Waveney District Council

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AUDIT AND GOVERNANCE

Thursday, 12th January 2017

TREASURY MANAGEMENT AND INVESTMENT STRATEGY FOR 2017/18 (REP1338)

EXECUTIVE SUMMARY

1. This report sets out the Council's Treasury Management Policy Statement, Investment Strategy and Prudential Indicators for 2017/18 and covers:
   - the capital plans (including prudential indicators);
   - the treasury management strategy (how the investments and any future borrowing are to be organised) including treasury indicators; and
   - an investment strategy (the parameters on how investments are to be managed).
2. The report recommends that the Treasury Management and Investment Strategy for 2017/18 and Prudential Indicators are approved and adopted.

Is the report Open or Exempt?	Open

Wards Affected:	All Wards within the District

Cabinet Member:	Councillor Mike Barnard Cabinet Member for Resources and Welfare Reforms

Supporting Officer:	Homira Javadi Chief Finance Officer (01394) 444529 homira.javadi@eastsuffolk.gov.uk

1 INTRODUCTION

1.1 Each year, every local authority must approve a policy strategy, which will govern its day-to-day treasury management objectives for that year. In this context, treasury management is the balance between maximising performance from investments, money market and capital market transactions whilst minimising the risk to the Council's cash flows and banking. The overriding principle is security of Council's money.

1.2 The report ultimately seeks that the Audit and Governance Committee and Cabinet recommend to Full Council the approval of the Treasury Management Policy Statement given at Appendix A, the Treasury Management & Investment Strategy given at Appendix B and the Prudential Indicators at Appendix C.

1.3 The Chartered Institute of Public Finance & Accountancy (CIPFA) defines treasury management as "The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

2 ECONOMIC BACKGROUND

2.1 The United Kingdom (UK) Gross Domestic Product (GDP) growth rates of 2.2% in 2013 and 2.9% in 2014 were strong but 2015 was disappointing at 1.8%, though it still remained one of the leading rates among the G7 countries (Canada, France, Germany, Italy, Japan, the UK and the United States (US)). Growth improved in Quarter Four of 2015 from +0.4% to 0.7% but fell back to +0.4% (2.0% year on year) in Quarter One of 2016 before bouncing back again to +0.7% (2.1% year on year) in Quarter Two.

2.2 During most of 2015, the economy had faced headwinds for exporters from the appreciation during the year of Sterling against the Euro, and weak growth in the European Union (EU), China and emerging markets, plus the dampening effect of the Government's continuing austerity programme.

2.3 The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys, pointing to an impending sharp slowdown in the economy. However, subsequent surveys have shown a sharp recovery in confidence and business surveys, though it is generally expected that although the economy will now avoid flat lining, growth will be weak through 2017.

2.4 The Bank of England meeting on 4th August addressed an expected slowdown in growth by a package of measures including a cut in the Bank of England base rate from 0.50% to 0.25%. The Inflation Report included an unchanged forecast for growth for 2016 of 2.0% but cut the forecast for 2017 from 2.3% to just 0.8%. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market.

2.5 Mark Carney also warned that the Bank of England could not do all the "heavy lifting" and suggested that the Government will need to help growth by increasing investment expenditure and possibly by using fiscal policy tools (taxation). The new Chancellor, Phillip Hammond, announced after the referendum result that the target of achieving a budget surplus in 2020 will be eased and he confirmed this in his Autumn Statement on 23rd November stating the government has set new fiscal targets which aim for 2% underlying deficit and debt falling by 2020, and a balanced budget as soon as possible thereafter.

2.6 The Inflation Report also included a sharp rise in the forecast for inflation to around 2.4% in 2018 and 2019. Consumer Price Index (CPI) has started rising during 2016 as the falls in the price of oil and food twelve months ago fall out of the calculation during the year and, in addition, the post referendum 10% fall in the value of Sterling on a trade weighted basis is likely to result in a 3% increase in CPI over a time period of three to four years.

2.7 However, the Monetary Policy Committee (MPC) is expected to look past this one off upward blip from this devaluation of Sterling in order to support economic growth, especially if pay increases continue to remain subdued and therefore pose little danger of stoking core inflationary price pressures within the UK economy.

