

Report to: **Cabinet**

Date: **24 January 2017**

By: **Chief Operating Officer**

Title of report: **Treasury Management Policy and Strategy 2017/18**

Purpose of report: **This report proposes the Treasury Management Policy and Strategy for 2017/18. The Council is also required to set Prudential Indicators as set out in the Prudential Code which are included in this strategy for approval.**

RECOMMENDATIONS

Cabinet is recommended to recommend the County Council to:

- 1) approve the Treasury Management Policy and Strategy Statement for 2017/18;**
- 2) approve the Prudential and Treasury Indicators 2017/18 to 2019/20; and**
- 3) approve the revised Minimum Revenue Provision (MRP) Policy Statement 2016/17 and 2017/18;**

1. Background

1.1 A requirement under the Chartered Institute for Public Finance and Accountancy (CIPFA) Code of Practice for Treasury Management in the Public Services is to prepare a Treasury Management Policy and Strategy setting out the Council's policies for managing investments and borrowing.

1.2 The Local Government Act 2003 and supporting regulations requires the Council to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

1.3 The proposed Treasury Management Policy and Strategy Statement for 2017/18 is presented in **Appendix 'A'** to this report.

1.4 The strategy includes the Treasury Management Policy Statement, the Treasury Management Strategy Statement, the Annual Investment Strategy, Prudential and Treasury Indicators for the next three years and the annual Minimum Revenue Provision Policy Statement.

1.5 Details of changes and considerations for the 2017/18 borrowing and investment strategies include the following –

- Revised Minimum Revenue Provision policy statement for 2016/17 and 2017/18, as presented to the ABVCS RPPR Scrutiny Board and as discussed at Cabinet Briefing;
- Seek to reduce liquidity where possible and extend duration of investments within current limits. A sensible rebalancing of our liquidity requirements will improve yield without significant additional risk;
- The Council will make use of AAA rated Enhanced Money Market / Cash Funds and the high quality banking institutions from the existing counterparty list;
- Given the low returns from short-term bank investments, the Council should investigate the option of alternative asset classes (i.e., property funds). Diversification into a property fund will be considered during the period of the 2017/18 strategy with the assistance of the Council's treasury advisors (Capita). No investment in such asset class is proposed at this stage, pending a further report to Cabinet and Council that will take into account the views of Scrutiny;

2. Supporting Information

Treasury Management Reporting

2.1 As well as this annual strategy, the CIPFA Code requires the Council reports as a minimum:

- A mid-year review;
- An annual report at the close of the year.

2.2 This Council meets this requirement and also presents a treasury management monitoring position to Cabinet four times a year.

Economic Background

2.3 The Council takes advice from Capita Asset Services on its treasury management activities. A detailed view of the current economic situation and forecasts, as prepared by Capita Asset Services is included in **Appendix 'B'** to this report.

Minimum Revenue Provision (MRP)

2.4 The Council has carried out a review of the Minimum Revenue Provision (MRP) and look at the options for re-profiling the existing provision to generate revenue savings (Appendix C). The outcome of the review is that the Council is proposing to change its method of calculating MRP on debt prior to 2008 from a reducing balance to a straight line fixed period (45 year) of write down. This would bring the methodology in line with how MRP is calculated for post 2008 debt using the asset life method. The Council's external auditors have been consulted on the outcome of the MRP review.

3. Conclusion and recommendations

3.1 This policy sets out the acceptable limits on ratings, investment periods, amounts to be invested and the borrowing strategy. Cabinet will be aware that the financial position is kept under constant review and if at any time it is felt that any of these limits represent an unacceptable risk appropriate and immediate action will be taken accordingly.

3.2 Cabinet is recommended to recommend the Treasury Management Policy and Strategy Statement 2017/18 for approval by the County Council.

KEVIN FOSTER

Chief Operating Officer

Contact Officer: Ola Owolabi, Head of Accounts and Pensions

Tel. No. 01273 482017

Email: Ola.Owolabi@eastsussex.gov.uk

Local Member(s): All

BACKGROUND DOCUMENTS

CIPFA Prudential Code /CIPFA Treasury Management in the Public Services - Code of Practice

Local Government Act 2003 Local Government Investments

CLG Capital Finance – Guidance on the Minimum Revenue Provision.

TREASURY MANAGEMENT POLICY AND STRATEGY 2017/18



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1. INTRODUCTION

The Treasury Management Policy and Strategy is one of the Council's key financial strategy documents and sets out the Council's approach to the management of its treasury management activities.

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

Another part of the treasury management service is the funding of the Council's capital programme. The capital programme provides a guide to longer cash flow planning to ensure that the Council can meet its capital investment requirement.

The Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

'the management of the 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'.

The Local Government Act 2003 and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy. This sets out the Council's policies for managing investments and for giving priority to the security and liquidity of those investments.

This strategy is updated annually to reflect changes in circumstances that may affect the strategy.

2. CIPFA REQUIREMENTS

The Council has adopted the Chartered Institute of Public Finance and Accountancy's Code of Practice on Treasury Management (Revised 2011).

The primary requirements of the Code are as follows:

- Creation and maintenance of a Treasury Management Policy Statement stating the policies, objectives and approach to risk management of the Council's treasury management activities (Section 3).
- Creation and maintenance of suitable Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities (Section 4).
- Receipt by Full Council of an annual Treasury Management Strategy Statement (Section 5) including the Annual Investment Strategy (Section 6) and the Minimum Revenue Provision Policy (Section 7) for the year ahead.

- Production of a mid-year review report and an annual report covering activities during the previous year (this Council also presents a quarterly monitoring report to Cabinet).
- Delegation by the Council of responsibilities for implementing and regular monitoring of its treasury management policies and practices and for the execution and administration of treasury management decisions (this Council delegates responsibility for implementation and monitoring treasury management to Cabinet and responsibility for the execution and administration of treasury management decisions to the Section 151 Officer. The role of the Section 151 Officer in treasury management is described in Section 8).
- Delegation by the Council of the role of scrutiny for treasury management strategy and policies to a specific named body (this Council delegates this responsibility to the Audit, Best Value and Community Services Scrutiny Committee).

3. TREASURY MANAGEMENT POLICY STATEMENT

The policies and objectives of the Council's treasury management activities are as follows:

1. This Council defines its treasury management activities as

'The management of the 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. 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, and any financial instruments entered into to manage these risks.

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 value for money in treasury management, and to employing suitable comprehensive performance management techniques, within the context of effective risk management.

4. TREASURY MANAGEMENT PRACTICES

The Council has created and maintains the following Treasury Management Practices (TMPs). These TMPs set out the manner in which the Council will seek to achieve its policies and objectives and how it will manage and control these activities.

TMP 1: Risk Management

TMP 2: Performance Management

TMP 3: Decision making and analysis

TMP 4: Approved instruments, methods and techniques

TMP 5: Organisation, clarity and segregation of responsibilities and dealing arrangements

TMP 6: Reporting requirements and management information arrangements

TMP 7: Budgeting, accounting and audit arrangements

TMP 8: Cash and cash flow management

TMP 9: Money laundering

TMP 10: Training and qualifications

TMP 11: Use of external service providers

TMP 12: Corporate governance

The Treasury Management Practices are regularly updated and further details of these can be found within the Accounts and Pensions Team.

