Subject: **Treasury Management Strategy 2017/18**

Report to: Policy and Resources Committee – 7 February 2017

Report by: Group Manager Resources

SUBJECT MATTER/RECOMMENDATIONS

To consider and recommend to Council the 2017/18 Treasury Management Strategy, including the Prudential Indicators, Minimum Revenue Provision Policy Statement and the Annual Investment Strategy.

1. INTRODUCTION/BACKGROUND

1.1 The Council is required to determine annually its Treasury Management Strategy (TMS). The TMS for the 2017/18 financial year is attached at Appendix A and includes the following:

- the Prudential Indicators,
- Minimum Revenue Provision Policy Statement and
- The Annual Investment Strategy.

1.2 The Council continues to maintain an under-borrowed position which 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. An under borrowing position is forecast to continue.

1.3 The Council is required to operate a balanced budget, whereby cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

1.4 The second main function of the treasury management service is the funding of the Council's planned capital plans. These capital plans provide a guide to the borrowing need of the Council, informing the longer term cash flow planning, to ensure the Council can meet its capital spending obligations.

1.5 The management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet the Council risk or cost objectives.

1.6 The treasury strategy has been informed by the current capital programme and updates to the programme as included within the budget report which is being recommended elsewhere on the agenda.

1.7 The revenue implications of the strategy have been included in the General Fund and HRA budgets for 2017/18.

2. FINANCIAL IMPLICATIONS

Detailed within the Strategy Document

3. RISK IMPLICATIONS

Detailed within the Strategy Document

4. CONCLUSIONS

The Council is required to determine annually its TMS, as covered within the attached reports Treasury Management Strategy, the Prudential Indicators, Minimum Revenue Provision Policy Statement and the Annual Investment Strategy.

5. RECOMMENDATIONS

It is recommended that Cabinet agree and recommend to Council:

a) The TMS for 2017/18;
b) The Prudential Indicators and Limits for the three year period 2017/18 to 2019/20 as contained (Section 2.3 of the TMS document);
c) The Minimum Revenue Provision Statement (Section 2.3 of the TMS document)
d) The Annual Investment Strategy (Section 4.1 of the TMS document)

6. **BACKGROUND PAPERS**

The Council is required to determine annually its Treasury Management Strategy.

Area for consideration	**Comment**
Monitoring Officer Consultation:	No
Section 151 Officer Consultation:	Yes
Existing Council Policies:	Yes
Financial Implications:	Yes
Legal Implications (including human rights):	Yes
Risk Implications:	No
Equality Issues/EQIA assessment:	No
Crime & Disorder:	No
Every Child Matters:	No

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

2017/18

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1 INTRODUCTION

1.1 Background

The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council's low risk appetite, providing adequate liquidity initially before considering investment return.

The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

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."*

1.2 Reporting requirements

The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid-year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny
The above reports are required to be adequately scrutinised before being recommended to Council, Policy and Resources Committee undertake this role.

1.3 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital issues

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

Treasury management issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny and recommendation of the TMS. The following training from Chris Scott, Director, Capita was provided to members on 3rd November 2016 and further training will be arranged as required.
The training needs of treasury management officers are periodically reviewed.

1.5 Treasury management advisors

The Council uses Capita Asset Services, Treasury solutions as its external treasury management advisors.

The Council recognises that responsibility for treasury management decisions remain with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019/20 AND MRP STATEMENT

The Council's capital expenditure plans are the key driver of treasury management activity. The output of the capital expenditure plans is reflected in the prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1 Capital expenditure

This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital expenditure £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Housing & Neighbourhoods	3,468	17,515	2,282	403
Customer Services	1,280	601	700	240
Resources, Governance & Growth	1,856	10.555	0	0
Transformation Team	292	0	0	0
Non-HRA (GF) Total	**6,896**	**28,671**	**2,982**	**643**
HRA	11,129	10,554	8,307	8,809
Total	**18,025**	**39,225**	**11,289**	**9,452**

Other long term liabilities. The above financing need excludes other long term liabilities, such as leasing arrangements which already include borrowing instruments.

The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need.

Financing of capital expenditure £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Non-HRA (GF)Total	£6,896	£28,671	£2,982	£643
HRA	£11,129	£10,554	£8,307	£8,809
Total	**£18,025**	**£39,225**	**£11,289**	**£9,452**
Financed by:				
Capital receipts	£1,386	£1,197	£882	£828
Capital grants	£1,418	£3,607	£1,877	£363
Capital reserves	-	-	-	-
Revenue	£7,813	£7,425	£6,065	£5,986
Net financing need for the year	**£7,408**	**£26,996**	**£2,465**	**£2,275**

2.2 The Council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

The CFR includes any other long term liabilities (e.g. finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £0.978m of such schemes within the CFR.

