PAPER B

Purpose: For Decision

Committee report

Committee	**FULL COUNCIL**
Date	**15 MARCH 2017**
Title	**TREASURY MANAGEMENT STRATEGY 2017-18**
Report of	**PENSION FUND AND TREASURY MANAGEMENT ACCOUNTANT**

EXECUTIVE SUMMARY

1. This report presents the Treasury Management Strategy 2017-18. The strategy forms part of the council's overall annual budget strategy.

2. The committee is asked to agree the Treasury Management Strategy for 2017-18, for onward approval by full council.

BACKGROUND

3. The Local Government Act 2003 and subsequent regulations require the council to set out its annual strategy with regard to both borrowing and the repayment of external debt. These are set out in the Borrowing Strategy (Section 4 of the attached Treasury Management Strategy Statement) and the Minimum Revenue Provision (MRP) Statement (Appendix D of the attached Treasury Management Strategy Statement) respectively.

4. The Act and subsequent regulations require the council to have regard to the Chartered Institute of Public Finance and Accountancy's (CIPFA's) revised Code of Practice for Treasury Management ("the Code"), and Treasury Management Practices ("TMPs"); the council is also required to have regard to the CIPFA Prudential Code for Capital Finance ("the Prudential Code") and to set prudential indicators for the next three years to ensure that the council's investment plans are affordable, prudent and sustainable. With regard to its investment plans the council also has a duty to determine a prudent MRP.

5. The council must also approve an annual Investment Strategy in compliance with government guidance on local government investments. Section 5 of the attached Treasury Management Strategy Statement sets out the council's policy for managing its investments and for giving priority to the security and liquidity of those investments.

6. The council's TMPs, included in Appendix E of the attached Treasury Management Strategy Statement, sets out how the council proposes to

achieve its stated policy objectives, and how it will manage and control its treasury management activities. The TMPs specifically cover the following areas:

- TMP 1 – Risk management
- TMP 2 – Performance measurement
- TMP 3 – Decision making and analysis
- TMP 4 – Approved Instruments, methods and techniques
- TMP 5 – Organisation, clarity and segregation of responsibilities, and dealing arrangements
- TMP 6 – Reporting requirements and management information arrangements
- TMP 7 – Budgeting, accounting and audit arrangements
- TMP 8 – Cash and cash flow management
- TMP 9 – Money laundering
- TMP 10 –Training and qualifications
- TMP 11 – Use of external service providers
- TMP 12 – Corporate governance

7. 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. The framework requires that the council sets and monitors its performance against a set of prudential indicators which are designed to support and record local decision making in these key areas.

8. The prudential indicators, included in Appendix C of the attached Treasury Management Strategy Statement, are intended to ensure that decisions concerning capital expenditure, debt and treasury management are both affordable and prudent.

STRATEGIC CONTEXT

9. The Treasury Management Strategy forms part of the council's overall budget strategy, specifically supporting the latest Corporate Plan 2015-17, under priority 4: Ensuring that all the resources available to the Island are used in the most effective way in achieving the Island's priorities

10. The strategy specifically supports the council's capital programme and the Medium Term Financial Strategy, ensuring the key priorities of the council are deliverable within the reduced resources available to the council.

CONSULTATION

11. The draft strategy has been prepared in conjunction with advice received from the council's treasury management advisers, Arlingclose Limited, who have provided details of the external economic context and have reviewed the draft strategy for compliance with regulations, etc.

FINANCIAL / BUDGET IMPLICATIONS

12. The Council's Medium Term Financial Strategy approved in October 2016, set out the case for changing the Council's current MRP policy. It was aimed at increasing the Council's financial capacity and therefore is operational capacity to implement change over a more manageable period. To achieve this, the Annuity Method as the methodology for setting aside a "prudent amount" for the provision for debt repayment from 2016/17 was approved. This has the effect of securing savings commencing at £2m per annum and provides the ability to release £39.6m of "overprovision" of MRP to support the Council's new Medium Term Financial Strategy.

13. In practice, the change to the Annuity Method allows the Council to take a "Debt Repayment holiday" for the next 5 years in order to draw down on the "overprovision" for funding debt liabilities at sums between £7m to £8m per annum with the consequent effect of "smoothing out" the necessary savings, allowing more time for transformation plans and initiatives to improve funding / income generation to take effect

14. There are no other direct financial or budgetary implications arising from the review of the Treasury Management Strategy and policy. However, the establishment of effective arrangements for the regular monitoring and review of the council's treasury management arrangements and prudential indicators is a key part of the effective financial management of the council.

15. The indicative budget for investment income in 2017-18 is £0.16 million, and this is based on an average investment portfolio of £38.3 million at an interest rate of 0.41 per cent.

16. The indicative budget for debt interest paid in 2017-18 is £7.5 million. The cash flows, on which this strategy is based, include an average debt portfolio of £170.7 million at an average interest rate of 4.4 per cent.

17. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

LEGAL IMPLICATIONS

18. The Local Government Act 2003 and subsequent regulations require the council to set out its annual strategy with regard to both borrowing and the repayment of external debt. The Act and subsequent regulations require the council to have regard to CIPFA's revised Code of Practice for Treasury Management in Local Authorities, and TMPs. The council is also required to have regard to the CIPFA Prudential Code for Capital Finance, and to set prudential indicators for the next three years to ensure the council's investment plans are affordable, prudent and sustainable.

EQUALITY AND DIVERSITY

19. The council has a legal duty under the Equality Act 2010 to seek to eliminate discrimination, victimisation and harassment in relation to age, disability, gender reassignment, pregnancy and maternity, race, religion, sex, sexual orientation and marriage and civil partnerships. The treasury management strategy is not considered to have any impacts upon the equality duties.

RISK MANAGEMENT

20. Treasury management activities have a high level of risk in that they relate to transactions that can amount to several million pounds which are undertaken with external bodies. When the council has surplus monies to invest, there are risks if those organisations to whom it lends default on repayment. The costs to the council of its treasury management activities are dependent on fluctuating interest rates.

21. The overall strategy of borrowing short-term and avoiding long-term debt carries the risk that, if interest rates suddenly rise, when longer term debt is eventually required, it will cost more.

22. The council manages these risks by adopting a treasury management strategy which includes a statement of treasury management practice specifically relating to risk, covering the following risk areas:

- Credit and counterparty risk – who the council is permitted to lend to and borrow from and what instruments it can utilise
- Liquidity risk – ensuring that sufficient, but not excessive, funds are available when needed
- Interest rate risk – minimising the council’s exposure to significant fluctuations in interest rates, both investment income and borrowing costs, by continually reviewing the instruments it uses
- Exchange rate risk – minimising the council’s exposure to foreign exchange risk by restricting the exposure to foreign currency investments and overseas counterparties
- Refinancing risk – ensuring that the maturity profile of long term debt is as evenly spread as possible, and planning for the replacement of maturing debt at the most favourable interest rates
- Legal and regulatory risk – ensuring compliance with regulations and statutory requirements
- Risk of fraud, error and corruption – ensuring that appropriate controls are in place around staffing and processes, and ensuring appropriate business continuity arrangements exist
- Market risk – ensuring that the council’s treasury management activities are not compromised by adverse economic circumstances.

23. The committee's overview of the council's treasury management arrangements plays an important part in the council's overall governance regime. It has an important role to play in the monitoring of treasury management activities, including overview of the risks faced by this function both internally, which are directly controllable through segregation of duties and reporting arrangements, and externally, controllable through the monitoring of counterparties and lending limits, and also regular monitoring of general economic factors.

RECOMMENDATION

24. That the council be recommended to agree the following changes to the 2016-17 Treasury Management Strategy:

(i) that the minimum revenue provision for the repayment of government supported borrowing, other than finance leases and service concessions (including private finance initiative schemes) is changed from a straight 2% annual provision to a 50 year annuity provision with effect from 2016-17 (paragraph 4 Appendix D of Treasury Management Strategy).

(ii) that with regard to capital expenditure loans to third parties the principal element of the repayment is set aside to repay the borrowing that has financed these assets (paragraph 6 Appendix D of Treasury Management Strategy)

(iii) that with regard to the purchase of investment properties – such properties will be disposed of before there is a significant consumption of the asset, and that the council provides for the repayment of the borrowing undertaken for their purchase by setting aside the capital receipt on their disposal rather than providing a revenue provision.

(iv) that the maximum investment in a single Local Authority will be increased from £4m to £10m

(v) that the maximum investment that can be made into any one organisation (other than the UK Government including Local Authorities) be increased from £4m to £8m

25. That the council be recommended to agree the Treasury Management Strategy for 2017-18.

APPENDICES ATTACHED

26. Appendix 1 - Treasury Management Strategy 2017-18

BACKGROUND PAPERS

- CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes (2011 Edition)
  http://www.tisonline.net/investments/content/Treasury_Code_2011.pdf

- CIPFA The Prudential Code for Capital Finance in Local Authorities (2011 Edition)
  http://www.tisonline.net/localauthorityaccounting/content/Prudential_Code_2011.pdf

Contact Point: Jo Cooke, Pension Fund and Treasury Management Accountant
☎ 821000 e-mail jo.cooke1@iow.gov.uk

CHRIS WARD
Director of Finance and
Section 151 Officer

CLLR STUART HUTCHINSON
Deputy Leader and
Executive Member for Corporate Resources

APPENDIX 1

Isle of Wight Council
TREASURY MANAGEMENT STRATEGY STATEMENT
2017-18

Document Information

Title: Status:	Treasury Management Strategy Statement 2017-18 FINAL
Current Version:	1.2
Author:	Jo Cooke, Pension Fund and Treasury Management Accountant Financial Management jo.cooke1@iow.gov.uk ☎ (01983) 821000 ext. 6397
Sponsor:	Chris Ward, Director of Finance and Section 151 Officer Financial Management chris.ward@portsmouthcc.gov.uk ☎ (01983) 821000
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Version	Date	Description
1.0	09 January 2017	First draft – template review
1.1	24 February 2017	Second Draft
1.2	27 February 2017	Final Draft

Contents

1 Introduction

1.1 The Isle of Wight Council defines its treasury management activities 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".