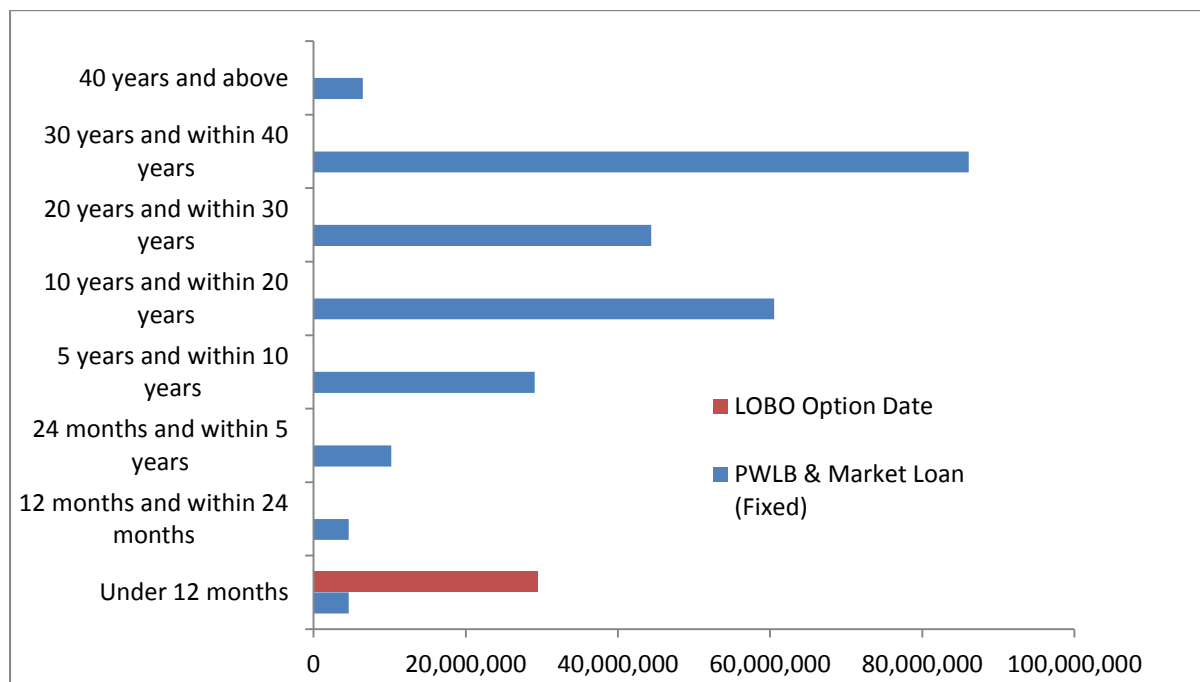
5. TREASURY MANAGEMENT STRATEGY STATEMENT

5.1 Current Investment & Borrowing Position

During 2016/17, the Council had average investments of £275 million, and the forecast for the year end is within the range of £260 to £280 million. The forecast average interest rate for the year is 0.55%, compared to the bank base rate of 0.25%. The investments will provide investment income of approximately £1.8 million in 2016/17.

The Council's long-term external borrowing (excluding PFI and finance lease arrangements) is projected to be £275.4m at 31 March 2017 with the majority sourced from the Public Works Loan Board (PWLB) at fixed interest rates of between 2.60% - 8.63%, with a weighted average rate of 4.82%. The PWLB allows local authorities to repay loans early and either pay a premium or obtain a discount according to a formula based on current interest rates.

The Council's debt maturity profile as at 31 December 2016, showing the outstanding level of loans each year, is shown in **Graph 1** below:



5.2 Prospects for Interest Rates

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the result of the EU referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

The economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The 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. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The Council has appointed Capita Asset Services as its treasury advisors and part of their service is to assist the Council to formulate a view on interest rates. Table 1 below gives the Capita Asset Services central view for short term (Bank Rate) and longer fixed interest rates.

Table 1	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2016	0.25	1.60	2.90	2.70
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00
Dec 2019	0.50	2.00	3.30	3.10
Mar 2020	0.50	2.00	3.40	3.20

The Monetary Policy Committee (MPC) meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. There is a risk of a cut in Bank Rate if economic growth were to take a significant dip downwards. Forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on any forecasts.

The current economic outlook and structure of market interest rates and government debt yields have several key treasury management implications:

- Investment returns are likely to remain relatively low during 2017/18 and beyond;
- Borrowing interest rates have been highly volatile during 2016 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields have continued to remain at historically low levels during 2016. 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 the Council will not be able to avoid new borrowing to fund capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new borrowing unless immediately spent as it will cause an increase in investments and this will incur a revenue loss between borrowing costs and investment returns as well as increased counterparty risks.

5.3 Borrowing Strategy

Capital Investment can be paid for using cash from one or more of the following sources:

- i. Cash from existing and/or new capital resources (e.g. capital grants, receipts from asset sales, revenue contributions or earmarked reserves);
- ii. Cash raised by borrowing externally;
- iii. Cash being held for other purposes (e.g. earmarked reserves or working capital) but used in the short term for capital investment. This is known as 'internal borrowing' as there will be a future need to borrow externally once the cash is required for the other purposes.

Under the Cipfa Prudential Code an authority is responsible for deciding its own level of affordable borrowing within set prudential indicator limits (see section 5.4).

Borrowing does not have to take place immediately to finance its related capital investment and may be deferred or borrowed in advance of need within policy. The Council's primary objective when borrowing is to strike an appropriately low risk balance between securing low interest rates and achieving cost certainty over the period for which funds are required.

The amount that notionally should have been borrowed is known as the **capital financing requirement (CFR)**. The CFR and actual borrowing may be different at a point in time and the difference is either an under or over borrowing amount.

The Council is required to repay an element of the CFR each year through a revenue charge. This is known as the minimum revenue provision (MRP) and is currently estimated (revised) to be £7.4m for 2016/17. MRP will cause a reduction in the CFR annually.

When MRP is not required to repay debt, it will accumulate as cash balances which will then be invested. **Graph 1** shows that most of the Council's debt is long dated and matures from 2045. Investment balances will therefore be increased by MRP each year until the debt is repaid.

External borrowing has not been needed over the past few years in order to reduce the cost of carry at a time when investment returns are low and counterparty risks continue to be relatively high.

Strategy for 2017/18

The Council's 'Draft Revenue Budget and Capital Programme 2016/17 to 2020/21' forecasts £415m of capital investment over the next four years with £334m met from existing or new resources. The amount of new borrowing required over this period is therefore £81m as shown in **Table 2** below.

Table 2	2016/17 Projected	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	Total
	£m	£m	£m	£m	£m	£m
Capital Expenditure	92	95	84	77	67	415
Financed by: Capital Reserves, Capital Grants, Capital Receipts, Revenue Contributions	(72)	(69)	(69)	(65)	(59)	(334)
Borrowing Need	20	26	15	12	8	81

As existing and new resources are insufficient, borrowing of £81m will be met initially from internal borrowing. By essentially lending the Council's own surplus funds to itself, the Council will minimise borrowing costs and reduce overall treasury risk by reducing the level of external investments.

With official interest rates forecast to remain low, an internal borrowing strategy could be viewed as being beneficial but is unsustainable in the longer-term. The benefits of internally borrowing will be monitored against the potential for incurring additional costs through deferring new external borrowing into future years when long-term borrowing rates are forecast to rise.

Table 3 below includes the figures from Table 2 and shows the actual external borrowing against the capital financing requirement, identifying any under or over borrowing.

Table 3	2016/17 Projected	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
	£m	£m	£m	£m	£m
Borrowing at 1 April	280	275	270	265	261
less loan maturities	(5)	(5)	(5)	(4)	(3)
Borrowing at 31 March	275	270	265	261	258
CFR at 1 April	247	259	277	284	288
Net Capital Expenditure	20	26	15	12	8
MRP	(8)	(8)	(8)	(8)	(8)
CFR at 31 March	259	277	284	288	288
Under/(over) borrowing	(16)	7	19	27	30

The Council is currently maintaining an over-borrowed position as it took advantage of historic low borrowing rates. As at the end of 2016/17 the Council is projected to be over borrowed by £16m, moving to a under borrowing of £7m in 2017/18 if no external borrowing is undertaken. This means that the capital borrowing need has not been fully funded with loan debt and cash supporting the Council's reserves, balances and cash flow has been used as a short term measure.

PWLB Transfer of Function

The Treasury launched a consultation over the summer proposing to abolish the PWLB in its current form and transfer the functions to another body. The government's preferred approach is to transfer the PWLB's powers to the Treasury, with operational responsibility delegated to the Debt Management Office. CAS don't believe these changes will have any tangible impact on our ability to borrow with regard to the manner that we currently do.