The Council is asked to approve the CFR projections below:

£'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital Financing Requirement				
CFR – non housing	£ 48,398	£ 62,294	£ 61,392	£ 59,536
CFR – housing	£ 79,651	£ 81,703	£ 83,063	£ 85,058
Total CFR	**£128,049**	**£143,998**	**£144,455**	**£144,594**
Movement in CFR	**£ 5,855**	**£ 15,948**	**£0,458**	**£0,139**

Net financing need for the year (above)	£7,428	£17,750	£2,530	£2,276
Less MRP/VRP and other financing movements	-£1,573	-£1,802	-£2,072	-£2,137
Movement in CFR	**£ 5,855**	**£ 15,948**	**£0,458**	**£0,139**

2.3 Minimum revenue provision (MRP) policy statement

The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision – MRP), although is also allowed to undertake additional voluntary payments if required (voluntary revenue provisions – VRP).

Community of Local Government regulations have been issued which require the full Council to approve **an MRP Statement** in advance each year. The Council is recommended to approve the following MRP Statement.

For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:

- **Existing Practice** – MRP will follow the existing practice outlined in former CLG regulations (option 1);

These options provide for an approximate 4% reduction in the borrowing need (CFR) each year.

From 1 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, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3)

These options provide for a reduction in the borrowing need over approximately the asset's life.

There is no requirement on the HRA to make a minimum revenue provision but there is a requirement for a charge for depreciation to be made (although there are transitional arrangements in place).

Repayments included in finance leases are applied as MRP.

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £'000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Fund balances / reserves	£19,847	£17,849	£17,582	£17,301
Capital receipts	£0,642	£0,642	£0,642	£0,642
Provisions	£5,232	£0	£0	£0
Other	£0	£0	£0	£0
Total core funds	£25,722	£18,491	£18,224	£17,943
Working capital*	-£4,226	-£4,728	£2,661	£5,219
Under/over borrowing**	£29,948	£23,219	£15,563	£12,724
Expected investments	£0	£0	£0	£0

*Working capital balances shown are estimated year end; these may be higher mid-year

2.5 Affordability prudential indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

a. Ratio of financing costs to net revenue stream

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.

%	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Non-HRA	15.44%	18.85%	23.24%	28.76%
HRA	10.94%	10.93%	11.12%	11.61%

The estimates of financing costs include current commitments and the proposals in this budget report.

b. Incremental impact of capital investment decisions on council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of funding and service delivered which are not certain over the three year period.

Incremental impact of capital investment decisions on the band D council tax

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council tax - band D	£8.83	£14.34	£10.13	£2.42

c. Estimates of the incremental impact of capital investment decisions on housing rent levels

Similar to the council tax calculation, this indicator identifies the trend in the cost of proposed changes in the housing capital programme recommended in this budget report compared to the Council's existing commitments and current plans, expressed as a discrete impact on weekly rent levels.

d. Incremental impact of capital investment decisions on housing rent levels

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Weekly housing rent levels	£25.69	£24.56	£20.16	£19.99

This indicator shows the revenue impact on any newly proposed changes, although any discrete impact will be constrained by rent controls.

e. HRA ratios

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
HRA debt £m	**£77.610**	**£79.662**	**£81.022**	**£83.017**
Number of HRA dwellings	**5873**	**5838**	**5808**	**5783**
Debt per dwelling £	**£13.215**	**£13.645**	**£13.950**	**£14.355**

3 BORROWING

The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is managed in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the management of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The Council's treasury portfolio position at 1 April 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
External Debt				
Debt at 1 April	£96.198	£98.101	£120.779	£128.892
Expected change in Debt	£1.000	£21.850	£7.360	£2.300
Other long-term liabilities (OLTL)	£0.978	£0.903	£0.828	£0.753
Expected change in OLTL	-£0.075	-£0.075	-£0.075	-£0.075
Actual gross debt at 31 March	**£98.101**	**£120.779**	**£128.892**	**£131.870**
The Capital Financing Requirement	**£128.409**	**£143.998**	**£144.455**	**£144.594**
Under / (over) borrowing	**£29.948**	**£23.219**	**£15.563**	**£12.724**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Finance Director reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Full details of the capital programme can be found as an appendix to the budget report for 2017-18 included within the Policy and Resources Committee February 2017 agenda. Initially to fund the projects short term loans will be used to maximize on very low interest rates. However, longer term borrowing will be required and the timing of this will be critical, to ensure that we secure affordable long term rates for the future.