2.8 The US economy had a patchy 2015 with sharp swings in the growth rate leaving the overall growth for the year at 2.4%. Quarter One of 2016 disappointed at +0.8% on an annualised basis while Quarter Two improved, but only to a lacklustre +1.4%. The Federal Reserve embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase.

2.9 In the Eurozone (EZ), the European Central Bank (ECB) commenced in March 2015 its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month; this was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting.

2.10 At its December and March meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise from around zero towards the target of 2%. GDP growth rose by 0.6% in Quarter One 2016 (1.7% year on year) but slowed to +0.3% (+1.6% year on year) in Quarter Two.

2.11 This has added to comments from many forecasters that central banks around the world are running out of ammunition to stimulate economic growth and to boost inflation. They stress that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand in the their economies and economic growth.

2.12 Japan is still bogged down in slow growth and making little progress on fundamental reform of the economy while Chinese economic growth has been weakening and medium term risks have been increasing.

2.13 Bank of England Base Rate: The MPC meeting of 4th August cut the base rate to 0.25% and gave forward guidance that it expected to cut the base rate again to near zero before the year end, however at it's meeting on the 15th December the MPC left rates unchanged.

3 TREASURY MANAGEMENT & INVESTMENT STRATEGY FOR 2017/18

3.1 The strategy for 2017/18 set out in Appendix B covers two main areas:

Capital issues:

- the capital plans and the prudential indicators; and
- the minimum revenue provision (MRP) strategy.

Treasury management issues:

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;

- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

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

4 HOW DOES THIS RELATE TO EAST SUFFOLK BUSINESS PLAN?

4.1 The Treasury Management and Investment Strategy report is a CIPFA requirement, the report does not link directly to the Vision of the Business Plan, but through ensuring good governance arrangements and security of the Councils investment income this will help to achieve financial self-reliance and the planned actions set out in the Business Plan.

5 FINANCIAL AND GOVERNANCE IMPLICATIONS

5.1 Security of the Council's cash is the over-riding consideration in setting the Treasury Management Policy Statement. During the year, the Council is constantly receiving advice from its external Treasury Advisors, Capita Asset Services, with regard to the creditworthiness of financial institutions in order to inform investment decisions.

5.2 The Council's banking provider is Lloyds Bank Plc and the initial contract term commenced on the 1st April 2015 and is for a period of three years.

6 REASON FOR RECOMMENDATION

The Local Government Act 2003 requires the Council to set out its Treasury Strategy for borrowing and to prepare an Annual Investment Strategy in advance of each financial year. This strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

RECOMMENDATIONS

1. That the Committee recommends to Full Council the adoption of the Treasury Management Policy Statement for 2017/18, the Treasury Management & Investment Strategy for 2017/18, the Prudential Indicators 2017/18 and the 2016/17 to 2017/18 Counterparty list.

APPENDICES	
Appendix A	Treasury Management Policy Statement 2017/18
Appendix B	Treasury Management & Investment Strategy 2017/18
Appendix C	Prudential Indicators 2017/18 to 2020/21 including revisions to 2016/17

BACKGROUND PAPERS - none

TREASURY MANAGEMENT POLICY STATEMENT FOR 2017/18

1 INTRODUCTION AND BACKGROUND

1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of that Code.

2 APPROVED ACTIVITIES

2.1 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:

- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities.
- Suitable treasury management practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

2.2 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 mid-year review and an annual report after its close, in the form prescribed in its TMPs.

2.3 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Cabinet and for the execution and administration of treasury management decisions to the Chief Finance Officer, who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management and also nominates the Audit & Governance Committee to be responsible for ensuring scrutiny of the treasury management strategy and policies.

3 POLICIES AND OBJECTIVES

3.1 The Council defines its treasury management activities as:

"The management of the Council's investments and cash flows, it's 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".

3.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

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

3.4 The Council's borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.

3.5 The Council's primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yield earned on investments remain important but are secondary considerations.

3.6 The Council's appetite for risk in terms of its treasury management activities is low. A premium is placed on the security of capital in terms of investment and on the maintenance of financial stability in terms of the costs of borrowing.

TREASURY MANAGEMENT STRATEGY STATEMENT AND INVESTMENT STRATEGY FOR 2017/18

1 BACKGROUND

1.1 The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code") requires local authorities to determine the Treasury Management Strategy Statement (TMSS) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) which is a requirement of the Department for Communities and Local Government's (DCLG) Investment Guidance.