Borrowing other than with the PWLB

The Council has previously borrowed mainly from the PWLB, but will continue to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates. Any new borrowing taken out will be completed with regard to the limits, indicators, the economic environment, the cost of carrying this debt ahead of need, and interest rate forecasts. The S151 Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances.

One such other source has been **LOBO** (Lender Option Borrower Option) type loans. The Council's debt portfolio contains £29.45m of these products (see **Graph 1**), which could be "called" during 2017/18 the interest paid on our LOBO debt is between 3.75% - 4.39%. A LOBO is called when the Lender (Banks) exercises its right to amend the interest rate on the loan at which point the Borrower (the Council) can accept the revised terms or reject them and repay the loan. LOBO loans present a potential refinancing risk to the Council since the decision to call a LOBO is entirely at the lender's discretion.

The **Local Capital Finance Company Limited (Municipal Bond Agency)**, potentially could be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the PWLB. This Council has approval to make use of this new source of borrowing as and when appropriate.

The Local Capital Finance Company Limited claims that local authority financing costs could be reduced by up to a prudent 0.20% to 0.25% compared to the certainty rate provided by the PWLB. The Company will offer competition to PWLB but as a result the PWLB could react by reducing its own margins thereby making the Local Capital Finance Company Limited rate unattractive for local authority borrowers. Whilst it is difficult to predict the reaction to the establishment of the Local Capital Finance Company Limited, either way, it has the potential for local authorities to access lower borrowing rates.

Policy on Borrowing in Advance of Need

The Council will not borrow purely in order to profit from investment of extra sums borrowed. Any decision to borrow in advance will be within 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 activity will be subject to prior appraisal and subsequent reporting.

Debt Rescheduling

Officers continue to regularly review opportunities for debt rescheduling, but there has been a considerable widening of the difference between new borrowing and repayment rates, which has made PWLB debt restructuring now much less attractive. Consideration would have to be given to the large premiums (cash payments) which would be incurred by prematurely repaying existing PWLB loans. It is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing. However, some interest savings might still be achievable through using LOBO loans, and other market loans, in rescheduling exercises rather than using PWLB borrowing as the source of replacement financing.

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).

The strategy is to continue to seek opportunity to reduce the overall level of Council's debt where prudent to do so, thus providing in future years cost reduction in terms of lower debt repayments costs, and 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 agreed by the S151 Officer.

Continual Review

Treasury officers continue to review the need to borrow taking into consideration the potential increases in borrowing costs, the need to finance new capital expenditure, refinancing maturing debt, and the cost of carry that might incur a revenue loss between borrowing costs and investment returns.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Chief Finance Officer will continue to 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 sharp fall in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.
- 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 with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

5.4 Prudential and Treasury Indicators 2017/18 to 2020/21

The Council's capital expenditure plans are a key driver of treasury management activities. The output of the capital expenditure plans are reflected in prudential indicators. Local Authorities are required to 'have regard to' the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable. The Code sets out the indicators that must be used but does not suggest limits or ratios as these are for the authority to set itself.

The Prudential Indicators for 2017/18 to 2020/21 are set out in **Table 4** below:

Table 4	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Expenditure £m (gross) Council's capital expenditure plans	£95m	£84m	£77m	£67m
Capital Financing Requirement £m Measures the underlying need to borrow for capital purposes (including PFI & Leases) as at 31 st March	£366m	£369m	£369m	£368m
Ratio of financing costs to net revenue stream Identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against net revenue stream	5.55%	5.52%	5.22%	4.99%
Incremental impact of capital investment decisions on council tax Identifies the revenue costs associated with proposed changes to the three year programme compared to the existing approved commitments	0.00	0.00	0.00	0.00

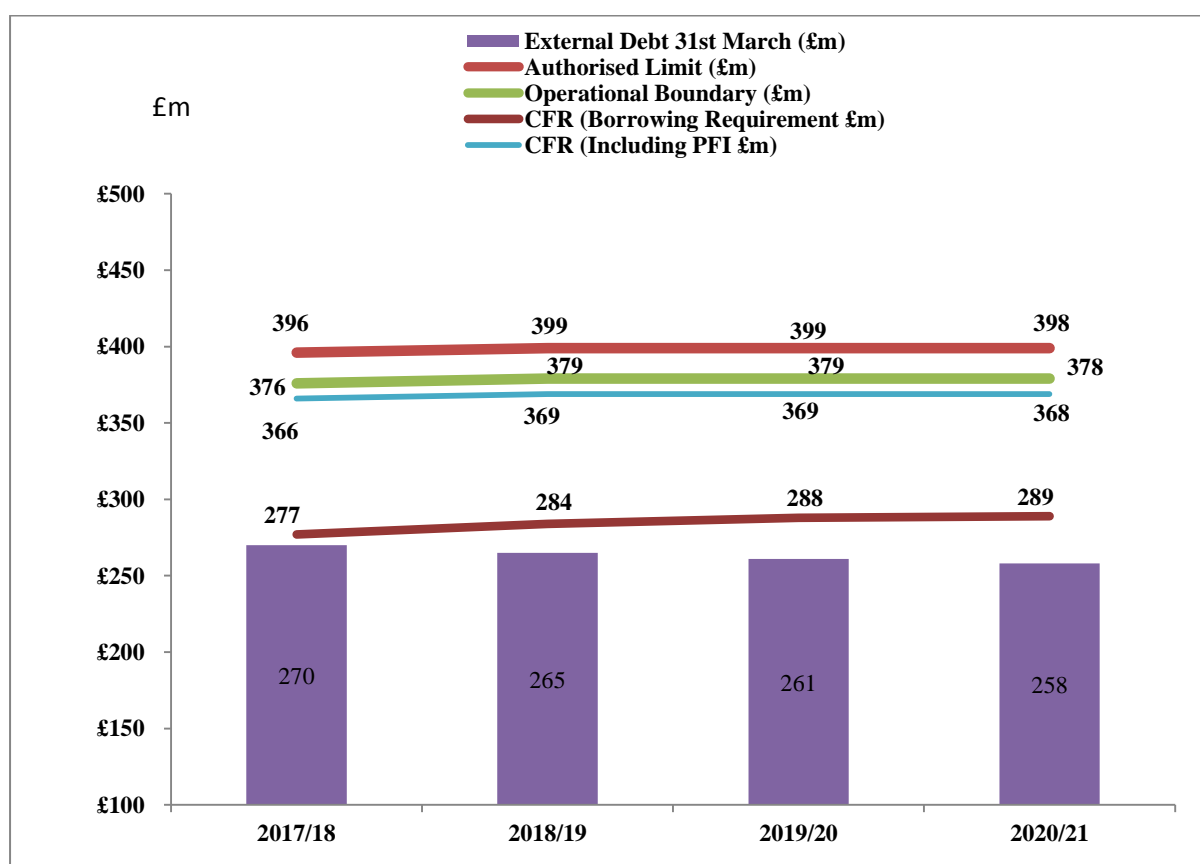
The Treasury Management Code requires that Local Authorities set a number of indicators for treasury performance in addition to the Prudential Indicators which fall under the Prudential Code. The Treasury Indicators for 2017/18 to 2019/20 are set out in **Table 5** below:

Table 5	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Authorised Limit for External Debt £m* The Council is expected to set a maximum authorised limit for external debt. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by Full Council.	£396m	£399m	£399m	£398m
Operational boundary for external debt £m* The Council is required to set an operational boundary for external debt. This is the limit which external debt is not normally expected to exceed. This indicator may be breached temporarily for operational reasons.	£376m	£379m	£379m	£378m
Upper limit for fixed interest rate exposure* Identifies a maximum limit for fixed interest rates for borrowing and investments.	100%	100%	100%	100%
Upper limit for variable interest rate exposure* Identifies a maximum limit for variable interest rates for borrowing and investments.	15%	15%	15%	15%

Maturity Structure of Borrowings*				
The Council needs to set upper and lower limits with respect to the maturity structure of its borrowing				
Upper limit for under 12 months	25%	25%	25%	25%
Lower limit for under 12 months	0%	0%	0%	0%
Upper limit for 12 months to 2 years	40%	40%	40%	40%
Lower limit for over 12 months to 2 years	0%	0%	0%	0%
Upper limit for 2 years to 5 years	60%	60%	60%	60%
Lower limit for 2 years to 5 years	0%	0%	0%	0%
Upper limit for 5 years to 10 years	70%	70%	70%	70%
Lower limit for 5 years to 10 years	0%	0%	0%	0%
Upper limit for over 10 years	90%	90%	90%	90%
Lower limit for over 10 years	0%	0%	0%	0%

Note-

**the Treasury Indicators above have been calculated and determined by Officers in compliance with the Treasury Management Code of Practice.*



6. ANNUAL INVESTMENT STRATEGY

6.1 Investment Policy

The Council's investment policy has regard to the DCLG's Guidance on Local Government Investments and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes. The Council's investment priorities are:

- i. the security of capital;
- ii. the liquidity of its investments;
- iii. the yield (return).