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The Head of Finance Officer reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in the budget report.

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £'000	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Debt	£130.000	£146.000	£146.000	£147.000
Other long term liabilities	£2.000	£2.000	£2.000	£2.000
Total	£132.000	£148.000	£148.000	£149.000

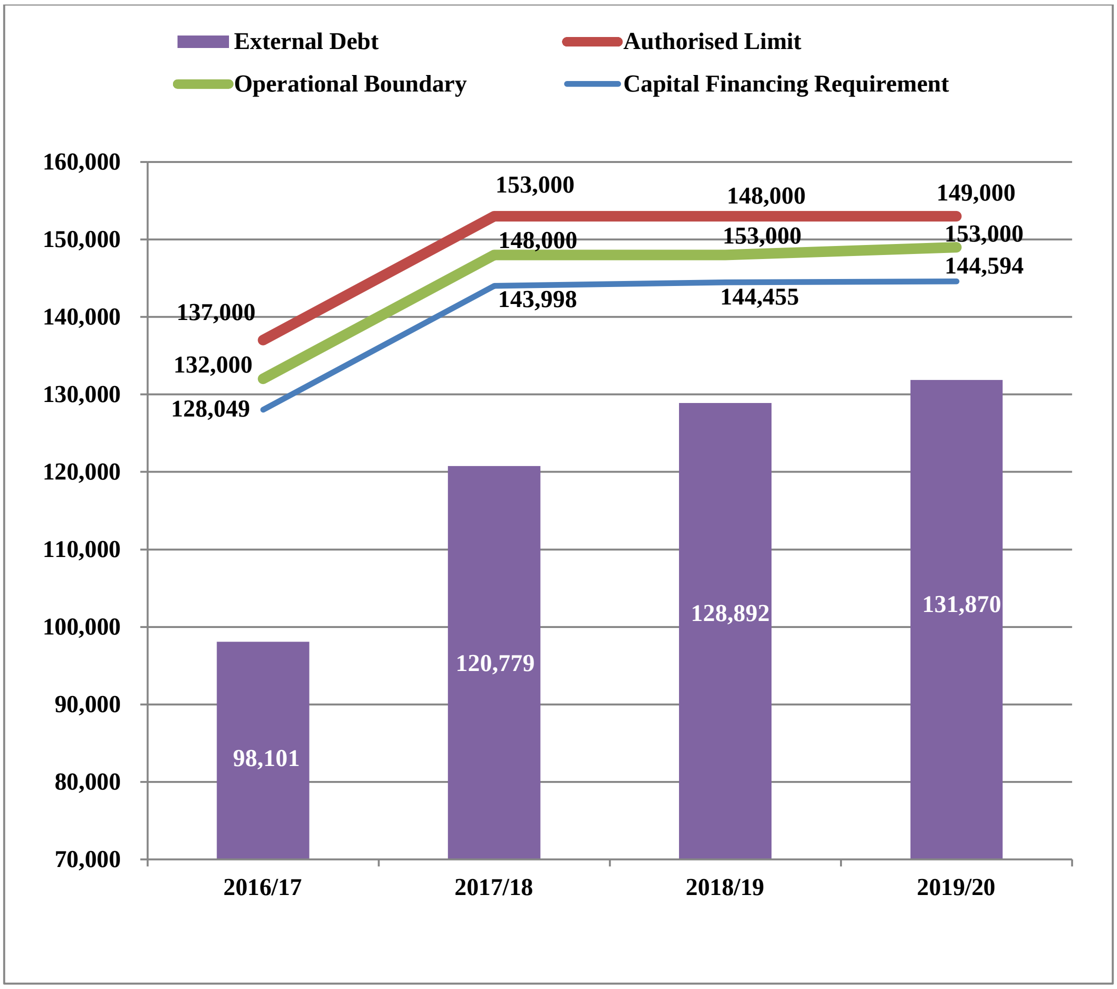
The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

1. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.
2. The Council is asked to approve the following authorised limit:

Authorised limit £'000	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Debt	£135.000	£151.000	£151.000	£152.000
Other long term liabilities	£2.000	£2.000	£2.000	£2.000
Total	£137.000	£153.000	£153.000	£154.000

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £'000	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
HRA debt cap	89.998	89.998	89.998	89.998
HRA CFR	79.651	81.705	83.065	85.058
HRA headroom	10.347	8.293	6.933	4.94



3.3 Prospects for interest rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

	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	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

External and Internation Factors

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August 2016 in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and 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 investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets.