1.2 In February 2003 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

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

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

1.5 The Council has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Council's treasury management strategy.

1.6 **Revised strategy:** In accordance with the CLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance.

2 External Context

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

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

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

2.4 Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

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

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

2.7 Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The likelihood of losing unsecured bank deposits is therefore greater in the event of a bank defaulting on its senior debtReturns from cash deposits also continue to fall.

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

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

2.10 A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Appendix A**.

2.11 For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.41%, and that new long-term loans will be borrowed at an average rate of 4.4%.

3 Local Context

3.1 On 31st January 2017, the Council held £160.8m of borrowing and £38.3m of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Forecast £m	31.3.19 Forecast £m	31.3.20 Forecast £m
Total CFR	**275.3**	**300.8**	**416.0**	**479.6**	**475.8**
Less: Other debt liabilities *	(69.2)	(85.4)	(101.8)	(106.9)	(100.5)
Borrowing CFR	**206.1**	**215.4**	**314.2**	**372.7**	**375.3**
Less: External borrowing **	(158.4)	(137.3)	(128.1)	(122.9)	(116.7)
Internal borrowing	**47.7**	**78.1**	**186.1**	**249.8**	**258.6**
Less: Usable reserves	(70.9)	(68.9)	(63.6)	(56.1)	(37.6)
Less: Working capital	(2.0)	(2.0)	(2.0)	(2.0)	(2.0)
Investments / (New borrowing)	**25.3**	**(7.2)**	**(120.5)**	**(191.7)**	**(219)**

* finance leases, PFI liabilities and transferred debt that form part of the Council's total debt
** shows only loans to which the Council is committed and excludes optional refinancing

3.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment.

3.3 The council's total CFR is increasing due to a number of factors, the most significant of which relate to the financing of the Council's Highways PFI and Waste contracts plus the intention by the Council to establish a £100m Commercial Property Acquisition Fund over the forthcoming 2 years.

Borrowing is required for the contracted capital expenditure arising under the Highway's PFI contract and will be funded through the Highways PFI Grant which is spread over the 25 year contract.

The council's Borrowing CFR is increasing as a result of the new Waste project which was approved by the council in July 2015, and includes the requirement to borrow approximately £80m over the life of the contact, of which £62m is required in the first three years. This was approved as a better value for money option than the alternative of the Waste Contractor financing the necessary capital investment and recovering its cost through the contract.

Other planned borrowing relates to the establishment of the Commercial Property Acquisition Fund, intended to generate revenue income streams for the Council over the long term but which remains subject to the Council approving a Commercial Property Investment Strategy governing the use of the fund.

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

4 Borrowing Strategy

4.1 The Council currently holds £160.8 million of loans, an increase of £29.4 million on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Council expects to borrow up to £120.5m in 2017/18. The Council may also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £416.1million.

4.2 **Objectives:** The Council'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 renegotiate loans should the Council's long-term plans change is a secondary objective.

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

4.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of either internal or 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 modestly. Arlingclose will assist the Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

4.5 Alternatively, the Council may arrange forward starting loans during 2017/18, 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.

4.6 In addition, the Council may borrow further short-term loans to cover unplanned cash Flow shortages.

4.7 **Sources:** The Council may borrow from any reputable source including:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except Isle of Wight Council Pension Fund)
- capital market bond investors

- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

4.8 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

4.9 The Council 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.

4.10 **Municipal Bond Agency:** UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities will 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 full Council.

4.11 **LOBOs:** The Council holds £5.0m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The full balance of these LOBOs has options during 2017/18, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk.

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

4.13 **Debt Rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

5 Investment Strategy

5.1 As at 31 January 2017 the Council held invested funds of £38.3m, which included a £17.75m capital receipt, as well as income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £20.8 and £63.1 million, and similar levels are expected to be maintained in the forthcoming year.

5.2 **Objectives:** Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

5.3 **Negative Interest Rates:** If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is 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.

5.4 **Strategy:** Given the increasing risk and falling returns from short-term unsecured bank investments, the Council aims to diversify into more secure and/or higher yielding asset classes during 2017/18. All of the Authorities surplus cash is currently invested in short-term unsecured bank deposits, local authorities and money market funds. This diversification will represent a continuation of the new strategy adopted in 2015/16.