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give more priority to the security of its investments.

In accordance with guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council stipulates the minimum acceptable credit quality of counterparties for inclusion on the counterparty lending list.

Furthermore, the Council recognises 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 in relation to the economic and political environments in which institutes operate. The borrowing of monies purely to invest or on-lend and make a return is not permitted and the Council will not engage in such activity.

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 (i.e., 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:

Year	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%

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

6.2 Specified and Non-Specified Investments

An investment is a **specified investment** if all of the following apply:

- the investment is denominated in sterling and any payments or repayments in respect of the investment are payable only in sterling;
- the investment is not a long term investment (i.e. up to 364 days);
- the making of the investment is not defined as capital expenditure by virtue of regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003 [SI 3146 as amended];

- the investment is made with a body or in an investment scheme of high credit quality (i.e. a minimum credit rating as outlined in this strategy) or with one of the following public-sector bodies:
 - The United Kingdom Government;
 - A local authority in England or Wales (as defined under section 23 of the 2003 Act) or a similar body in Scotland or Northern Ireland;

Strategy for 2017/18

For 2017/18 it is recommended to include sovereign nations and their banks which hold either a AAA or AA+ rating, with the exception of the UK which is currently rated AA by two of the three rating agencies (Aa1 Moody's). Maximum investment limits and duration periods will remain the same as in the previous strategy at £60 million and one year respectively. The list of countries that qualify using this credit criteria (as at the date of this report) are shown below:

AAA Australia, Canada, Denmark, Germany, Netherlands, Singapore, Sweden and Switzerland

AA+ Finland and USA.

AA UK (S&P and Fitch)

Creditworthiness Policy

The Treasury Management Strategy needs to set limits on the amount of money and the time period the Council can invest with any given counterparty. In order to do this the Council uses the Credit Rating given to the counterparty by the three main Credit Rating Agencies (Fitch, Moody's and Standard and Poor's). This forms part of the consistent risk based approach that is used across all of the financial strategies.

Treasury Officers regularly review both the investment portfolio and counterparty risk and make use of market data to inform their decision making. The officers are members of various benchmarking groups to ensure the investment portfolio is current and performing as other similar sized Local Authorities.

The Council as part of its due diligence in managing creditworthiness, uses amongst other information, a tool provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three credit rating agencies.

The Capita Asset Services credit worthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue reliance to just one agency's ratings.

This modelling approach combines credit ratings with the following overlays:

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

This weighted scoring system then produces an end product of 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.

The Council will therefore use counterparties within the following durational bands provided they have a minimum AA+ sovereign rating from three rating agencies:

- Yellow 5 years
- Purple 2 years
- Blue 1 year (*semi nationalised UK Bank – NatWest/RBS*)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour Not to be used

Y	P	B	O	R	G	N/C
Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yrs	Up to 6 months	Up to 100 days	Not to be used

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of 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.

The primary principle governing the Council's investment criteria is the security of its investments, although the 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 and the criteria for choosing investment counterparties with adequate security, and monitoring their security;
- It has sufficient liquidity in its investments.

All credit ratings are monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services credit worthiness service. If a downgrade results in the counterparty or investment scheme no longer meeting the Council's minimum criteria, its 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 re movements in Credit Default Swap 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.

The counterparties in which the Council will invest its cash surpluses is based on officers assessment of investment security, risk factors, market intelligence, a diverse but manageable portfolio and their participation in the local authority market.

Table 6 below summarises the types of specified investment counterparties available to the Council, and the maximum amount and maturity periods placed on each of these. Further details are contained in section 10.

Enhanced Money Market / Cash Funds

Is a fund designed to produce an enhanced return which typically requires the fund manager to take more risk than an instant access cash money market fund. The manager achieves this by investing their portfolio with a longer weighted average maturity (WAM). These funds can be AAA rated by credit rating agencies and are to be used by the Council to hold funds in the 3-12 month duration but notice to have funds returned can be given within 2-4 days (depending on the fund). The Council will use our treasury advisors and conduct due diligence before selecting any fund to ensure it matches our prudent approach to investments.

Criteria for Specified Investments:

Table 6	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Debt Management and Deposit Facilities (DMADF)	UK	Term Deposits (TD)	unlimited	1 yr
Government Treasury bills	UK	TD	unlimited	1 yr
Local Authorities	UK	TD	unlimited	1 yr
Lloyds Banking Group • Lloyds Bank • Bank of Scotland	UK	TD (including callable deposits), Certificate of Deposits (CD's)	£60m	1 yr
RBS/NatWest Group • Royal Bank of Scotland • NatWest	UK		£60m	1 yr
HSBC	UK		£60m	1 yr
Barclays	UK		£60m	1 yr
Santander	UK		£60m	1 yr
Goldman Sachs Investment Bank	UK		£60m	1 yr
Standard Chartered Bank	UK		£60m	1 yr
Individual Money Market Funds (MMF)	UK/Ireland/ domiciled	AAA rated Money Market Funds	£60m	Liquidity/instant access
Enhanced Money Market / Cash Funds (EMMFs)	UK/Ireland/ EU domiciled	AAA Bond Fund Rating	£60m	Liquidity
Counterparties in select countries (non-UK) with a Sovereign Rating of at least AA+				
Australia & New Zealand Banking Group	Australia	TD / CD's	£60m	1 yr
Commonwealth Bank of Australia	Australia	TD / CD's	£60m	1 yr
National Australia Bank	Australia	TD / CD's	£60m	1 yr
Westpac Banking Corporation	Australia	TD / CD's	£60m	1 yr
Royal Bank of Canada	Canada	TD / CD's	£60m	1 yr

Table 6	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Toronto Dominion	Canada	TD / CD's	£60m	1 yr
Development Bank of Singapore	Singapore	TD / CD's	£60m	1 yr
Overseas Chinese Banking Corp	Singapore	TD / CD's	£60m	1 yr
United Overseas Bank	Singapore	TD / CD's	£60m	1 yr
Svenska Handelsbanken	Sweden	TD / CD's	£60m	1 yr
Nordea Bank AB	Sweden	TD / CD's	£60m	1 yr
ABN Amro Bank	Netherlands	TD / CD's	£60m	1 yr
Rabobank	Netherlands	TD / CD's	£60m	1 yr
ING Bank NV	Netherlands	TD / CD's	£60m	1 yr
DZ Bank	Germany	TD / CD's	£60m	1 yr
UBS	Switzerland	TD / CD's	£60m	1 yr
Credit Suisse	Switzerland	TD / CD's	£60m	1 yr
Danske Bank	Denmark	TD / CD's	£60m	1 yr
Nordea Bank	Finland	TD / CD's	£60m	1 yr
JP Morgan Chase	U.S.A	TD / CD's	£60m	1 yr

Non-Specified investments are any other types of investment that are not defined as specified. The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out in **Table 7** below.

Non specified investments would include any sterling investments and the purchase of shares in the Municipal Bonds Agency (Local Capital Finance Company Limited). The Council will make an investment in the form of shares in the Municipal Bond Agency (Local Capital Finance Company Limited) where the primary purpose is to support the Council's priorities rather than to speculate on the capital sum invested. With the exception of the municipal bonds agency investment, only investments where there is no contractual risk to the capital invested and where the rate of return justifies their use will be entered into.