The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the federal. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum December 2016 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election March 2017;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in 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.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- 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.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;

- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

3.4 Borrowing strategy

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

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Finance Director will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast,* perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised. Most likely, fixed rate funding will be drawn whilst interest rates are lower than they are projected to be in the next few years.

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

3.5 Treasury indicators for debt

There are three debt released treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs/improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

The Council is asked to approve the following treasury indicators and limits:

£m	2015/16	2016/17	2017/18
Interest rate exposures			
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	100%	100%	100%
Limits on variable interest rates based on net debt	100%	100%	100%
Maturity structure of fixed interest rate borrowing 2015/16			
		Lower	**Upper**
Under 12 months		0%	20%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%
Maturity structure of variable interest rate borrowing 2015/16			
		Lower	Upper
Under 12 months		0%	20%
12 months to 2 years		0%	40%
2 years to 5 years		0%	60%
5 years to 10 years		0%	80%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%

3.6 Policy on borrowing in advance of need

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.

Risks associated with any borrowing in advance of activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.7 Debt rescheduling

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;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the Council, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The Council's investment policy has regard to the CLG'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, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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

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.

Investment instruments identified for use in the financial year are listed in appendix 5.1 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

4.2 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.

The Finance Director will maintain a counterparty list 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.

Credit rating information is supplied by Capita Asset Services, our treasury advisors, 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. Any rating changes, rating Watches (notification of a likely change), rating Outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating Watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions.

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

- 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 *AAA*

  and have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):
  i. Short Term – *F1, P1*
  ii. Long Term – *A-,A3*
- Banks 2 – Part nationalised UK bank – Royal Bank of Scotland. This bank can be included provided it continues to be part nationalised or it meets the ratings in Banks 1 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 invested.
- Building societies the Council will *use* all societies which:
  i. Meet the ratings for banks outlined above;
  ii. Have assets in excess of *£2bn;*;

  or meet both criteria.
- Money market funds (MMFs) – *AAA*
- Enhanced money market funds (EMMFs) - *AAA*
- UK Government (including gilts and the DMADF)

- Local authorities, parish councils etc
- Supranational institutions

A limit of 30% will be applied to the use of non-specified investments.

Use of additional information other than credit ratings. Additional requirements under the Code require 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. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

Time and monetary limits applying to investments. 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 and/or % Limit	Time Limit
Banks 1 higher quality	***AA***	**£4m**	**3 yrs**
Banks 1 medium quality	***AA***	**£4m**	**1 yr**
Banks 1 lower quality	***A-***	**£3m**	**1 yr**
Banks 2 – part nationalised	**N/A**	**£4m per group**	**1 yr**
Limit 3 category – Council's banker (not meeting Banks 1)	**XXX**	**£3m**	**3 months**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£3m**	**2 yrs**
	Fund rating	**Money and/or % Limit**	**Time Limit**
Money market funds	**AAA**	**£3m per fund**	**liquid**
Enhanced money market funds	**AAA**	**£3m per fund**	**liquid**

The proposed criteria for specified and non-specified investments are shown in Appendix 5.1 for approval.

4.3 Country and sector limits

Due care will be taken to consider the country, group and sector exposure of the Council's investments.

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AAA.* The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.2. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

In addition:

- no more than 10% will be placed with any non-UK country at any time;
- limits in place above will apply to a group of companies;
- sector limits will be monitored regularly for appropriateness.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

	Now
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council’s liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