1.2 The purpose of this TMSS is, therefore, to approve:

- Treasury Management Strategy for 2017/18;
- Annual Investment Strategy for 2017/18; and
- MRP Statement.

1.3 Treasury Management is about the management of risk. The Council is responsible for its treasury decisions and activity. No treasury management activity is without risk.

1.4 As per the requirements of the Prudential Code, the Council has adopted the CIPFA Treasury Management Code at a meeting of its Full Council on the 27th March 2003. Subsequent revisions to the Treasury Management Code were adopted by Full Council on 20th January 2016.

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

2 THE TREASURY POSITION

2.1 The Council maintains records of its processes and practices applied each day to ensure that supporting evidence is maintained for all treasury management activities.

2.2 The Council's current level of investments and loans is set out at Annex A.

3 INTEREST RATE FORECAST

3.1 The economic and interest rate forecast provided by the Council's treasury management advisors can be found below. The Council will reappraise its strategies from time to time in response to evolving economic, political and financial events. Capitas forward view on interest rates can be found in Annex C.

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18
Upside Risk	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Base Rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%
Downside Risk	-0.10%	-0.10%	-0.10%	-0.10%	-0.25%	-0.25%	-0.25%

4 BORROWING STRATEGY

4.1 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

4.2 The Council will adopt a flexible approach to this borrowing in consultation with its treasury management advisers, Capita Asset Services Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability;
- Maturity profile of existing debt;
- Interest rate and refinancing risk; and
- Borrowing source.

4.3 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.

4.4 In conjunction with advice from its treasury advisor, Capita Asset Services Ltd, the Council will keep under review the following borrowing sources:

- PWLB;
- Local Authorities (Borough/County/District/Metropolitan/Police/Unitary);
- Commercial Banks;
- European Investment Bank;
- Money markets;
- Capital markets (stock issues, commercial paper and bills);
- Structured finance; and
- Leasing.

4.5 The cost of carry, which is the difference between servicing the debt (interest incurred) and investing the money (interest received), has resulted in an increased reliance upon shorter dated and variable rate borrowing. This type of borrowing injects volatility into the debt portfolio in terms of interest rate risk but is counterbalanced by its affordability and alignment of borrowing costs with investment returns. The Council's exposure to shorter dated and variable rate borrowing is kept under regular review by reference to the difference or spread between variable rate and longer term borrowing costs. A narrowing in the spread by 0.5% will result in an immediate and formal review of the borrowing strategy to determine whether the exposure to shorter dated and variable rates is maintained or altered.

5 ANNUAL INVESTMENT STRATEGY

5.1 In accordance with Investment Guidance issued by the DCLG and best practice, this Council's primary objective in relation to the investment of public funds remains the security of capital. The liquidity or accessibility of the Council's investments followed by the yields earned on investments is important but are secondary considerations.

5.2 Investments are categorised as "Specified" or "Non-Specified" within the investment guidance issued by the DCLG:

5.3 Specified investments are sterling denominated, with maturities up to maximum of one year, meeting the minimum 'high' quality criteria where applicable.

5.4 Non Specified investments are any investments which do not meet the specified investment criteria. A maximum of 25% will be held in aggregate in non-specified investment.

5.5 A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the above categories.

5.6 The types of investments that could be used by the Council are as follows:

Table 2: Specified and Non-Specified Investments

Investment	Specified	Non-Specified
Term deposits with banks and building societies	✓	✓
Term deposits with other UK local authorities	✓	✓
Certificates of deposit with banks and building societies	✓	✓
Gilts	✓	✓
Treasury Bills (T-Bills)	✓	✗
Bonds issued by Multilateral Development Banks	✓	✓
Local Council Bills	✓	✗
Commercial Paper	✓	✗
Corporate Bonds	✓	✓
Money Market Funds	✓	✗
Other Money Market and Collective Investment Schemes	✓	✓
Debt Management Account Deposit Facility	✓	✗

6 INVESTMENT POLICY

6.1 The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second and then return.

6.2 In accordance with the above guidance from the DCLG and CIPFA and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflect in the eyes of each agency. Using the Capita ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

6.3 Further, the Council's officers recognise that ratings should not be the sole determinant of the quality of an institution and that it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to monitor market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

6.4 Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

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

6.6 Investment instruments identified for use in the financial year are listed in Section 5, Table 2 under the ‘specified’ and ‘non-specified’ investments categories. Counterparty limits will be as set through the Council’s Treasury Management Practices Schedules.