Table 7	Minimum credit criteria	Maximum investments	Max. maturity period
UK Local Authorities	Government Backed	£60m	2 years
Local Capital Finance Company Limited	Local Government Agency Backed	£100k	N/A

A detailed list of specified and non-specified investments that form the counterparty list is shown in section 10.

Investment in Pooled Property Funds

Local authorities have for many years invested in non-liquid assets or property by directly purchasing properties, but a simpler and more efficient route would be to invest in an appropriate property unit trust. This is a more diversified form of investment than an individual purchase of property and would give greater geographic spread and access to assets that the Council could not afford to own through use of its own resources.

A property investment fund should be considered as a long term investment and should only be committed to if the Council is prepared to accept that in some years capital values may decline, but in the longer run capital growth should be possible. If a fund achieves its objectives then the Council will achieve capital growth and reasonable returns.

Property Fund offers all the advantages of a professionally managed property portfolio, with broadly diversified exposure to high quality properties in the strongest areas of the market. By investing in the Fund, the Council avoid the potential problems, costs and administrative difficulties of investing in properties directly.

Officers in conjunction with the Council's treasury advisors will be reviewing other investment options that are not currently included within our 2017/18 Strategy, which will include investment in property funds.

6.3 Risk and Sensitivity Analysis

Treasury management risks are identified in the Council's approved Treasury Management Practices. The main risks to the Council's treasury activities are:

- liquidity risk (inadequate cash resources);
- market or interest rate risk (fluctuations in interest rate levels and thereby in the value of investments);
- inflation risks (exposure to inflation);
- credit and counterparty risk (security of investments);
- refinancing risks (impact of debt maturing in future years); and
- legal and regulatory risk (i.e. non-compliance with statutory and regulatory requirements, risk of fraud).

Treasury Officers, in conjunction with the treasury advisers, will monitor these risks closely and particular focus will be applied to:

- the global economy – indicators and their impact on interest rates will be monitored closely. Investment and borrowing portfolios will be positioned according to changes in the global economic climate;
- Counterparty risk – the Council follows a robust credit worthiness methodology and continues to monitor counterparties and sovereign ratings closely particularly within the Eurozone.

7. MINIMUM REVENUE PROVISION POLICY STATEMENT

The statutory requirement for local authorities to charge the Revenue Account each year with a specific sum for debt repayment. A variety of options is provided to councils to determine for the financial year an amount of minimum revenue provision (MRP) that it considers to be prudent. This replaces the previous requirement that the minimum sum should be 4% of the Council's Capital Financing Requirement (CFR).

A Statement on the Council's policy for its annual MRP should be submitted to the Full Council for approval before the start the financial year to which the provision relate. The Council is therefore legally obliged to have regard to CLG MRP guidance in the same way as applies to other statutory guidance such as the CIPFA Prudential Code, the CIPFA Treasury Management Code and the CLG guidance on Investments.

The MRP guidance offers four options under which MRP might be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is commensurate with that over which the capital expenditure is estimated to provide benefits (i.e. estimated useful life of the asset being financed).

The guidance also requires an annual review of MRP policy being undertaken and it is appropriate that this is done as part of this annual Treasury Management Policy and Strategy.

The International Financial Reporting Standards (IFRS) involves Private Finance Initiative (PFI) contracts and some leases (being reclassified as finance leases instead of operating leases) coming onto the Council's Balance Sheet as long term liabilities. This accounting treatment impacts on the Capital Financing Requirement with an annual MRP provision being required.

To ensure that this change has no overall financial impact on Local Authorities, the Government has updated their "Statutory MRP Guidance" which allows MRP to be equivalent to the existing lease rental payments and "capital repayment element" of annual payments. The implications of these changes are reflected in the Council's MRP policy from 2016/17.

The revised policy recommended for adoption from 1 April 2016 and 1 April 2017 retains the key elements of the policy previously approved including provisions regarding PFI, closed landfill, and finance leases. The ongoing policy from 2016/17 and future years is therefore as follows:-

For borrowing incurred before 1 April 2008, the MRP policy will be:

- Straight line basis over the next 45 years to coincide with the repayment of external debt.

From borrowing incurred after 1 April 2008, the MRP policy will be:

- Asset Life Method (equal instalment method) – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations. This option will also be applied for any expenditure capitalised under a capitalisation directive.

For PFI schemes, finance leases and closed landfill sites that come onto the Balance Sheet, the MRP policy will be:

- Asset Life Method (annuity method) - The MRP will be calculated according to the flow of benefits from the asset, and where the principal repayments increase over the life of the

asset. Any related MRP will be equivalent to the “capital repayment element” of the annual charge payable.

There is the option to charge more than the prudent provision of MRP each year through a Voluntary Revenue Provision (VRP).

For loans to third parties that are being used to fund expenditure that is classed as capital in nature, the policy will be to set aside the repayments of principal as capital receipts to finance the initial capital advance in lieu of making an MRP.

In view of the variety of different types of capital expenditure incurred by the Council, which is not in all cases capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure.

This approach also allows the Council to defer the introduction of an MRP charge for new capital projects/land purchases until the year after the new asset becomes operational rather than in the year borrowing is required to finance the capital spending. This approach is beneficial for projects that take more than one year to complete and is therefore included as part of the MRP policy.

Half-yearly review of the Council's MRP Policy will be undertaken and reported to Members as part of the Mid-Year Treasury Management Strategy report.

8. SCHEME OF DELEGATION

1. Full Council

In line with best practice, Full Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals. These reports are:

i. Treasury Management Policy and Strategy Report

The report covers:

- the capital plans (including prudential indicators);
- a Minimum Revenue Provision 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).

ii. A Mid-Year Review Report and a Year End Stewardship Report

These will update members with the progress of the capital position, amending prudential indicators as necessary, and indicating whether the treasury strategy is meeting the strategy or whether any policies require revision. The reports also provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

2. Cabinet

- Approval of the Treasury Management quarterly update reports;
- Approval of the Treasury Management outturn report.

3. Audit, Best Value and Community Services Scrutiny Committee

- Scrutiny of performance against the strategy.

4. Role of the Section 151 Officer

The Section 151 (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.

5. Training

Treasury Management training for committee members will be delivered as required to facilitate more informed decision making and challenge processes.

9. OTHER TREASURY ISSUES

9.1 Banking Services

NatWest, which is part Government owned, currently provides banking services for the Council.

9.2 Policy on the use of External Service Providers

The Council uses Capita Asset Services as its external treasury management advisors. The Council recognises that responsibility for treasury management decisions remains with the Council 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. Such a review is due by 31st March 2017.

9.3 Lending to third parties

The Council has the power to lend monies to third parties subject to a number of criteria. These are not treasury type investments rather they are policy investments. Any activity will only take place after relevant due diligence has been undertaken. Loans of this nature will be approved by Cabinet. The primary aims of the Investment Strategy are the security of its capital, liquidity of its capital and to obtain a return on its capital commensurate with levels of security and liquidity. These aims are crucial in determining whether to proceed with a potential loan.

In order to ensure security of the Council's capital, extensive financial due diligence must be completed prior to any loan or investment being agreed. The Council will use specialist advisors to complete financial checks to ascertain the creditworthiness of the third party. Where deemed necessary, additional guarantees will be sought. This will be via security against assets and/or through guarantees from a parent company.

9.4 MiFID II – (The Markets in Financial Instruments Directive)

MiFID is the EU legislation that regulates firms who provide services to clients linked to 'financial instruments' (shares, bonds, units in collective investment schemes and derivatives), and the venues where those instruments are traded. The new MiFID II environment is set to commence on the 3rd January 2018. Within this new regulation there is a key change affecting Local Authorities. Under the new regime LA's will be deemed 'Retail' clients by default potentially restricting access to certain types of Investment. The Treasury Team will be working closely with our advisors and counterparties in the run up to January 2018 to consider options for the Council to 'opt-up' to 'Professional' client status.