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

Table 2: Approved Investment Counterparties and Limits

Credit Rating	**Banks Unsecured**	**Building Societies**	**Government including Local Government**	**Corporates**	**Registered Providers**
UK Gov't	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AA- or better	£8.0m 5 years	£8.0m 5 years	£10.0m 10 years	£8.0m 6 years	£8.0m 6 years
A+	£8.0m 2 years	£8.0m 5 years	£10.0m 10 years	£8.0m 3 years	£8.0m 5 years
A	£8.0m 13 months	£8.0m 2 years	£10.0m 10 years	£8.0m 2 years	£8.0m 5 years
A-	£8.0m 6 months	£8.0m 13 months	£10.0m 10 years	£8.0m 13 months	£8.0m 5 years
BBB+	£4.0m 100 days	£8.0m 6 months	£10.0m 10 years	£4.0m 6 months	£4.0m 2 years
None	£1.0m 100 days	£4.0m 100 days	£10.0m 10 years	£50,000 6 months	£8.0m 2 years
Pooled funds		£8.0m per fund			

This table must be read in conjunction with the notes below

5.6 **Credit Rating:** Institutions are deemed to be credit rated when they have at least two credit ratings from Fitch, Moody's or Standard & Poor's. Exceptions to this are enhanced money market funds and registered social landlords (RSLs) for which a single credit rating will be required. Industry practice is for enhanced money market funds to have a single credit rating, but such funds are well diversified. Most registered social landlords (RSLs) are only rated by a single agency. However RSLs are regulated by the Homes and Communities Agency (HCA) which rates the financial viability of RSLs. It is recommended that investments are only placed with RSLs that have a financial viability rating of V1 from the HCA.

5.7 Investment limits are set by reference to the average 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. This means that where an investment is secured it is the credit quality of the security that will be considered rather than the credit quality of the investment counter party. Other relevant factors will be taken into account when making investment decisions.

5.8 **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.

5.9 **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.

5.10 **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.

5.11 **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.

5.12 **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 the likelihood of receiving government support if needed.

5.13 **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.

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

5.15 **Risk Assessment and Credit Ratings**: Credit ratings are obtained and monitored by the Council'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.

5.16 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 no new investments will be made with that organisation until the outcome of the review is announced. This policy will also apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

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

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

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

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

5.20 The Council defines "high credit quality" organisations and securities 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.

5.21 **Non-specified Investments**: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. 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 limits on total non-specified investments are shown in table 3 below. The individual category limits in table 3 may be exceeded provided that the limit on total non-specified investments is not exceeded.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£28m
Total investments without credit ratings or rated below A-	£5m
Total investments (except pooled funds) denominated in foreign currencies	£5m
Total non-specified investments	£38m

5.22 **Investment Limits**: The Council's revenue reserves available to cover investment losses are forecast to be £42 million on 31st March 2017. In order that no more than 20% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government including Local Authorities) will be £8.0 million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers' nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£10.0m each
UK Central Government	Unlimited
Any group of organisations under the same ownership	£8.0m per group
Any group of pooled funds under the same management	£8.0m per manager
Asia and Australia	£8.0m per region
Americas	£8.0m per region
Eurozone	£8.0m per region
Continental Europe outside the Eurozone	£8.0m per region
Registered Providers	£20.0m in total
Investments with Building Societies	£20.0m in total
Money Market Funds	£25.0m in total

5.23 **Liquidity Management:** The Council uses the Logotech PSTM system, purpose-built cash flow forecasting software to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a cautious basis, with receipts under-estimated and payments over-estimated, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

6 Treasury Management Indicators

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

6.1 **Liquidity:** The Council maintains detailed cash flow forecasts with a view to keeping minimum surplus cash balances. It addresses liquidity issues by restricting a significant proportion of its investment opportunities to short term and instant access deposits.

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

	2017/18	**2018/19**	**2019/20**
Upper limit on fixed interest rate exposure	£314.2m	£372.7m	£375.3m
Upper limit on variable interest rate exposure	£186.4m	£249.8m	£258.6m

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

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

	Upper	Lower
Under 12 months	30%	0%
12 months and within 24 months	30%	0%
24 months and within 5 years	30%	0%
5 years and within 10 years	50%	0%
10 years and above	95%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.
As a consequence of decision to borrow short, to take advantage of very low borrowing rates, the proportion of short term debt is high in 2017-18. This is consistent with previous strategies.

6.4 **Principal Sums Invested for Periods Longer than 364 days:** The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£28m	£44m	£72m

Consistent with previous strategies, the upper limit on principal invested for periods beyond 364 days allows for the investment of early surpluses on the Highways PFI contract to generate sufficient returns to cover the later years of the contract.

7 Other Items

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

7.1 **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).

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

7.3 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 region limit.

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

7.5 Staff are given the opportunity to attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

7.6 **Investment Advisers:** The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is reviewed at an annual meeting, and advice is assessed through regular contact and meetings with the advisers throughout the year to review the outcomes of their advice.

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

7.8 The total amount borrowed will not exceed the authorised borrowing limit of £416.1 million. The maximum period between borrowing and expenditure is expected to be three years, although the Council is not required to link particular loans with particular items of expenditure.

8 Financial Implications

8.1 The budget for investment income in 2017/18 is £0.16 million, based on an average investment portfolio of £38.3 million at an interest rate of 0.41%. The budget for debt interest paid in 2017/18 is £7.5million, based on an average debt portfolio of £170.7 million at an average interest rate of 4.4%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

9 Other Options Considered

9.1 The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Director of Finance, having consulted the members of the Audit Committee, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	**Impact on income and expenditure**	**Impact on risk management**
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast (November 2016)

Underlying assumptions:

1 The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

2 The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.

3 However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.

4 Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.