6.7 Creditworthiness policy - the primary principle governing the Council’s investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council’s prudential indicators covering the maximum principal sums invested.

6.8 The Chief Finance Officer will maintain a counterparty list (Annex B) in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

6.9 The minimum rating criteria uses the lowest common denominator method of selecting counterparties and applying limits. This means that the application of the Council’s minimum criteria will apply to the lowest available rating for any institution. For instance, if an institution is rated by two agencies, one meets the Council’s criteria, the other does not, and the institution will fall outside the lending criteria. Credit rating information is supplied by Capita Asset Services, our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list.

6.10 The criteria for providing a pool of high quality investment counterparties (both specified and non-specified investments) are:

- Banks 1 - Good credit quality – the Council will only use banks which:
  - i. are UK banks; and/or
  - ii. are non-UK and domiciled in a country which has a minimum sovereign long term rating of AA+

  and have, as a minimum, the following Fitch, Moody’s and Standard and Poor’s credit ratings (where rated):

  iii. Short term – F1

  iv. Long term – A-

  Please note UK Banks will continue to be used in the event of a sovereign rating downgrade.
- Banks 2 – Part nationalised UK banks – Lloyds Banking Group and Royal Bank of Scotland. These banks can be included if they continue to be part nationalised or they meet the ratings above.
- Banks 3 – The Council’s own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- Bank subsidiary and treasury operation - the Council will use these where the parent bank has provided an appropriate guarantee or has the necessary ratings outlined above.

- Building societies - The Council will use all societies which:
    i. meet the ratings for banks outlined above; and
    ii. have assets in excess of £3bn.
- Money market funds – AAA.
- UK Government (including gilts and the DMADF).
- Local authorities, parish councils etc.
- Supranational institutions.

6.11 A limit of 25% will be applied to the use of non-specified investments (this will partially be driven by the long term investment limits).

6.12 Country and sector considerations - due care will be taken to consider the country, group and sector exposure of the Council's investments. In part, the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above. In addition:

- no more than 15% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies; and
- sector limits will be monitored regularly for appropriateness.

6.13 Use of additional information other than credit ratings - additional requirements under the Code requires the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties.

6.14 This additional market information (for example Credit Default Swaps (CDS), negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties. Therefore in addition to the above criteria, the Council may apply the following additional methodology to determine whether a counterparty should be considered suitable for investment and to assign an appropriate duration of investment.

6.15 This methodology employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- Credit watches and credit outlooks from credit rating agencies;
- CDS spreads to give early warning of likely changes in credit ratings; and
- Sovereign ratings to select counterparties from only the most creditworthy countries.

6.16 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments.

- Yellow 5 years
- Purple 2 years
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No colour not to be used.

6.17 This methodology uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a short term rating (Fitch or equivalents) of short term rating F1, long term rating A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

6.18 All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

6.19 If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, it's further use as a new investment will be withdrawn immediately. In addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a weekly basis. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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

6.21 The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Fitch Long term Rating (or equivalent)	Money Limit	Time Limit
Banks 1 higher quality	A-	£15m	1yr
Banks 1 medium quality	A-	£15m	1yr
Banks 1 lower quality	A-	£15m	1yr
Banks 2 – part nationalised	A-	£20m per group	2 yrs.
Limit 3 category – Council's banker (not meeting Banks 1)	A-	£5m	1 day
Other institutions limit	-	£5m	1yr
DMADF	AAA	unlimited	6 months
Local Authorities	N/A	£8m per LA	2yrs
Money Market Funds	AAA	£8m per fund	liquid

6.22 The Council operates a 'group limit', whereby the collective investment exposure to individual banks within the same banking group is restricted to a group total.

7 DEBT RESHEDULING

7.1 The Council's debt portfolio can be restructured by prematurely repaying loans and refinancing them on similar or different terms to achieve a reduction in risk and/or savings in interest costs.

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

- the generation of cash savings and/or discounted cash flow savings;

- helping to fulfil the treasury strategy; or
- to enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

7.3 Borrowing and rescheduling activity will be reported to Council in the Annual Treasury Management Report and the regular treasury management reports presented to the Cabinet.