9.5 EU Money Market Fund Reform

The EU parliament has been striving to reform MMF's that operate within the EU, the key proposal may require funds to move from Constant net asset value (CNAV) to Low Volatility net asset value (LVNAV). At the present time, there has been no issuance of draft regulations outlining the new reforms in significant detail. The expected time horizon for full implementation is likely to be up to two years. This would mean that no changes to Investment Strategy documents at the moment but consideration should be given in future strategies.

10. Counterparty List 2017/18

Bank with duration colour	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	ESCC Duration	Capita Duration Limit	Money Limit
Specified Investments:		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
Lloyds Banking Group:													
Lloyds Bank	UK	A+	F1	a	5	A1	P-1	A	A-1	76.8	6	6	60
Bank of Scotland	UK	A+	F1	a	5	A1	P-1	A	A-1	72.3	6	6	
RBS/NatWest Group:													
NatWest Bank	UK	BBB+	F2	bbb+	5	A3	P-2	BBB+	A-2	-	12	12	60
Royal Bank of Scotland	UK	BBB+	F2	Bbb+	5	Ba1	P-2	BBB+	A-2	127.1	12	12	
HSBC Bank	UK	AA-	F1+	a+	1	Aa2	P-1	AA-	A-1+	75.8	12	12	60
Barclays Bank	UK	A	F1	a	5	A2	P-1	A-	A-2	91.0	6	6	60
Santander (UK)	UK	A	F1	a	2	Aa3	P-1	A	A-1	-	6	6	60
Goldman Sachs IB	UK	A	F1	-	-	A1	P-1	A	A-1	86.0	6	6	60
Standard Chartered Bank	UK	A+	F1	a	5	Aa3	P-1	A	A-1	124.1	1	1	60
Non UK Counterparties:													
Australia & New Zealand Banking Group	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	-	12	12	60
Commonwealth Bank of Australia	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	73.7	12	12	60
National Australia Bank	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	73.7	12	12	60
Westpac Banking Corporation	Australia	AA-	F1+	aa-	1	Aa2	P-1	AA-	A-1+	73.7	12	12	60
Royal Bank of Canada	Canada	AA	F1+	aa	2	Aa3	P-1	AA-	A-1+	-	12	12	60
Toronto Dominion	Canada	AA-	F1+	aa-	2	Aa1	P-1	AA-	A-1+	-	12	12	60
Dev. Bank of Singapore	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
Oversea Chinese Banking Corp	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
United Overseas Bank	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	24	60
Svenska Handelsbanken	Sweden	AA	F1+	aa	2	Aa2	P-1	AA-	A-1+	-	12	12	60
Nordea Bank AB	Sweden	AA-	F1+	aa-	2	Aa3	P-1	AA-	A-1+	-	12	12	60
ABN AMRO Bank	Netherlands	A+	F1	a	5	A1	P-1	A	A-1	-	6	6	60
Rabobank	Netherlands	AA-	F1+	a+	5	Aa2	P-1	A+	A-1	63.4	12	12	60

Continued Counterparty list Bank with duration colour	Country	Fitch Ratings				Moody's Ratings		S & P Ratings		CDS Price	ESCC Duration	Capita Duration	Money Limit
		L Term	S Term	Viab.	Supp.	L Term	S Term	L Term	S Term		(Months)	(Months)	(£m)
ING Bank NV	Netherlands	A+	F1	a+	5	A1	P-1	A	A-1	65.0	6	6	60
UBS	Switzerland	A+	F1	a	5	Aa3	P-1	A+	A-1	65.4	12	12	60
Credit Suisse	Switzerland	A	F1	a-	5	A1	P-1	A	A-1	146.1	6	6	60
DZ Bank	Germany	AA-	F1			Aa1	P-1	AA-	A-1+	-	12	12	60
Danske Bank	Denmark	A	F1	a	5	A1	P-1	A	A-1	62.5	6	6	60
Nordea Bank Finland	Finland	AA-	F1+	aa-	5	Aa3	P-1	AA-	A-1+	-	12	12	60
JP Morgan Chase	U.S.A	AA-	F1+	a+	5	Aa2	P-1	A+	A-1	61.4	12	12	60

Yellow	Purple	Blue	Orange	Red	Green	No Colour
Up to 5yrs	Up to 2yrs	Up to 1yr (semi nationalised UK bank NatWest/RBS)	Up to 1yr	Up to 6 months	Up to 100 days	Not to be used

Non-Specified Investments:			
	Minimum credit Criteria	Maximum Investments	Maximum maturity period
UK Local Authorities	Government Backed	£60m	2 years
Local Capital Finance Company Limited	Local Government Agency Backed	£100k	N/A

11. GLOSSARY

Basis Point

1/100th of 1%, i.e. 0.01%

Base Rate

Minimum lending rate of a bank or financial institution in the UK.

Callable Deposit

A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen, the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.

Capital Financing Requirement (CFR)

The underlying need to borrow for capital purposes.

Certificate of Deposit (CD)

Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.

Commercial Paper

Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.

Counterparty

Another (or the other) party to an agreement or other market contract (e.g. lender / borrower / writer of a swap etc.)

CPI

Consumer Price Index - calculated by collecting and comparing prices of a set basket of goods and services as bought by a typical consumer, at regular intervals over time. The CPI covers some items that are not in the RPI, such as unit trust and stockbrokers fees, university accommodation fees and foreign students' university tuition fees.

Credit Rating

An evaluation made by a credit rating agency of an organisations likelihood of default.

Credit Default Swap

CDS - a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.

DMADF

Deposit Account offered by the Debt Management office (DMO), guaranteed by the UK government.

DMO

Debt Management Office. An Executive Agency of Her Majesty's Treasury. The DMO's responsibilities include debt and cash management for the UK Government, lending to local authorities and managing certain public sector funds.

ECB

European Central bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is to keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.

EMU

European Monetary Union

Fed.

Federal Reserve Bank of America – sets the central rates in the USA.

Fixed Term Deposit (FTD)

Investment made with a financial institution for a fixed period at a fixed rate.

FCA (Financial Conduct Authority)

Body responsible for overseeing financial services.

Fiscal Policy

The Government policy on taxation and welfare payments.

Gilt

Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.

Minimum Revenue Provision (MRP)

Prudent provision for the repayment of debt.

Money Market Fund (MMF)

A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short term instruments.

Monetary Policy Committee (MPC)

Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the Committee. Their secondary target is to support the Government in maintaining high and stable levels of growth and employment.

PWLB

Public Works Loans Board. A statutory body operating within the DMO and is responsible for lending money to local authorities and other prescribed bodies.

Term Deposit

A deposit held in a financial institution for a fixed term at a fixed rate.

Treasury Bill (T Bills)

Treasury bills are short term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.

Capita Asset Services on the Economic Background and Forward View

1. The Global Economy

- 1.1 **The Eurozone.** the ECB commenced, in March 2015 a €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. At its December and March 2016 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 significantly from low levels towards the target of 2%.
- 1.2 **Eurozone Elections.** Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Key Dates 2017:

- Spring: Dutch General Election / French Presidential Election
 - Summer: French National Assembly
 - Autumn: German Federal Election
- 1.3 **USA.** The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, the first estimate for quarter 3 at 2.9% signalled a rebound to strong growth. The Fed. 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 which is now strongly expected early in 2017. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis.

The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment.

However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields have risen sharply in the week since his election. Time will tell if this is a temporary over reaction, or a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

The election does not appear likely to have much impact on the Fed. in terms of holding back further on increasing the Fed. Rate. Accordingly, the next rate rise is still widely expected to occur in December 2016, followed by sharper increases thereafter, which may also cause Treasury yields to rise further. If the Trump package of policies is fully implemented, there is likely to be a significant increase in inflationary pressures which could, in turn, mean that the pace of further Fed. Rate increases will be quicker and stronger than had been previously expected.

