These are statutory requirements.
Council Priorities	Value for Money
Implications: Financial/Staff Link to relevant CAT	<p>Interest earned on balances and interest paid on external debt, impact on the resources available to the Authority.</p> <p>Could impact upon all CAT's.</p>

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 Deputy Section 151 Officer	The report is satisfactory
Comments of Monitoring Officer	The report is satisfactory
Consultees	None.
Background papers	<p>The <u>“Annual Treasury Management Stewardship Report 2008/09 and Re-Adoption of the CIPFA Revised Code of Practice and Treasury Management Policy Statement 2011”</u> – Cabinet 16th June 2009</p> <p>The <u>“Housing Revenue Account (HRA) Business Plan”</u> – Cabinet 13 March 2012</p> <p>The <u>“Capital Programmes – General Fund, Coalville Special Expenses and Housing Revenue Account (HRA). Projected Outturn 2015/16 and Programmes 2016/17 to 2020/21”</u> – Cabinet 9 February 2016</p>
Recommendations	<p>RECOMMEND THE RE-ADOPTION OF THE CIPFA TREASURY MANAGEMENT IN PUBLIC SERVICES: CODE OF PRACTICE.</p> <p>RECOMMEND THE TREASURY MANAGEMENT STRATEGY STATEMENT 2016/17, PRUDENTIAL INDICATORS -REVISED 2015/16 AND 2016/17 TO 2018/19, AND THE ANNUAL MINIMUM REVENUE PROVISION STATEMENT, FOR APPROVAL BY FULL COUNCIL</p>

1.0 INTRODUCTION

- 1.1 The Chartered Institute of Public Finance and Accountancy’s Treasury Management in Public Services Code of Practice (the “CIPFA TM Code”) and the Prudential Code require local authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes

the Annual Investment Strategy (AIS) that is a requirement of the CLG's Investment Guidance.

- 1.2 As per the requirements of the Prudential Code, the Authority adopted the CIPFA Treasury Management Code of Practice at a meeting of the Cabinet on 16 June 2009. The revised CIPFA Treasury Management in The Public Services Code of Practice was published in 2011. The clauses that were adopted in 2009 remain the same under the revised code and are re-submitted for Council approval (Appendix A).
- 1.3 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."
- 1.4 The TMSS and prudential indicators ensure that the Authority complies with statutory, regulatory, and professional (CIPFA) requirements.

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 1.6).
- c. The role of the Authority's treasury advisor (paragraph 1.7).
- d. Reporting and monitoring of treasury management activity (paragraph 1.8).
- e. Borrowing and debt rescheduling strategies. Total Authority's interest payments on existing debt are estimated at £2,787,941 in 2016/17.
- f. Investment Strategy. Security of capital is the first and most important investment policy objective. Total investment income is estimated at £182,000 in 2016/17 (General Fund - £116k, HRA - £66k).
- g. Treasury Management and Prudential Indicators for 2016/17 to 2018/19. These are designed to monitor borrowing limits, debt levels and investment returns.
- h. Annual Minimum Revenue Provision Statement for 2016/17. General Fund MRP is estimated at £610,990.

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

- 1.5 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)

1.6 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.

The Authority's treasury advisor provides seminars, conferences, workshops and training courses to refresh and enhance the knowledge of treasury management staff.

1.7 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.

1.8 Reporting and Monitoring of Treasury Management Activity

The Treasury Management Stewardship Report for 2015/16 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 2016/17.

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 CLG 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 2016/17

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

- Re-adoption of the CIPFA Code of Practice for Treasury Management (APPENDIX A)
- The Borrowing Strategy 2016/17 (APPENDIX B)
- The Debt Rescheduling Strategy 2016/17 (APPENDIX C)
- The Annual Investment Strategy 2016/17 (APPENDIX D)
- The Apportionment of Interest Strategy 2016/17 (APPENDIX E)
- The Treasury Management and Prudential Indicators 2016/17 to 2018/19 (APPENDIX F)
- The Annual Minimum Revenue Provision (APPENDIX G)

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

- **Economic Background:** Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.
- The outcome of the UK general election in May 2015, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.
- China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators however suggest recent global turbulence has not knocked the American recovery off course. The Federal Reserve raised policy

rates at its meeting in December 2015, the first rise in US policy rates since 2006. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

- Credit outlook: The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.
- 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 UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. 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 stubbornly low.
- Interest rate forecast: The Authority's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.
- A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of interest rate rises are likely to prompt short-term volatility in gilt yields.