7.4 Every Local Council in the UK could apply for a PWLB Certainty rate which provides a discount on borrowing of 0.2%. The Council has been successful in obtaining this rate from 1st April 2013.

8 BALANCED BUDGET REQUIREMENT

8.1 The Council complies with the provisions of S32 of the Local Government Finance Act 1992 to set a balanced budget.

9 2017/18 MRP STATEMENT

9.1 The Council is required to pay off an element of the accumulated General Fund capital spend each year (the Capital Financing Requirement - CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP). DCLG regulations have been issued which require Full Council to approve the MRP Statement in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision.

9.2 The four MRP options in the guidance are:

- Option 1: Regulatory Method
- Option 2: CFR Method
- Option 3: Asset Life Method
- Option 4: Depreciation Method

NB This does not preclude other prudent methods.

The Council is recommended to approve the following MRP Statement:

9.3 For capital expenditure incurred before 1st April 2008, the MRP policy will be:

- **Asset life method (currently Regulatory Method)** - MRP will be based on a 50 year life and on an annuity basis, in accordance with the regulations (Option 3).
- This option ensures that capital expenditure incurred before 1st April 2008 is repaid within 50 years and repayment matches use of the asset more accurately.
- Under Option 1 (Regulatory Method), it would take 411 years to repay capital expenditure and the Adjustment A value of £289k would never be repaid, as at the time Adjustment A was introduced, this amount was to be supported by the Revenue Support Grant, which is now reducing.

9.4 From 1st April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets on an annuity basis, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3).

10 MONITORING AND REPORTING ON THE TREASURY OUTTURN AND PRUDENTIAL INDICATORS

10.1 The Cabinet Member with Responsibility for Resources will report to Full Council on treasury management activity / performance and Performance Indicators as follows:

- Mid year against the strategy approved for the year.
- An outturn report on its treasury activity by no later than 30th September after the financial year end.
- The Audit & Governance Committee will be responsible for the scrutiny of treasury management activity and practices.

11 **OTHER ITEMS**

11.1 Training - CIPFA's Code of Practice requires the responsible officer to ensure that all Members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

12 INVESTMENT CONSULTANTS/TREASURY ADVISORS

12.1 DCLG's Guidance on local government investments recommend that the Investment Strategy should state:

- whether, and if so, how the Council uses external contractors offering information, advice or assistance relating to investment; and
- how the quality of any such service is controlled.

12.2 The Council uses Capita Asset Services' Treasury Solutions as its external treasury management advisors. They provide information, advice and assistance in all areas of treasury. The Council has a close working relationship and are in contact with their advisors on a daily basis.

12.3 The Council is committed to the prevention, deterrence and detection of bribery and has a zero tolerance towards bribery. All Treasury staff has access to the Councils Anti Bribery Policy and procedures and will be mindful when carrying out their Treasury duties.

Annex A – Existing Investment & Loans Portfolio Position (Section 2.2)

	31/03/2016 Actual Portfolio £m	31/11/2016 Actual Portfolio £m
External Borrowing:		
Fixed Rate – PWLB	67.76	67.61
Variable Rate – PWLB	20.29	20.29
Fixed Rate – LA (Local Authority)	3.00	3.00
Total External Borrowing	91.05	90.90
Other Long Term Liabilities:		
- PFI	0	0
- Finance Leases	7.30	7.30
Total Gross External Debt	98.35	98.20
Investments:		
Managed in-house		
- Short-term monies (Deposits/ monies on call /MMFs)	27.83	39.68
		0
- Long-term investments	0	
Managed externally		0
- By Fund Managers	0	0
- Pooled Funds	0	
Total Investments	27.83	39.68

Annex B – *Counterparty List 2016/17 & 2017/18 Revised (Section 6.8)