- 1.4 **Asia.** Economic growth in China has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated. This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in Japan is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

- 1.5 **Emerging countries.** There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that \$340bn of emerging market corporate debt will fall due for repayment in the

remaining two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

2. The UK Economy

2.1 UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

2.2 The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013.

Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

2.3 There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would

raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

2.4 The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q2 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

2.5 The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20.

3. Capita Asset Services forward view

3.1 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.

3.2 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.

3.3 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.

3.4 Downside risks currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly 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 European banks.
- Monetary policy action failing to stimulate sustainable growth and combat the treat of deflation in western economies, especially the Eurozone and Japan.

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

- Uncertainty around the terms of a UK exit from the EU.
- The commencement by the US Federal Reserve 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.

3.6 **Brexit timetable and process:**

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members i.e. not that likely.
- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

Review of the Minimum Revenue Provision Policy

1. Background

1.1 This report reviews the policy for accounting for the Minimum Revenue Provision. The MRP arises because there is statutory requirement for local authorities to set aside some of their revenues as provision for debt repayment. The provision is in respect of capital expenditure financed by borrowing or credit arrangements. The underlying need to borrow is termed the Capital Financing Requirement (CFR) and represents the amount of borrowing required to finance capital investment after including any financing from capital receipts, capital grants, contributions, reserves and revenue financing.

1.2 Prior to April 2007, the MRP set aside was specified as a percentage of the Council's CFR. Since April 2007, MRP requirements have been relaxed significantly and the set aside is no longer a prescribed amount. The Department for Communities and Local Government (CLG) guidance now permits a variety of methods to be used to calculate the MRP set aside and the subsequent guidance issued in February 2012 sets out a number of possible methods a council might wish to follow, although even these are not exhaustive.

1.3 MRP calculations no longer directly impact on central government funding, since the link between Revenue Support Grant and levels of supported borrowing have been eroded. The implied grant support charge of 4% is no longer relative and a lower amount could be applied. The core requirement now is simply that the Council has an approved policy for calculating MRP and sets aside an amount which it deems to be prudent, having regard to the CLG's statutory guidance.

2. Minimum Revenue Provision

2.1 The MRP budget of £13.02m is based on three component parts:

- CFR pre April 2008 (including government supported borrowing)
- CFR post April 2008 – 2016 (unsupported/prudential borrowing)
- A voluntary contribution

2.2 The method of calculating MRP on pre 2008 CFR is a 4% reducing balance method which in the CLG guidance referred to in paragraph 2.4 is option 2. The MRP calculation for post 2008 CFR is based on the useful asset life of those capital schemes to which the borrowing relates (option 3 in the guidance). Previously only options 1 (the regulatory method) and option 2 are normally available for pre 2008 CFR and options 3 and 4 (the depreciation method) are for self-financed (unsupported) borrowing. The Council has also in the past opted to make an additional voluntary contribution of £0.2m pa.

3. Review of MRP

3.1 Officers have recently undertaken a review of the MRP budget and received advice from Arlingclose an independent Treasury Management adviser. The CLG guidance on the calculation of MRP, includes a number of methods which it considers to be prudent. However the guidance is clear that authorities are also free to devise other methods they consider to be prudent.

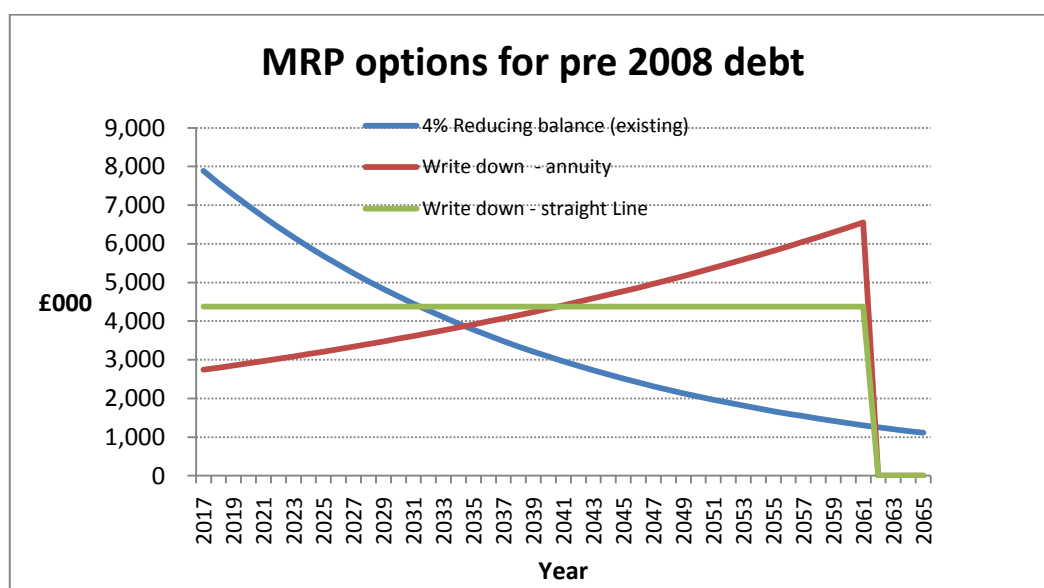
3.2 The guidance defines prudence as charging MRP to the revenue account “over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of government supported borrowing, reasonably commensurate with the period implicit in the determination of the grant. Re-profiling the MRP payments over time could generate up-front revenue savings on the budget.

3.3 Other prudent methods that are now considered to be available to re-profile MRP are as follows:

- Fixed period of write down;
- Link to formula grant;
- Link with debt maturity profile.

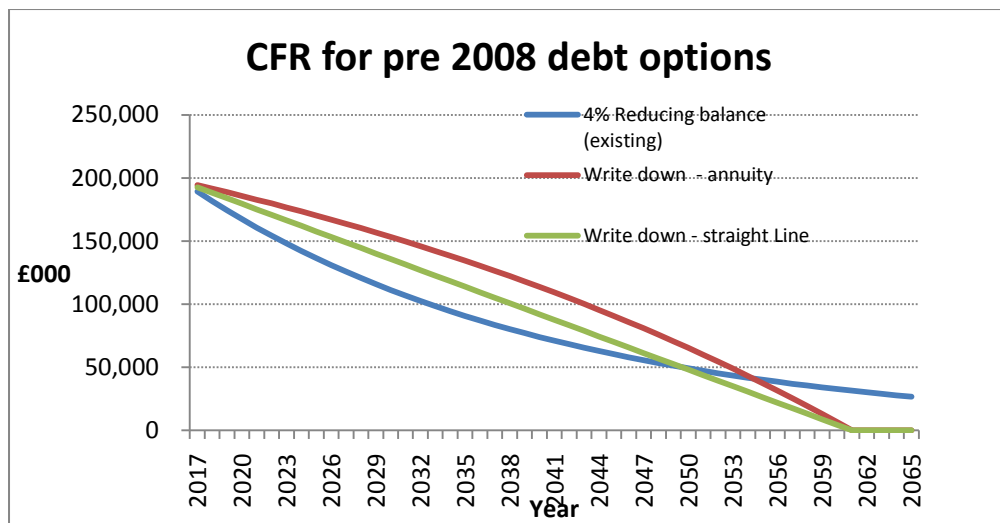
Fixed period of write down

3.4 The period of write down method can be fixed and therefore reduced when compared to a reducing balance method. The repayment can then be calculated either on either a straight line (equal instalments) or an annuity basis. The annuity method is like a repayment mortgage with lower principal (ie MRP) in the earlier years and increasing over time and a 2% annuity is typical (based on the Bank of England’s inflation target). The asset life chosen for either method could be linked to the individual assets supported by the borrowing or if this information is not available on an assumed weighted average life, usually 50 years. The graph below compares the existing 4% reducing balance method to the straight line and annuity options of fixed period write down.



3.5 The figures are based on re-profiling the pre 2008 CFR, which represents 80% of the total CFR. The weighted average asset life is over a 45 year period to align closer to when the debt would be fully repaid rather than the standard 50 year period. The MRP charge for 2016/17 would then reduce from £7.9m under the existing reducing balance method to £4.4m using a straight line method and £2.7m using an annuity method. The graph shows that the straight line method is lower than the reducing balance method up until 2031/32 and for the annuity method up until 2034/35.