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.

Dec. 2015	March 2016	June 2016	Sept. 2016	Dec. 2016	March 2017	June 2017	Sept. 2017	Dec. 2017
0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%

The Authority's treasury advisor has forecast the first rise in official interest rate in Quarter 3 of 2016.

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 financial year 2016/17.
- 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.
- 3.3 The Treasury Management Strategy Statement will be monitored throughout the year and, if necessary, amended and brought back to Members for approval.

4.0 THE AUTHORITY'S CURRENT BALANCE SHEET AND TREASURY POSITION

- 4.1 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). Usable reserves and balances 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:

	31.03.15 Actual £m	31.03.16 Estimate £m	31.03.17 Forecast £m	31.03.18 Forecast £m	31.03.19 Forecast £m
General Fund CFR	13.7	14.2	15.3	15.4	16.1
HRA CFR	77.2	76.1	75.1	74.0	72.9
Total CFR	90.9	90.3	90.4	89.4	89.0
Less: External Borrowing	85.5	84.5	83.4	82.3	81.2
Internal Borrowing	5.4	5.8	7.0	7.1	7.8
Less: Usable Reserves	(22.8)	(15.8)	(17.8)	(20.5)	(19.5)
Less: Working Capital	5.6	(1.5)	(1.5)	(1.5)	(1.5)
Investments (or New Borrowing)	22.6	23.1	26.3	29.1	28.8

- 4.2 The Authority has an increasing General Fund CFR due to the use of borrowing to fund the Capital Programme.
- 4.3 The Authority's level of physical debt and investments is linked to these 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 current 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 2015 £m	Portfolio as at 22 Dec 2015 £m	Average Rate %
External Borrowing:			
PWLB	77.074	76.561	3.340%
Local Authorities	1.000	1.000	6.875%
LOBO Loans	7.440	7.440	4.770%
<i>Total External Borrowing</i>	<i>85.514</i>	<i>85.001</i>	
Other Long Term Liabilities	0.126	0.126	3.150%
TOTAL GROSS EXTERNAL DEBT	85.640	85.127	
Investments:			
Short Term - Managed in-house	15.755	21.846	0.54%
Long Term - Managed in-house	5.000	9.500	1.23%
Fund Managers–Managed Externally	0.000	0.000	
Pooled Funds-Managed Externally	0.500	14.400	0.39%
<i>Total Investments</i>	<i>21.255</i>	<i>45.746</i>	
NET DEBT	64.385	39.381	

- 4.4 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 2016/17.

THE REVISED CIPFA CODE OF PRACTICE FOR TREASURY MANAGEMENT 2011

This Council re-adopts the four key recommendations of the CIPFA Code of Practice for Treasury Management.

1. The Council will create and maintain, as the cornerstones for effective treasury management:
 - A treasury management policy statement, stating the policies and objectives of its treasury management activities
 - Suitable treasury management practices (TMP's) 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.
2. 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, a midyear review and an annual report after its close, in the form prescribed in the TMP's.
3. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Cabinet and for execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the Council's policy statement and TMP's and CIPFA's Standard of Professional Practice on Treasury Management.
4. The Council's Audit and Governance Committee is responsible for ensuring effective scrutiny of the treasury management strategy, policies and activity.

BORROWING STRATEGY 2016/17

At the 31st March 2016, the Authority will hold loans totalling £84.5m (£76.1m HRA and £8.4m General Fund). This is a decrease of £1m on the previous year (£77.1m 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 17th January 2012 in the "Housing Revenue Account (HRA) Business Plan".

The balance sheet forecast in paragraph 4.1 shows that the authority does not expect to need to borrow in 2016/17.

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 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 2016/17 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 2016/17, 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

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

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.