Instrument	Country	Counterparty	Maximum Limit of Investments £m
Call Account Only	UK	Lloyds Bank	£5m (day to day banking only)
Term Deposits	UK	Bank of Scotland (BoS/Lloyds)	£20m group limit
Term Deposits/Call Accounts	UK	Barclays	£15m
Term Deposits/Call Accounts	UK	DMADF, DMO	No limit
Term Deposits/Call Accounts	UK	HSBC	£10m
Term Deposits	UK	Lloyds (BoS/Lloyds)	£20m group limit
Term Deposits/Call Accounts	UK	MBNA Europe Bank	£8m
Term Deposits/Call Accounts	UK	Nationwide	£15m
Term Deposits/Call Accounts	UK	NatWest	£20m group limit
Term Deposits/Call Accounts	UK	Other UK Local Authorities (LA)	£8m per LA
Term Deposits/Call Accounts	UK	Royal Bank of Scotland	£20m group limit
Term Deposits/Call Accounts	UK	Santander (UK)	£15m
Term Deposits/Call Accounts	UK	Schroder's Plc	£8m
Term Deposits/Call Accounts	UK	Standard Chartered Bank	£8m
Term Deposits/Call Accounts	UK	UBS Ltd	£8m
Gilts	UK	DMO	No limit
Term Deposits/Call Accounts	Australia	Australia and NZ Banking Group	£8m
Term Deposits/Call Accounts	Australia	Commonwealth Bank of Australia	£8m
Term Deposits/Call Accounts	Australia	Macquarie Bank Ltd	£8m
Term Deposits/Call Accounts	Australia	National Australia Bank Ltd	£8m
Term Deposits/Call Accounts	Australia	Westpac Banking Corp	£8m
Term Deposits/Call Accounts	Canada	Bank of Montreal	£8m
Term Deposits/Call Accounts	Canada	Bank of Nova Scotia	£8m
Term Deposits/Call Accounts	Canada	Canadian Imperial Bank of Commerce	£8m
Term Deposits/Call Accounts	Canada	Royal Bank of Canada	£8m
Term Deposits/Call Accounts	Canada	Toronto-Dominion Bank	£8m
Term Deposits/Call Accounts	Finland	Nordea Bank Finland	£8m
Term Deposits/Call Accounts	Finland	Pohjola Bank	£8m
Term Deposits/Call Accounts	France	BNP Paribas	£8m
Term Deposits/Call Accounts	France	Caisse des Depots et Consignations	£8m
Term Deposits/Call Accounts	France	Credit Industrial et Commercial	£8m
Term Deposits/Call Accounts	France	Societe Generale (SG)	£8m
Term Deposits/Call Accounts	Germany	Deutsche Bank AG	£8m
Term Deposits/Call Accounts	Germany	DZ Bank AG	£8m
Term Deposits/Call Accounts	Germany	KfW	£8m
Term Deposits/Call Accounts	Germany	Landwirtschaftliche Rentenbank	£8m
Term Deposits/Call Accounts	Hong Kong	Hong Kong & Shanghai Bank Corp Ltd	£8m
Term Deposits/Call Accounts	Luxembourg	Banque et Caisse d'Espargne de l'Etat	£8m
Term Deposits/Call Accounts	Luxembourg	BGL BNP Paribas SA	£8m
Term Deposits/Call Accounts	Luxembourg	Clearstream Banking	£8m
Term Deposits/Call Accounts	Netherlands	Bank Nederlandse Gemeenten	£8m
Term Deposits/Call Accounts	Netherlands	ING Bank NV	£8m
Term Deposits/Call Accounts	Netherlands	Rabobank	£8m
Term Deposits/Call Accounts	Norway	DnB NOR Bank	£8m
Term Deposits/Call Accounts	Singapore	DBS Bank Ltd	£8m
Term Deposits/Call Accounts	Singapore	Oversea-Chinese Banking Corp	£8m

Instrument	Country	Counterparty	Maximum Limit of Investments £m
Term Deposits/Call Accounts	Singapore	United Overseas Bank Ltd	£8m
Term Deposits/Call Accounts	Sweden	Skandinaviska Enskilda Banken	£8m
Term Deposits/Call Accounts	Sweden	Svenska Hanelsbanken	£8m
Term Deposits/Call Accounts	Sweden	Swedbank AB	£8m
Term Deposits/Call Accounts	Switzerland	UBS AG	£8m
Term Deposits/Call Accounts	US	Bank of New York Mellon	£8m
Term Deposits/Call Accounts	US	HSBC USA	£8m
Term Deposits/Call Accounts	US	JP Morgan	£8m
Term Deposits/Call Accounts	US	State Street Bank & Trust Company	£8m
Money Market Funds	UK/Ireland/ Luxemburg	CNAV/VNAV MMFs	£8m per fund

*Please note this list could change if, for example, a counterparty/country is upgraded and meets our other creditworthiness tools. Alternatively, if a counterparty is downgraded, this list may be shortened.

