Report to:	**Cabinet**
Date:	**23 January 2018**
By:	**Chief Operating Officer**
Title of report:	**Treasury Management Policy and Strategy 2018/19**
Purpose of report:	**This report proposes the Treasury Management Policy and Strategy for 2018/19. 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 2018/19;

2) approve the Prudential and Treasury Indicators 2018/19 to 2020/21;

3) approve the Minimum Revenue Provision (MRP) Policy Statement 2018/19;

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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 summary of changes incorporated within the 2018/19 proposed Treasury Management Strategy is attached as **Appendix 'A'**, and the Treasury Management Policy and Strategy Statement for 2018/19 is presented in **Appendix 'B'** to this report. 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.

1.4 During November 2017, reports were received by the Audit, Best Value and Community Services' RPPR Board outlining various options for increasing investment income and seeking approval for them to be considered for inclusion in the 2018/19 strategy. Details of the changes proposed to investment and borrowing investment strategies include:

- Seek to reduce liquidity where possible and extend duration of investments within current limits. A sensible rebalancing of liquidity requirements will improve yield without significant additional risk;
- Wider use of other Local Authorities and Building Societies where rates are favourable;
- Inclusion of Short Dated Bond Funds and Corporate Bonds;
- Inclusion of pooled property funds and pooled mixed asset funds. Given the low returns from short-term bank investments, the Council will diversify with the use of pooled funds. With the assistance of the Council's treasury advisors (Link Asset Services), a selection process will take place in the new year where members and officers can scrutinise a suitable selection of funds;
- No external borrowing is planned for 2018/19, officers will be monitoring the situation in the next 12 months. Officers continue to regularly review opportunities for debt rescheduling, PWLB debt restructuring is now much less attractive as 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.

1.5 When compared to the SE Group, stretching of risk/return assumptions within the new investment strategy will allow the Council to invest in better performing funds, which will improve the Council performance benchmarks against other County Councils and improve the Council status within the benchmarking group. In addition, changes within the Treasury Management activities are expected to generate an additional income in the region of £1.6m from 2019/20.

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 Link Asset Services on its treasury management activities. A detailed view of the current economic situation and forecasts, as prepared by Link Asset Services is included in **Appendix 'C'** to this report.

Minimum Revenue Provision (MRP)

2.4 A review of the MRP policy was carried out in 2016/17 and the outcome was to change the method of calculation on debt prior to 2008 from a reducing balance to a straight line fixed period write down, which bring it in line with the post 2008 debt calculation using the asset life method. No major changes are proposed for 2018/19 other than the annual review of asset lives.

CIPFA & DCLG Consultations

2.5 Following consultation, CIPFA is about to publish its updated Prudential Code for Capital Finance and Treasury Management Code of Practice. In addition the DCLG is consulting on its amended investment guidance and minimum revenue provision guidance. The updates are mainly to address the implications of local authorities acting more commercially, their approaches to risk and ensuring financial sustainability.

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 It is proposed that the Cabinet recommends the 2018/19 Treasury Management Policy and Strategy Statement for approval by the County Council.

KEVIN FOSTER
Chief Operating Officer

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Local Member(s): All

BACKGROUND DOCUMENTS

CIPFA Prudential Code and CIPFA Treasury Management Code
Local Government Act 2003 – Capital Finance
DCLG Statutory Guidance on Local Authority Investments and the Minimum Revenue Provision.

APPENDIX 'A'

Summary of Changes incorporated within the 2018/19 Proposed Treasury Management Strategy

2017/18 Current Strategy	2018/19 Proposed Strategy
Summary Report - 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. 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;	**Summary Report** - During November 2017, reports were received by RPPR Board outlining various options for increasing investment income and seeking approval for them to be considered for inclusion in the 2018/19 strategy. Details of the changes proposed to investment and borrowing investment strategies include: • Seek to reduce liquidity where possible and extend duration of investments within current limits. A sensible rebalancing of liquidity requirements will improve yield without significant additional risk; • Wider use of other Local Authorities and Building Societies where rates are favourable; • Inclusion of Short Dated Bond Funds and Corporate Bonds; • Inclusion of pooled property funds and pooled mixed asset funds. Given the low returns from short-term bank investments, the Council will diversify with the use of pooled funds. With the assistance of the Council's treasury advisors (Link Asset Services), a selection process will take place in the new year where members and officers can scrutinise a suitable selection of funds; • No external borrowing is planned for 2018/19; officers will be monitoring the situation in the next 12 months. Officers continue to regularly review opportunities for debt rescheduling, PWLB debt restructuring is now much less attractive as 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.
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.	**Current Investment & Borrowing Position** During 2017/18, the Council had average investments of £260 million, and the forecast for the year end is around £255 million. The forecast average interest rate for the year is 0.60%, bank base rate was increased to 0.50% on 2nd November 2017. The investments will provide investment income of approximately £1.5 million in 2017/18.