The Council is asked to approve the treasury indicator and limit: -

Maximum principal sums invested > 364 days

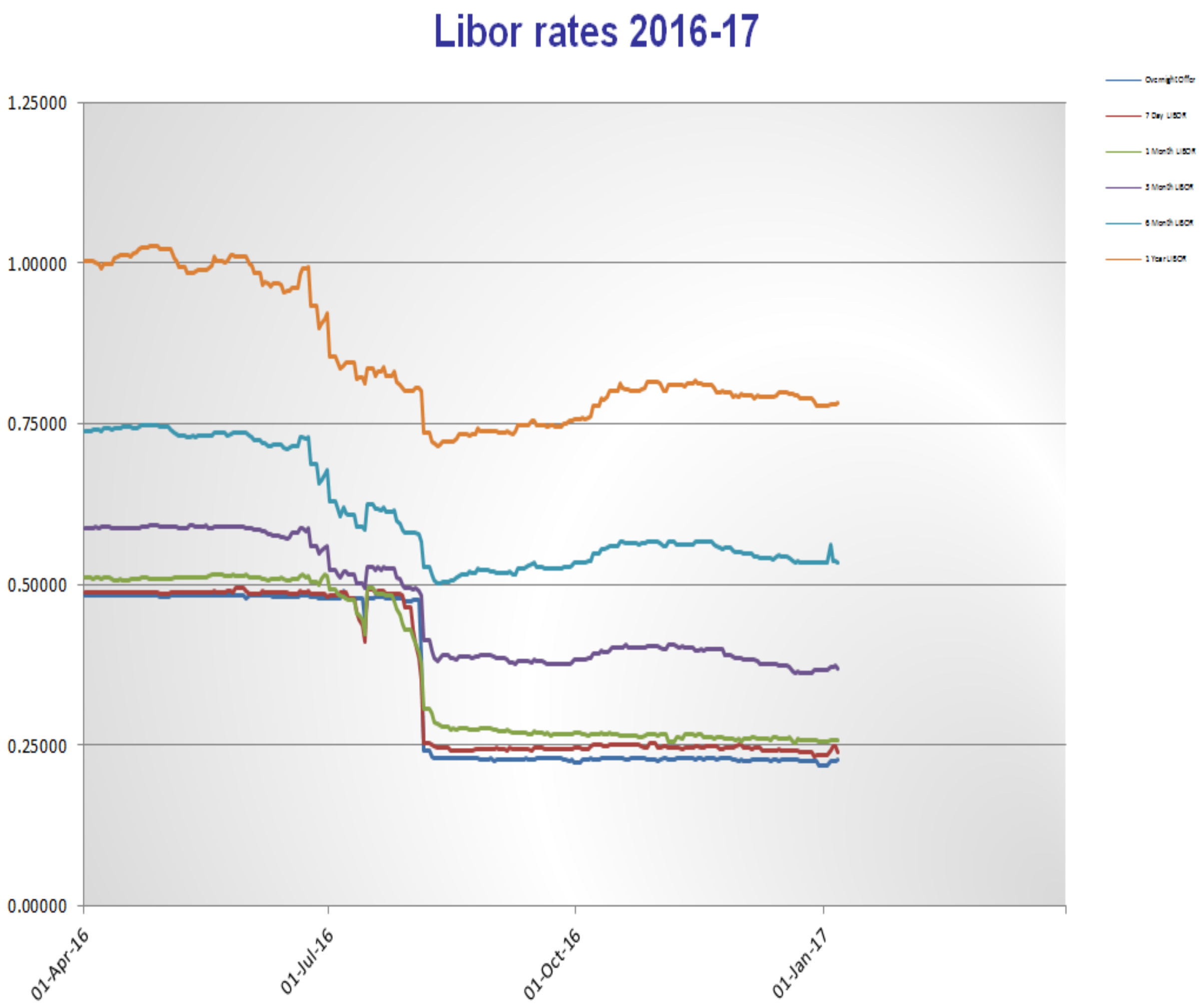
£m	2017/18	2018/19	2019/20
Principal sums invested > 364 days	£2m	£2m	£2m

Against this view the Treasury officers expect £25k.

For its cash flow generated balances, the Council will seek to utilise its business reserve instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

4.5 Investment risk benchmarking

This Council will use an investment benchmark to assess the investment performance of its investment portfolio of 7 day LIBID compounded / uncompounded.



4.6 End of year investment report

At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

4.7 Icelandic bank investments

Icelandic Bank Defaults - In October 2008, the Landsbanki, Kaupthing and Guiltnir collapsed and the UK subsidiaries of the banks, Heritable and Kaupthing Singer and Friedlander went into administration. The authority had £2m deposited with Heritable, with a maturity date of 15 October 2008 and interest rate as follows:

Amount Invested £'000	Interest Rate	Carrying Amount	Received to Date £'000 £'000	Impairment £'000	Principal Default %
2,000	5.87%	2,027	1,905	94	5%

All monies within these institutions are currently subject to the respective administration and receivership processes. The amounts and timing of payments to depositors such as the authority will be determined by the administrators/receivers.