The Council operates a 'group limit', whereby the collective investment exposure to individual banks within the same banking group is restricted to a group total.

All non-UK Banks are subject to a limit of 15% of the investment portfolio.

The Council does not currently invest with non-UK Banks and any such decision will be made in conjunction with the Councils Treasury Advisors and the Chief Finance Officer.

Annex C – Interest Rate Forecast & Forward View (Section 3.1)

Capita Asset Services forward view

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions); will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments. Major volatility in bond yields is likely to endure as investor fears and confidence ebb and flow between favouring more risky assets i.e. equities, or the safe haven of bonds.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. An eventual world economic recovery may also see investors switching from the safe haven of bonds to equities.
We have pointed out consistently that the Fed. Rate is likely to go up more quickly and more strongly than Bank Rate in the UK and recent events have not changed that view, just that the timing of such increases may well have been deferred somewhat during 2016. While there is normally a high degree of correlation between the two yields, we would expect to see a growing decoupling of yields between the two i.e. we would expect US yields to go up faster than UK yields. We will need to monitor this area closely and the resulting effect on PWLB rates.

The overall balance of risks to economic recovery in the UK remains to the downside, particularly with the current uncertainty over the final terms of Brexit.
We would, as always, remind clients of the view that we have expressed in our previous interest rate revision newsflashes of just how unpredictable PWLB rates and bond yields are at present. We are experiencing exceptional levels of volatility which are highly correlated to geo-political and sovereign debt crisis developments. Our revised forecasts are based on the Certainty Rate (minus 20 bps) which has been accessible to most authorities since 1st November 2012.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Europe, the Middle East and Asia, which could lead to increasing safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.
- A resurgence of the Eurozone sovereign debt crisis.
- Weak capitalisation of some European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the threat of deflation in western economies, especially the Eurozone and Japan.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Prudential Indicators 2016-17 to 2020-21

1 NET BORROWING AND THE CAPITAL FINANCING REQUIREMENT

1.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. It does not necessarily mean that borrowing will be undertaken. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing. This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing 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.

	2016/17 Approved £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Non-HRA	31.17	30.00	30.94	31.03	31.30	31.21
HRA	77.75	77.75	77.75	77.75	77.75	77.75
Total CFR	**108.92**	**107.75**	**108.69**	**108.78**	**109.05**	**108.96**

1.2 Chief Finance Officer reports that the Council has no difficulty meeting this requirement in 2017/18, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

2 ESTIMATES OF CAPITAL EXPENDITURE

2.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and in particular, to consider the impact on Council Tax.

	2016/17 Approved £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Non-HRA	3.75	5.12	4.33	10.32	12.83	12.58
HRA	8.65	7.46	18.56	10.00	7.61	5.09
Total Expenditure	**12.40**	**12.58**	**22.89**	**20.32**	**20.44**	**17.67**

Capital expenditure will be financed or funded as follows:

Capital Financing	**2016/17 Approved £m**	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Capital receipts/ Reserve	0	1.50	2.10	1.62	0.42	0.60
Government Grants	3.52	2.10	3.83	9.45	12.23	11.56
Third Party Contributions	0.15	0.50	0.50	0.50	0.50	0.50
Revenue contributions (Earmarked Reserves)	7.74	6.23	14.85	7.93	6.35	4.42
Total Financing	**11.41**	**10.33**	**21.28**	**19.50**	**19.50**	**17.08**
Supported borrowing	0	0	0	0	0	0
Total Funding	**0.99**	**2.25**	**1.61**	**0.82**	**0.94**	**0.59**
Total Financing Funding	**12.40**	**12.58**	**22.89**	**20.32**	**20.44**	**17.67**

3 COSTS TO NET REVENUE STREAM

3.1 This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream. The ratio of financing costs to net revenue stream is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budgets required to meet borrowing costs.