2017/18 Current Strategy	2018/19 Proposed Strategy

2017/18 Current Strategy

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.

2018/19 Proposed Strategy

Prospects for Interest Rates

The Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November 2017. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00

2017/18 Current Strategy

Borrowing Strategy - Capital Investment

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.

2018/19 Proposed Strategy

Borrowing Strategy - Capital Investment

The Council's Draft Revenue Budget and Capital Programme 2018/19 to 2021/22 forecasts £294m of capital investment over the next four years with £219m met from existing or new resources

2017/18 Current Strategy

Investment Policy

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.

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.

2018/19 Proposed Strategy

Investment Policy

The Council aims to achieve the optimum return on its investments commensurate with proper levels of security and liquidity, with priority being given to the security of its investments.

Investments will be made with reference to the core balance and cash flow requirements and the outlook for interest rates. Investment returns expectations (i.e., Bank Rate) is forecast to stay flat at 0.50% until quarter 3 2018 and not to rise above 1.00% by quarter 3 2019. Bank Rate forecasts for financial year ends (March) are:

2017/18	2018/19	2019/20	2020/21
0.50%	0.75%	1.00%	1.25%

The following rates are achievable, as of December 2017, investing in cash deposits with a base rate of 0.50%:

1 month	6 month	1 year	2 year	3 year	4 year+
0.40%	0.55%	0.70%	1.10%	1.20%	1.30%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong gross domestic product (GDP) growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

<table>
<tr><th>2017/18 Current Strategy</th><th>2018/19 Proposed Strategy</th></tr>
<tr>
<td>

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.

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<td>

Strategy for 2018/19
Previous Treasury Management Strategies, particularly since the banking crisis in 2008, have focused on the security of funds over liquidity and yield. The policy has been to generally invest in cash deposits that are high rated over short durations with no investments made beyond one year. The low risk based approach has ensured stability over this period but a consequence has been low yields.

Following consultation, the strategy for 2018/19 is to broaden the risk profile by reducing liquidity and to include some suitable, alternative investment products that are held for the medium (2-5 years) to longer term (5 years+). These products can generate better overall returns but there is a higher risk of volatility of performance so a longer term commitment is required. The inclusion of an investment product category in the strategy does not automatically result in investments being placed. Following due diligence, each investment decision considers the relative risks, returns and cash flow requirements within the context of the full investment portfolio.

Table 6 below summarises the changes to the 2018/19 strategy from those approved in 2017/18 and the proposal for the 2019/20 strategy. Each of the new investment products included are described in more detail in the paragraphs below -

<table>
<tr><th>Table 6 - Investment options</th><th>2017/18</th><th>2018/19</th><th>2019/20</th></tr>
<tr><td>Money Market Funds (Including LVNAV)</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>Bank Notice Accounts</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>Fixed Term Bank Deposits</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>UK Local Authorities</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>Enhanced Money Market Funds (VNAV)</td><td>✓</td><td>✓</td><td>✓</td></tr>
<tr><td>Building Societies</td><td>×</td><td>✓</td><td>✓</td></tr>
<tr><td>Pooled Property Funds</td><td>×</td><td>✓</td><td>✓</td></tr>
<tr><td>Corporate Bond Funds</td><td>×</td><td>✓</td><td>✓</td></tr>
<tr><td>Multi Asset Funds</td><td>×</td><td>✓</td><td>✓</td></tr>
<tr><td>Equity Funds</td><td>×</td><td>×</td><td>✓</td></tr>
</table>

</td>
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<tr>
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Criteria for Specified Investments:
Rabobank
Nordea Bank
JP Morgan Chase

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<td>

Criteria for Specified Investments:
Nationwide Building Society
Coventry Building Society
Individual Money Market Funds (MMF) CNAV and LVNAV
VNAV MMF's and
Ultra Short Dated Bond Funds