5 Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

6 The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

7 The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.

8 Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

9 Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely..

Forecast:

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

2 The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

3 Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.12
Arlingclose Central Case	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.40
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.18
Arlingclose Central Case	0.25	0.25	0.25	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.29
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.34
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.23
Arlingclose Central Case	0.60	0.50	0.50	0.50	0.50	0.50	0.50	0.60	0.70	0.85	0.90	0.90	0.90	0.65
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.24
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.39
Arlingclose Central Case	0.50	0.40	0.35	0.35	0.35	0.40	0.40	0.40	0.45	0.50	0.55	0.60	0.65	0.45
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.47
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.39
Arlingclose Central Case	1.15	0.95	0.85	0.85	0.85	0.85	0.85	0.90	0.95	1.00	1.05	1.10	1.15	0.96
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.47
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.39
Arlingclose Central Case	1.70	1.50	1.40	1.40	1.40	1.40	1.40	1.45	1.50	1.55	1.60	1.65	1.70	1.75
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.39
Arlingclose Central Case	1.60	1.40	1.30	1.30	1.30	1.30	1.30	1.35	1.40	1.45	1.50	1.55	1.60	1.41
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.57

Appendix B – Existing Investment & Debt Portfolio Position

	31 January 2017 Actual Portfolio £m	31 January 2017 Average Rate %
External Borrowing:		
Public Works Loan Board	133.8	4.52%
Local authorities	22.0	0.67%
LOBO loans from banks	5.0	4.27%
Total External Borrowing	**160.8**	**3.98%**
Other Long Term Liabilities:		
PFI	85.1	
Finance Leases	0.0	
Transferred Debt	-	
Total Gross External Debt	**245.9**	
Investments:		
Banks & building societies (unsecured)	8.0	0.8%
Covered bonds (secured)	-	-
Government (incl. local authorities)	22.3	0.61%
Corporate bonds and loans	-	-
Money Market Funds	8.0	0.28%
Other Pooled Funds	-	-
Total Investments	**38.3**	**0.41**
Net Debt	**207.6**	

Appendix C - Prudential Indicators 2017/18

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

2 **Estimates of Capital Expenditure:** The Council's planned capital expenditure and financing may be summarised as follows. Further detail is provided in Appendix E of the Council's "Budget and Council Tax Setting 2017/18 and Future Years Forecasts" paper presented to Full Council on 22 February 2017.

Capital Expenditure and Financing	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Total Expenditure	**26.2**	**115.4**	**55.2**	**1.2**
Capital Receipts	2.1	17.6	-	-
Government Grants	16.1	9.2	0.4	-
Reserves	1.7	0.2	-	-
Revenue	-	-	-	-
Borrowing	6.3	88.4	54.8	1.2
Leasing and PFI	-	-	-	-
Total Financing	**26.2**	**115.4**	**55.2**	**1.2**

3 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	31.03.17 Revised £m	31.03.18 Estimate £m	31.03.19 Estimate £m	31.03.20 Estimate £m
Total CFR	300.8	416.0	479.6	475.8

The CFR is forecast to rise by £175m over the next three years due to significant investment in the waste contact, as well as the proposed purchase of investment property, and as historic capital expenditure finance by debt outweighs resources put aside for debt repayment, principally as a result of the Highways PFI project.

4 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short term, exceed the total of capital financing requirement in the

preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Debt	**31.03.17 Revised £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
Borrowing	137.3	128.1	122.9	116.7
Finance leases	0.3	0.2	0.1	-
PFI liabilities	85.1	101.6	106.8	100.5
Transferred debt	-	-	-	-
Total Debt	**222.7**	**229.9**	**229.8**	**217.2**

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

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

Operational Boundary	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Borrowing	215.4	314.2	372.7	375.3
Other long-term liabilities	85.4	101.8	106.9	100.5
Total Debt	**300.8**	**416.0**	**479.6**	**475.8**

6 **Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	**2016/17 Limit £m**	**2017/18 Limit £m**	**2018/19 Limit £m**	**2019/20 Limit £m**
Borrowing	245.4	344.2	402.7	415.3
Other long-term liabilities	85.4	101.8	106.9	100.5
Total Debt	**576.2**	**446.0**	**509.6**	**515.8**

7 **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	2016/17 Revised %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
General Fund	6.4%	7.5%	15.0%	26.1%

8 **Incremental Impact of Capital Investment Decisions:** This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax 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 Estimate £	2018/19 Estimate £	2019/20 Estimate £
General Fund - increase in annual band D Council Tax	-	-	-3.49

The ratio above in respect of the impact of additional borrowing on Council Tax charges is purely illustrative. Should the cost of borrowing increase, the additional costs would have to be funded through savings in other areas, rather than being passed directly to council tax-payers.

The key focus of the treasury management strategy, and the associated prudential indicators, is to ensure that the council's commitments within its capital programme are prudently and affordably financed, without disadvantaging other areas of service delivery

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2003.