3.6 The graph below shows the impact of the MRP methods above on the CFR. With the fixed periods, the CFR would be repaid by 2060/61 but under the reducing balance method, the CFR is £31m and would then carry on indefinitely meaning an MRP would still need to be charged to council tax payers.



3.7 The advantages of the fixed period write down method over the reducing balance method are that it is more equitable, results in debt being fully repaid and generates revenue savings in the earlier years. The advantage of the straight line calculation over the annuity calculation is that it is evenly spread over time and so easier to calculate and budget for. The annuity method takes into account the 'time value of money' but its main disadvantage is that future tax payers will pay more for the asset even though they will receive less of the benefit as the asset deteriorates over time.

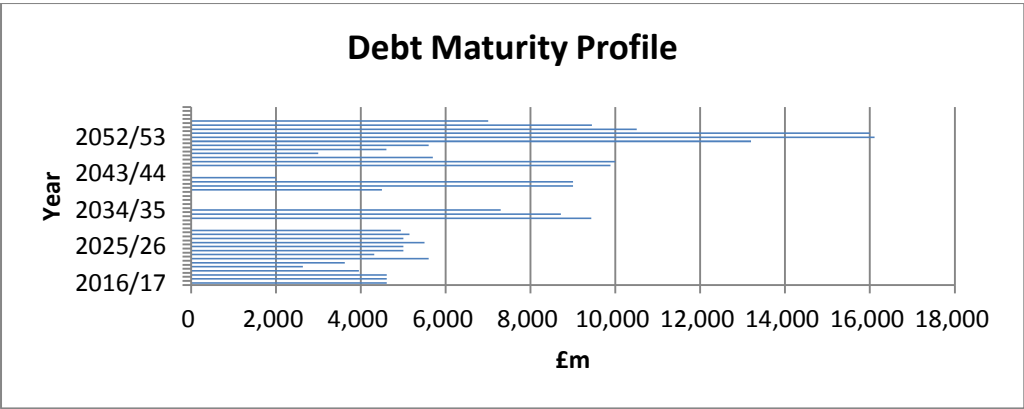
3.8 Nationally, a number of authorities have already moved to a reduction in the write down period for pre 2008 debt. Of twelve authorities reviewed that had moved away from the reducing balance method, ten adopted the straight line method and two the annuity method. KPMG the Council's external auditors have been consulted. The auditors has expressed some concerns with the annuity method and that adopting the straight line approach is less likely to face a challenge from the Council's auditors. The Council anticipates carrying out a further review of MRP profile/options within the next five years.

Link to formula grant

3.9 The link to formula grant (revenue support grant and business rates) reducing balance method is based on the premise that since 2008, local government funding has reduced so a historic 4% charge is now over providing and a rate closer to 2% is more realistic and prudent. A disadvantage of this method is the uncertainty over future grant settlements. If settlements were to rise then the MRP charge could increase and so eradicate any future savings. Another disadvantage is that with any reducing balance method, the CFR will never be completely financed and the life far exceeds the borrowing to which it relates.

Link with debt maturity profile

3.10 The link to debt maturity profile method is most suitable where outstanding debt is closely linked to the CFR. The pre 2008 CFR at 31 March 2016 was £197m compared to a higher debt of £226m. The debt maturity profile is shown in the graph below.

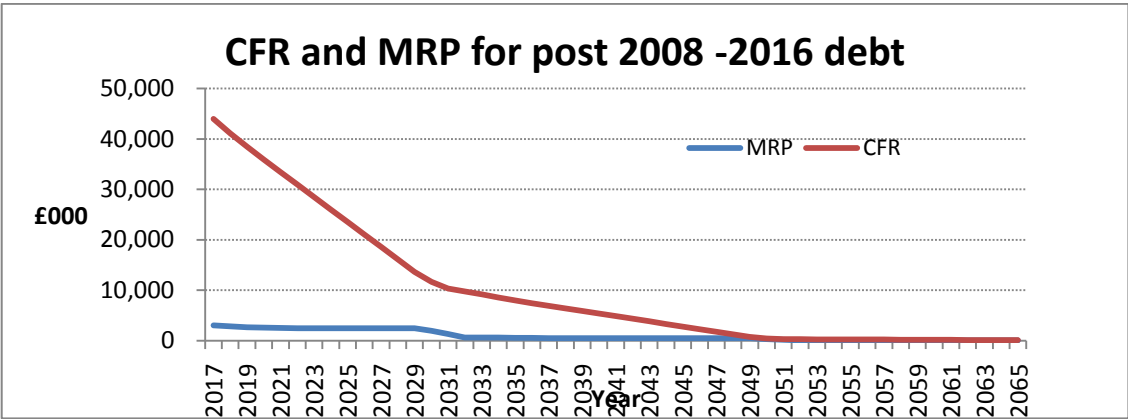


3.11 Existing pre 2008 debt will be fully repaid by 2056/57. The maturity profile is fairly even from 2016/17 to 2029/30 around £5m pa but after that there are maturity gaps. The repayments are significant and above £10m pa between 2051/52 and 2054/55. If linked to the debt maturity profile then there would have to be smoothing of the MRP in the middle years 2030/31 to 2044/45 to ensure a more even charge. This also assumes that there are resources available to repay the maturing debt and debt is not rescheduled or renewed.

3.12 The option which is considered therefore to be the most appropriate for pre 2008 CFR is the reduction in the period of the write down using a straight line calculation. This would result in an MRP for 2016/17 of £4.4m which would be a reduction of £3.5m compared to the £7.9m that would be charged under the existing reducing balance method.

Post 2008 – 2016 MRP and Voluntary MRP Contribution

3.13 The post 2008 MRP is currently being calculated using an option 3 individual asset life method and the charge in 2016/17 is £3.06m. There are no significant arguments to change from this approach and it would remain consistent with the proposed change to the pre 2008 method. The MRP and CFR profiles are shown in the graph below. By 2031/32, the MRP has reduced to £0.6m pa.



3.14 It is proposed to no longer charge a voluntary MRP contribution of £0.2m pa as a prudent provision is already being made.

Existing MRP Projections to 2020/21 (excluding future capital programme)

3.15 The changes outlined above, would reduce the total MRP charge for 2016/17 to £7.44m, based on the current CFR, a reduction of £5.58m on the budget. The forecast and resultant reductions over a five year period are shown in the table below:

	2016/17	2017/18	2018/19	2019/20	2020/21
	£m	£m	£m	£m	£m
Budget	13.02	12.38	11.79	11.79	11.79
Forecast	7.44	7.21	7.02	6.94	6.90
Reduction	(5.58)	(5.17)	(4.77)	(4.85)	(4.89)

3.16 The CFR will change however for future changes in the capital programme if the capital investment is not funded from existing or new resources. Unfinanced future capital expenditure will attract an MRP charge and also will need to be funded at some future point through actual borrowing on which interest will have to be paid. Section three below looks at the impact of future capital spending plans.

3.17 The Council's annual MRP Policy Statement will need to be updated for the changes proposed to the re-profiling of the MRP on pre 2008 debt and removing the additional voluntary MRP contribution.

4. Conclusion and Reasons for Recommendation

4.1 The review shows that, by re-profiling MRP payments, a reduced charge to the revenue account can be achieved in the period to 2032. This is possible by changing the method of calculation from a reducing balance to a straight line basis. There are also savings on the interest payable budget as historical debt is maturing and any new debt is taken out at much lower rates of interest. However the total savings are mitigated partially by a reduction in investment income as the base rate has been falling.

4.2 The current MTFP includes a £1m increase pa in the Treasury Management over the three year period 2018/19 to 2020/21 for any new capital investment or other borrowing required. This review has incorporated, and provided for, the latest information within the capital programme 2016-2023.

4.3 *The Committee is recommended to approve the preferred option for changing the method of calculating MRP and also the reduced revenue charges that could be generated from within the Treasury Management budget to help meet the MTFP funding shortfall.*