The current situation with regards to recovery of the sums deposited varies between each institution. A payment was received in August 2015 for £80,729. The Authority has exceeded the 95% expected recovery of the original deposit, having now recovered over 98%. It is unlikely any further payments will be received.

5 APPENDICES

1. Treasury management practice 1 – credit and counterparty risk management
2. Approved countries for investments
3. Treasury management scheme of delegation
4. The treasury management role of the Head of Finance officer

5.1 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT

The CLG issued Investment Guidance in 2010, and this forms the structure of the Council's policy below. These guidelines do not apply to either trust funds or pension funds which operate under a different regulatory regime.

The key intention of the Guidance is to maintain the current requirement for councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 25/05/2004 and will apply its principles to all investment activity. In accordance with the Code, the Finance Director has produced its treasury management practices (TMPs). This part, TMP 1(1), covering investment counterparty policy requires approval each year.

Annual investment strategy - The key requirements of both the Code and the investment guidance are to set an annual investment strategy, as part of its annual treasury strategy for the following year, covering the identification and approval of following:

- The strategy guidelines for choosing and placing investments, particularly non-specified investments.
- The principles to be used to determine the maximum periods for which funds can be committed.
- Specified investments that the Council will use. These are high security (i.e. high credit rating, although this is defined by the Council, and no guidelines are given), and high liquidity investments in sterling and with a maturity of no more than a year.
- Non-specified investments, clarifying the greater risk implications, identifying the general types of investment that may be used and a limit to the overall amount of various categories that can be held at any time.

The investment policy proposed for the Council is:

Strategy guidelines – The main strategy guidelines are contained in the body of the treasury strategy statement.

Specified investments – These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

1. The UK Government (such as the Debt Management Account deposit facility, UK treasury bills or a gilt with less than one year to maturity).
2. Supranational bonds of less than one year's duration.
3. A local authority, parish council or community council.
4. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated *AAA* by Standard and Poor's, Moody's and / or Fitch rating agencies.

5. A body that is considered of a high credit quality (such as a bank or building society For category 5 this covers bodies with a minimum Short Term rating of F1,P1 (or the equivalent) as rated by Standard and Poor's, Moody's and / or Fitch rating agencies .

	Fitch Long term Rating (or equivalent)	**Money Limit**	**Time Limit**
Banks 1 higher quality	***AA***	**£4m**	**3 yrs**
Banks 1 medium quality	***AA***	**£4m**	**364 days**
Banks 1 lower quality	***A+***	**£3m**	**364 days yr**
Banks 2 – part nationalised	**N/A**	**£4m per group**	**364 days**
Limit 3 category – Council's banker (not meeting Banks 1)	**A-**	**£3m**	**1 day**
DMADF	**AAA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£3m**	**1 yrs**
Money market funds	**AAA**	**£3m per fund**	**liquid**
Enhanced money market funds	**AAA**	**£3m per fund**	**liquid**

Non-specified investments –are any other type of investment (i.e. not defined as specified above). At present the Council does not have the resources to consider Non-Specified investments.

The monitoring of investment counterparties - The credit rating of counterparties will be monitored regularly. The Council receives credit rating information (changes, rating watches and rating outlooks) from Capita Asset Services as and when ratings change, and counterparties are checked promptly. On occasion ratings may be downgraded when an investment has already been made. The criteria used are such that a minor downgrading should not affect the full receipt of the principal and interest. Any counterparty failing to meet the criteria will be removed from the list immediately by the Finance Director, and if required new counterparties which meet the criteria will be added to the list.

5.2 APPROVED COUNTRIES FOR INVESTMENTS

AAA

- Australia
- Canada
- Denmark
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

5.3 TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) Full board/council

- receiving and reviewing reports on treasury management policies, practices and activities;
- approval of annual strategy.

(ii) Boards/committees/council/responsible body

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- budget consideration and approval;
- approval of the division of responsibilities;
- receiving and reviewing regular monitoring reports and acting on recommendations;
- approving the selection of external service providers and agreeing terms of appointment.

(iii) Body/person(s) with responsibility for scrutiny

- reviewing the treasury management policy and procedures and making recommendations to the responsible body.

5.4 The treasury management role of the Head of Finance officer

The S151 (responsible) officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- submitting regular treasury management policy reports;
- submitting budgets and budget variations;
- receiving and reviewing management information reports;
- reviewing the performance of the treasury management function;
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- ensuring the adequacy of internal audit, and liaising with external audit;
- recommending the appointment of external service providers.