Appendix D – Annual Minimum Revenue Provision Statement 2017/18

1 Where the Council 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 Council to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the CLG Guidance) most recently issued in 2012.

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

3 The CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

The Capital Financing Requirement (CFR) represents the underlying requirement to borrow for capital investment. The Council expects that its CFR will be £300.8m on 31st March 2017

4 The council has adopted the annuity method for capital expenditure. This method will ensure the repayment of the debt better reflects the consumption of these assets financed. MRP will be determined by charging the expenditure over the expected useful life of the relevant asset. This being equal to the principal repayment on an annuity with an annual interest rate equal to the relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

5 MRP will continue to be provided as principal repayments for finance leases and PFI arrangements as principal repayments are made to the lessor or the PFI operator**,** MRP will be determined as being equal to the element that goes to write down the balance sheet liability based on an annuity basis.

6 For capital expenditure loans to third parties the income received has an interest and principal element. The principal element will be taken to reduce the asset on the balance sheet. The principal element of the repayment will be set aside to repay the borrowing that has financed these assets.

7 The Council plans to purchase investment properties as set out in the Medium Term Financial Plan with a view to generating long term rental streams to support the delivery of Council services in the future and reduce dependence on Government grant. The investment properties will be sold before there is significant consumption of the assets, it is recommended that the Council provides for the repayment of the borrowing by setting aside the capital receipt on disposal rather than providing a revenue provision.

8 Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2017, the MRP charge for 2017-18 will be nil as the change to the annuity method has created a payment holiday from 1 April 2016.

	31.03.2017 Estimated CFR £m	**2017/18 Estimated MRP £**
Capital expenditure before 01.04.2008	**129**	Nil
Supported capital expenditure after 31.03.2008	**Nil**	Nil
Unsupported capital expenditure after 31.03.2008	**82**	Nil
Finance leases and Private Finance Initiative	**86**	Nil
Transferred debt	**Nil**	Nil
Loans to other bodies	**4**	Nil
Total General Fund	**301**	**Nil**

Appendix E – Treasury Management Practices (TMPs)

TMP1 – Risk management
The Director of Finance and Section 151 Officer will design, implement and monitor all arrangements for the identification, management and control of treasury management risk, will report at least annually on the adequacy/suitability thereof, and will report, as a matter of urgency, the circumstances of any actual or likely difficulty in achieving the council's objectives in this respect, all in accordance with the procedures set out in *TMP6 – Reporting requirements and management information arrangements.*

In respect of each of the following risks, the arrangements which seek to ensure compliance with these objectives are set out in the schedules to this document.

TMP1[1] Credit and counterparty risk management
The council regards a key objective of its treasury management activities to be the security of the principal sums it invests. Accordingly, it will ensure that its counterparty lists and limits reflect a prudent attitude towards organisations with which funds may be deposited, and will limit its investment activities to the instruments, methods and techniques referred to in *TMP4 – Approved instruments, methods and techniques* and listed in section 5 of this strategy document. It also recognises the need to have, and will therefore maintain, a formal counterparty policy in respect of those organisations from which it may borrow, or with whom it may enter into other financing arrangements.

TMP1[2] Liquidity risk management
The council will ensure it has adequate though not excessive cash resources, borrowing arrangements, overdraft or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives.

The council will only borrow in advance of need where there is a clear business case for doing so and will only do so for the current capital programme or to finance future debt maturities.

TMP1[3] Interest rate risk management
The council will manage its exposure to fluctuations in interest rates with a view to containing its interest costs, or securing its interest revenues, in accordance with the amounts provided in its budgetary arrangements as amended in accordance with *TMP6 – Reporting requirements and management information arrangements*.

It will achieve this by the prudent use of its approved financing and investment instruments, methods and techniques, primarily to create stability and certainty of costs and revenues, but at the same time retaining a sufficient degree of flexibility to take advantage of unexpected, potentially advantageous changes in the level or structure of interest rates. This should be the subject to the consideration and, if required, approval of any policy or budgetary implications.

It will ensure that any hedging tools, such as derivatives are only used for the management of risk and the prudent management of financial affairs and that the policy for the use of derivatives is clearly detailed in the annual strategy.

TMP1[4] Exchange rate risk management
The council will manage its exposure to fluctuations in exchange rates so as to minimise any detrimental impact on its budgeted income/expenditure levels.

TMP1[5] Refinancing risk management
The council will ensure that its borrowing, private financing and partnership arrangements are negotiated, structured and documented, and the maturity profile of the monies so raised are managed, with a view to obtaining offer terms for renewal or refinancing, if required, which are competitive and as favourable to the council as can reasonably be achieved in the light of market conditions prevailing at the time.

It will actively manage its relationships with its counterparties in these transactions in such a manner as to secure this objective, and will avoid over-reliance on any one source of funding if this might jeopardise achievement of the above.

TMP1[6] Legal and regulatory risk management
The council will ensure that all of its treasury management activities comply with its statutory powers and regulatory requirements. It will demonstrate such compliance, if required to do so, to all parties with whom it deals in such activities. In framing its credit and counterparty policy under *TMP1[1] Credit and counterparty risk management*, it will ensure that there is evidence of counterparties' powers, authority and compliance in respect of the transactions they may effect with the council, particularly with regard to duty of care and fees charged.