3.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Approved %	2016/17 Revised %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Non-HRA	21.15	17.16	15.28	14.40	16.15	15.40
HRA	44.39	29.23	34.40	24.38	24.76	24.05

4 ACTUAL EXTERNAL DEBT

4.1 This indicator is obtained directly from the Council'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 31/03/2016	**£m**
Borrowing	91.05
Other Long-term Liabilities	7.30
Total	**98.35**
Portfolio Analysis:	**£m**
Non HRA	20.91
HRA	77.44
Total	**98.35**

5 INCREMENTAL IMPACT OF CAPITAL INVESTMENT DECISIONS

5.1 This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over the MTFS period.

5.2 The decrease in the Band D amounts are as a direct result to the changes in the capital programme for 2016/17 and revised capital charges (Interest on borrowing and Minimum Revenue Provision, with the decrease in the average weekly housing rents being directly attributable to the reduction in the revised HRA capital programme and the reduction in the provision set for the variable rate borrowing in relation to the HRA self financing settlement.

5.3 The 2020/21 amount shows the revenue charges per Band D Council Tax and Housing Rent amounts purely based on the 2020/21 year.

Impact of Capital Investment Decisions	2016/17 £	2017/18 £	2018/19 £	2019/20 £	2020/21 £
GF Capital cost per Band D properties					
Revenue cost per Band D Council Tax - 2015/16 Capital Programme	45.87	50.59	50.77	50.92	N/A
Revenue cost per Band D Council Tax – 2016/17 Capital Programme	38.82	37.25	36.55	37.19	37.78
Increase/(decrease) in Revenue cost per Band D Council Tax	**-7.05**	**-13.34**	**-14.22**	**-13.73**	N/A
HRA Capital cost per dwelling					
HRA costs per Average Weekly Housing Rents - 2015/16 Capital Programme	8.68	8.75	8.82	8.88	N/A
HRA costs per Average Weekly Housing Rents - 2016/17 Capital Programme	8.64	8.69	8.69	8.69	8.69
Increase/(decrease) in HRA costs per Average Weekly Housing Rents	**-0.04**	**-0.06**	**-0.13**	**-0.19**	N/A

6 AUTHORISED LIMIT AND OPERATIONAL BOUNDARY FOR EXTERNAL DEBT

6.1 The Council 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 Council and not just those arising from capital spending reflected in the CFR.

6.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external borrowing 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 Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

6.3 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.

6.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	2016/17 Approved £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	122.00	122.00	122.00	122.00	122.00	122.00

6.5 **The Operational Boundary links** directly to the Council's estimates of the CFR and estimates of other cashflow 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.

6.6 The Chief Finance 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 Full Council.

Operational Boundary for External Debt	2016/17 Approved £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing	123.00	123.00	123.00	123.00	123.00	123.00

7 UPPER LIMITS FOR FIXED INTEREST RATE EXPOSURE AND VARIABLE INTEREST RATE EXPOSURE

7.1 If the Council was to make the transition from being debt free then it is recommended that the Council sets an Upper Limit on Fixed Interest Rate Exposures and also Variable Rate Exposure.

7.2 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, i.e. fixed rate debt net of fixed rate investments / net interest paid (i.e. interest paid on fixed rate debt net of interest received on fixed rate investments).

7.3 The upper limit for variable rate exposure has been set to ensure that the Council 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 level 31/03/16 %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 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

7.4 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. Those decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's Treasury Management Strategy.

8 MATURITY STRUCTURE OF FIXED RATE BORROWING

8.1 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.

8.2 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	Existing level (or Benchmark level) at 31/03/16 %	Lower Limit for 2017/18 %	Upper Limit for 2017/18 %
under 12 months	50	0	50
12 months and within 24 months	50	0	50
24 months and within 5 years	75	0	75
5 years and within 10 years	75	0	75
10 years and within 20 years	75	0	75
20 years and above	100	0	100

9 CREDIT RISK

9.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

9.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

9.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay (applying common sense).

9.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

10 UPPER LIMIT FOR TOTAL PRINCIPAL SUMS INVESTED OVER ONE YEAR

10.1 The Council does not normally invest for periods longer than one year but it is prudent to set a limit of £5m per annum for such maturities.

10.2 The Council does not currently invest sums for longer than one year.

Upper Limit for total principal sums invested over 364 days	2016/17 Approved £m	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
	5.0	5.0	5.0	5.0	5.0	5.0

11 ADOPTION OF THE CIPFA TREASURY MANAGEMENT CODE

11.1 The Council is required to demonstrate that the Council has adopted the principles of best practice in Treasury Management.

11.2 In compliance, the Council approved the adoption of the CIPFA Treasury Management Code at its Full Council meeting on 27th March 2003. In addition the Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies, procedures and practices and further updates approved at Full Council on 20th January 2016.