The Authority holds two LOBO (Lender's Option Borrower's Option) loans totalling £7.4m as part of its total borrowing of £84.5m, 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. These LOBO's have options during 2016/17 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.

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 2016/17

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 2016/17

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 4.1. Similar levels are expected to be maintained in 2016/17.

Investment Policy

Guidance from CLG on Local Governments in England requires that an Annual Investment Strategy (AIS) be approved by Full Council. Both the CIPFA Code and the CLG 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.

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 the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

Investment Strategy

Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to further invest in more secure asset classes during 2016/17. 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 and money market funds and short and long term with other Local Authorities. This strategy represents a continuation of the strategies adopted in 2014/15 and 2015/16.

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.

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.

INVESTMENT GUIDANCE AND COUNTERPARTY CRITERIA

In accordance with CLG Guidance, investments fall into two categories, Specified and Non-Specified.

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

- Denominated in pound sterling
- Due to be repaid within 12 months of arrangement
- not defined as capital expenditure by Legislation
- 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. Counterparties with 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.

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.

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	£15m in total
Total Investments without credit rating or rated below A-	£5m in total
Total Long-Term (Non-Specified) Investments	£12m in total

Counterparty Criteria

The Authority may invest its surplus funds with any of the counterparties in the table below, subject to the limits shown:

Counterparty		Cash limit		Time limit †
		Unsecured	Secured	
Banks (excluding the Authority's banking provider) & Building Societies, other organisations and securities whose lowest published long-term credit rating from Fitch, Moody's and Standard & Poor's is:	AAA	£1.5m each	£3m each	5 years*
	AA+			5 years*
	AA			4 years*
	AA-			3 years*
	A+			2 years
	A			13 months
	A-			6 months
	BBB+	£1m each	£1.5m	100days
BBB	£1m each	£1.5m	Next day	
Authority's Banking Provider ***		£2.5m		13 months
UK Central Government (irrespective of credit rating)		Unlimited		50 years**
UK Local Authorities (irrespective of credit rating)		£5m each		25 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is AA- or higher		£3m each		10 years**
UK Registered Providers of Social Housing whose lowest published long-term credit rating is A- or higher		£3m each		5 years
UK Registered Providers of Social Housing whose lowest published long-term credit rating is BBB- or higher and those without credit ratings		£2m each		2 years

UK Building Societies without credit ratings	£1m each	6 months
Money market funds and other pooled funds	£5m each	n/a
Any other organisation, subject to an external credit assessment and specific advice from the Authority's treasury management adviser	£3m each	3 months
	£1m each	1 year
	£100k each	5 years

* but no longer than 2 years in fixed-term deposits and other illiquid instruments

** but no longer than 5 years in fixed-term deposits and other illiquid instruments

*** The limit for the Authority's Banking Provider is higher to allow for unforeseen fluctuations in income

Credit Rating: Investment decisions are made 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.

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Authority's current account bank.

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

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK 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 risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by or secured on the assets of 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 a high likelihood of receiving government support if needed.

Money Market and other 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.

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

The 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 credit limit and the relevant foreign country limit.

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Corporate Portfolio Holder, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness.

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.

APPORTIONMENT OF INTEREST STRATEGY 2016/17

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 2016/17, the budgeted investment income is £182,000 and is apportioned as follows: £116,000 General Fund and £66,000 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 CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA 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 9 February 2016.

Capital Expenditure	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Non-HRA	2.597	2.079	2.799	1.176	1.802
HRA	9.105	9.982	8.165	7.110	8.187
Total	11.702	12.061	10.964	8.286	9.989

Capital expenditure will be financed or funded as follows:

Capital Financing	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Capital receipts	0.789	1.060	1.797	1.711	1.711
Government Grants	0.637	0.298	0.298	0.298	0.298
Major Repairs Allowance	3.991	2.816	4.984	4.863	4.077
Reserves	1.517	2.249	1.667	0.106	0.134
Other Contribution-S106	0.559	0.887	0.400	0.000	0.000
Grants - Other	0.000	0.944	0.000	0.000	0.000
Revenue contributions	3.159	2.771	0.136	0.566	2.401
Total Financing	10.652	11.025	9.282	7.544	8.621
Supported borrowing	0.000	0.000	0.000	0.000	0.000
Unsupported borrowing	1.050	1.036	1.682	0.742	1.368
Total Funding	1.050	1.036	1.682	0.742	1.368
Total Financing and Funding	11.702	12.061	10.964	8.286	9.989

3. Capital Financing Requirement

The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and its financing.