The council recognises that future legislative or regulatory changes may impact on its treasury management activities and, so far as it is reasonably able to do so, will seek to minimise the risk of these impacting adversely on the council.

TMP1[7] Fraud, error and corruption, and contingency management
The council will ensure that it has identified the circumstances which may expose it to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings. Accordingly, it will employ suitable systems and procedures, and will maintain effective contingency management arrangements, to these ends.

TMP1[8] Market risk management
The council will seek to ensure that its stated treasury management policies and objectives will not be compromised by adverse market fluctuations in the value of the principal sums it invests, and will accordingly seek to protect itself from the effects of such fluctuations.

TMP2 – Performance measurement
The council is committed to the pursuit of value for money in its treasury management activities, and to the use of performance methodology in support of that aim, within the framework set out in its treasury management policy statement.

Accordingly, the treasury management function will be the subject of on-going analysis of the value it adds in support of the council's stated business or service objectives. It will be the subject of regular examination of alternative methods of service delivery, of the availability of fiscal or other grant or subsidy incentives, and of the scope for other potential improvements.

Treasury management performance measures are included in the Financial Management service board report from CorBusiness.
On a quarterly basis, the treasury management function reports on:

- Actual external borrowing compared to the authorised and operational limits agreed in the prudential indictors.
- Actual interest rate exposure compared to the upper limits agreed in the Prudential Indicators.

Annually, the treasury management function reports on

- The average cost of long term debt – ensuring that the borrowings made minimise costs to the council.
- The affordability measures concerning the cost of borrowing as contained in the Prudential Indicators.
- The difference between actual external borrowing and the Capital Financing Requirement.

These performance measures are reported to the Financial Management mini service board meeting, and are included in the reports made to audit committee throughout the year.

The council also subscribes to the CIPFA Treasury Management Benchmarking Club, which enables comparison of the council's performance to other local authorities, in terms of interest payable and receivable, investment performance, borrowing requirements and maturity profiles, and the costs of carrying out treasury management activities.

TMP3 – Decision-making and analysis
The council will maintain full records of its treasury management decisions, and of the processes and practices applied in reaching those decisions, both for the purposes of learning from the past, and for demonstrating that reasonable steps were taken to ensure that all issues relevant to those decisions were taken into account at the time.

The Director of Finance and Section 151 Officer is responsible for treasury management decisions.

On a daily basis, decisions regarding investments of short term cash surpluses are made by the Treasury Management Assistant, in discussion with the Pension Fund and Treasury Management Accountant, and reviewed and approved by the Technical Finance Manager.

A monthly Treasury Management Group meeting is held to make decisions regarding borrowing requirements, changes to the approved lending and borrowing lists, and any other strategic treasury management decisions. The members of the Treasury Management Group are the Director of Finance and Section 151 Officer, the Strategic Manager - Finance, the Technical Finance Manager, the Pension Fund and Treasury Management Accountant and three Principal Accountants. Notes of these meetings are taken to support decisions made.

Any changes to the Treasury Management Strategy made throughout the year will be reported to the audit committee.

TMP4 – Approved instruments, methods and techniques
The council will undertake its treasury management activities by employing only those instruments, methods and techniques detailed in this document, and within the limits and parameters defined in *TMP1 – Risk management.*

Where the council intends to use derivative instruments for the management of risks, these will be limited to those set out in its annual treasury strategy. The council will seek proper advice and will consider that advice when entering into arrangements to use such products to ensure that it fully understands those products.

TMP5 – Organisation, clarity and segregation of responsibilities, and dealing arrangements
The council considers it essential, for the purposes of the effective control and monitoring of its treasury management activities, for the reduction of the risk of fraud or error, and for the pursuit of optimum performance, that these activities are structured and managed in a fully integrated manner, and that there is at all times a clarity of treasury management responsibilities.

The principle on which this will be based is a clear distinction between those charged with setting treasury management policies and those charged with implementing and controlling these policies, particularly with regard to the execution and transmission of funds, the recording and administering of treasury management decisions, and the audit and review of the treasury management function.

If and when the council intends, as a result of lack of resources or other circumstances, to depart from these principles, the Director of Finance and Section 151 Officer will ensure that the reasons are properly reported in accordance with *TMP6 – Reporting requirements and management information arrangements*, and the implications properly considered and evaluated.

The Director of Finance and Section 151 Officer will ensure that there are clear written statements of the responsibilities for each post engaged in treasury management, and the arrangements for absence cover. The Director of Finance and Section 151 Officer will also ensure that at all times those engaged in treasury management will follow the policies and procedures set out.

The Director of Finance and Section 151 Officer will ensure there is proper documentation for all deals and transactions, and that procedures exist for the effective transmission of funds.