Capital Financing Requirement	2014/15 Actual £m	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Non-HRA	13.730	14.199	15.270	15.396	16.117
HRA	77.159	76.127	75.072	73.993	72.890
Total CFR	90.889	90.326	90.342	89.389	89.007

The General Fund CFR is forecast to rise over the next three years. 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 9 February 2016.

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	2015 Actual £m	2016 Estimate £m	2017 Estimate £m	2018 Estimate £m	2019 Estimate £m
Borrowing	85.514	84.482	83.427	82.348	81.245
Finance Leases	0.000	0.000	0.000	0.000	0.000
Transferred Debt	0.126	0.117	0.108	0.100	0.093
Total Debt	85.640	84.599	83.535	82.448	81.338

The Section 151 Officer reports that the Authority has had no difficulty meeting this requirement in 2015/16, nor is there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

5. 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. The definition of financing costs is set out in the Prudential Code.

The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2015/16 Approved %	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Non-HRA	7.30	8.27	8.33	8.88	10.33
HRA	13.81	12.79	12.78	12.78	12.77
Total (Average)	11.39	11.11	11.06	11.31	11.92

6. Actual External Debt

This indicator is obtained directly from the Authority's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2015	£m
Borrowing	85.514
Other Long-term Liabilities	0.010
Total	85.524

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	2015/16 Approved £	2015/16 Revised £	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
Increase in Band D Council Tax	2.05	1.97	2.31	2.91	3.38
Increase/(Decrease) in Average Weekly Housing Rents *	4.27	4.27	(0.83)	(0.82)	(0.82)

* Current Government Policy requires an actual decrease in Housing Rents of 1% per year for four years. This is reflected in the estimates above.

8. Authorised Limit and Operational Boundary for External Debt

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.

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 has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

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.

Authorised Limit for External Debt	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	95.967	95.895	96.579	94.710	94.979
Other Long-term Liabilities	0.700	0.700	0.700	0.700	0.700
Total	96.667	96.595	97.279	95.410	95.679

The Operational Boundary links directly to the Authority's estimates of the CFR and estimates of other cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

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	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	93.967	93.895	94.579	92.710	92.979
Other Long-term Liabilities	0.500	0.500	0.500	0.500	0.500
Total	94.467	94.395	95.079	93.210	93.479

9. Adoption of the CIPFA Treasury Management Code

This indicator demonstrates that the Authority has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Authority has re-affirmed adoption of the CIPFA Treasury Management Code within this strategy, 9 February 2016.

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

TREASURY MANAGEMENT INDICATORS

10. Upper Limits for Fixed Interest Rate Exposure 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 31/03/15 %	2015/16 Approved %	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100	100	100
Upper Limit for 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.

11. 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 2016/17 %	Upper Limit for 2016/17 %
under 12 months	0	40
12 months and within 24 months	0	40
24 months and within 5 years	0	40
5 years and within 10 years	0	50
10 years and within 20 years	0	50
20 years and within 30 years	0	70
30 years and within 40 years	0	50

12. 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.

Given the risk and continued low returns from short-term unsecured bank investments, the Authority aims to maintain diversification into more secure and/or higher yielding asset classes during 2016/17. This is especially the case for the estimated £12m that is available for longer-term investment. The Authorities surplus cash is invested in various short-term unsecured bank deposits, notice accounts, money market funds and fixed term deposits with other Local Authorities.

	2015/16 Approved £m	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Upper Limit	10	10	12	12	12

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 CLG Guidance requires the Authority to approve an Annual MRP Statement each year. The broad aim of the CLG 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 2016/17, 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 CLG 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 2016/17:

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 2016, the 2016/17 budget for General Fund MRP is £610,990. The HRA Subsidy Reform payment for 2016/17 is £1,055,106.