The delegations to the Director of Finance and Section 151 Officer in respect of treasury management are set out in the council's Constitution. The Director of Finance and Section 151 Officer will fulfil all such responsibilities in accordance with the council's policy statement and TMPs and, if a CIPFA member, the Standard of Professional Practice on Treasury Management.

TMP6 – Reporting requirements and management information arrangements
The council will ensure that regular reports are prepared and considered on the implementation of its treasury management policies; on the effects of decisions taken and transactions executed in pursuit of those policies; on the implications of changes, particularly budgetary, resulting from regulatory, economic, market or other factors affecting its treasury management activities; and on the performance of the treasury management function.

As a minimum the audit committee will receive:
- an annual report on the strategy and plan to be pursued in the coming year
- a mid-year review
- an annual report on the performance of the treasury management function, on the effects of the decisions taken and the transactions executed in the past year, and on any circumstances of non-compliance with the council's treasury management policy statement and TMPs.

The full council will receive and approve the annual strategy and plan to be pursued in the coming year, as part of the council's budget strategy.

The audit committee will receive regular monitoring reports on treasury management activities and risks.

The audit committee will have responsibility for the scrutiny of treasury management policies and practices.

Local authorities should report the treasury management indicators as detailed in their sector-specific guidance notes.

TMP7 – Budgeting, accounting and audit arrangements

The Director of Finance and Section 151 Officer will prepare, and the council will approve and, if necessary, from time to time will amend, an annual budget for treasury management, which will bring together all of the costs involved in running the treasury management function, together with associated income. The matters to be included in the budget will at minimum be those required by statute or regulation, together with such information as will demonstrate compliance with *TMP1 – Risk management*, *TMP2 – Performance measurement*, and *TMP4 – Approved instruments, methods and techniques*.

The Director of Finance and Section 151 Officer will exercise effective controls over this budget, and will report upon and recommend any changes required in accordance with *TMP6 – Reporting requirements and management information arrangements*. The council will account for its treasury management activities, for decisions made and transactions executed, in accordance with appropriate accounting practices and standards, and with statutory and regulatory requirements in force for the time being.

TMP8 – Cash and cash flow management

Unless statutory or regulatory requirements demand otherwise, all monies in the hands of the council will be under the control of Director of Finance and Section 151 Officer, and will be aggregated for cash flow and investment management purposes. Cash flow projections will be prepared on a regular and timely basis, and the Director of Finance and Section 151 Officer will ensure that these are adequate for the purposes of monitoring compliance with *TMP1[2] Liquidity risk management*.

The council uses the Logotech Public Sector Treasury Management (PSTM) system for recording cash flow movements and creating cash flow forecasts.

Daily cash flow activities are recorded on the system and the daily bank balances reconciled.

Cash flow forecasts, based on historic activity and current year budget assumptions, are prepared at the start of each financial year, and are discussed at the monthly treasury management meetings detailed under *TMP3 – Decision-making and analysis* above.

TMP9 – Money laundering

The council is alert to the possibility that it may become the subject of an attempt to involve it in a transaction involving the laundering of money. Accordingly, it will maintain procedures for verifying and recording the identity of counterparties and reporting suspicions, and will ensure that staff involved in this are properly trained.

The council's Anti-Money Laundering Policy sets out the council's procedures to prevent the use of council services for money laundering purposes, including the name of the officer to whom reports should be made.

TMP10 – Training and qualifications
The council recognises the importance of ensuring that all staff involved in the treasury management function are fully equipped to undertake the duties and responsibilities allocated to them. It will therefore seek to appoint individuals who are both capable and experienced and will provide training for staff to enable them to acquire and maintain an appropriate level of expertise, knowledge and skills. The Director of Finance and Section 151 Officer will recommend and implement the necessary arrangements.

The Director of Finance and Section 151 Officer will ensure that council members tasked with treasury management responsibilities, including those responsible for scrutiny, have access to training relevant to their needs and those responsibilities.

Those charged with governance recognise their individual responsibility to ensure that they have the necessary skills to complete their role effectively.

TMP11 – Use of external service providers
The council recognises that responsibility for treasury management decisions remains with the council at all times. It recognises that there may be potential value in employing external providers of treasury management services, in order to acquire access to specialist skills and resources. When it employs such service providers, it will ensure it does so for reasons which have been submitted to a full evaluation of the costs and benefits. It will also ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review. And it will ensure, where feasible and necessary, that a spread of service providers is used, to avoid over-reliance on one or a small number of companies. Where services are subject to formal tender or re-tender arrangements, legislative requirements will always be observed. The monitoring of such arrangements rests with the Director of Finance and Section 151 Officer.

TMP12 – Corporate governance
The council is committed to the pursuit of proper corporate governance throughout its businesses and services, and to establishing the principles and practices by which this can be achieved. Accordingly, the treasury management function and its activities will be undertaken with openness and transparency, honesty, integrity and accountability.

The council has adopted and has implemented the key principles of the Code. This, together with the other arrangements detailed in the schedules to this document, are considered vital to the achievement of proper corporate governance in treasury management, and the Director of Finance and Section 151 Officer will monitor and, if and when necessary, report upon the effectiveness of these arrangements.