</td>
</tr>
</table>

2017/18 Current Strategy	2018/19 Proposed Strategy

2017/18 Current Strategy

Non-Specified investments

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

2018/19 Proposed Strategy

Non-Specified investments

Table 8	Minimum credit criteria	Maximum investments	Period
UK Local Authorities	Government Backed	£60m	2 years
Corporate Bond Fund(s)	Investment Grade	£30m	2 - 5 years
Pooled Property Fund(s)	N/A	£30m	5+ years
Mixed Asset Fund(s)	Appropriate rating	£30m	2 - 5 years

2017/18 Current Strategy

MINIMUM REVENUE PROVISION POLICY STATEMENT

For borrowing incurred before 1 April 2008, the MRP policy will be on a straight line basis over the next 45 years to coincide with the repayment of external debt.

2018/19 Proposed Strategy

MINIMUM REVENUE PROVISION POLICY STATEMENT

The policy from 2017/18 and in future years is for borrowing incurred before 1 April 2008, the MRP policy will be on a straight line basis over a maximum of 40 years.

CIPFA & DCLG Consultations

Following consultation, CIPFA is about to publish its updated Prudential Code for Capital Finance and Treasury Management Code of Practice. In addition the DCLG is consulting on its amended investment guidance and minimum revenue provision guidance. The updates are mainly to address the implications of local authorities acting more commercially, their approaches to risk and ensuring financial sustainability.

APPENDIX 'B'

TREASURY MANAGEMENT POLICY AND STRATEGY 2018/19

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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) define 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 management 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

4.1 In compliance with the CIPFA recommendations, 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

TMP 13: Investment management Practices for non-treasury investments (pending CIPFA consultation)

4.2 These TMPs follow the wording recommended by the latest edition of the CIPFA Treasury Management Code. Schedules are maintained and updated as necessary, being operational procedures and forming an integral part of the Council's treasury management activities.

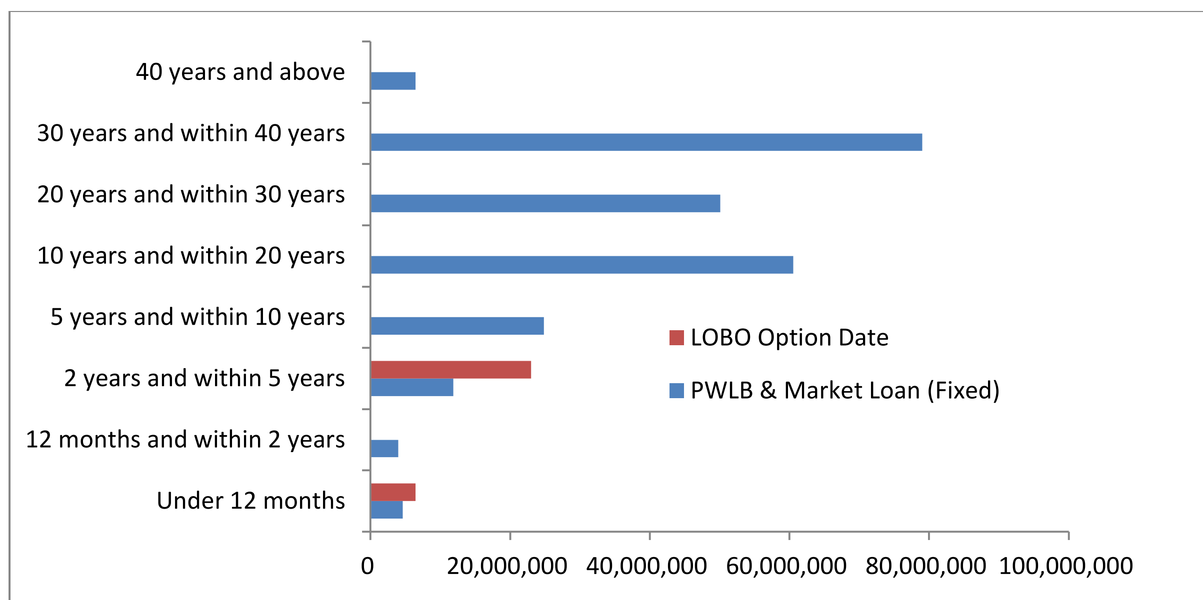
5. TREASURY MANAGEMENT STRATEGY STATEMENT

5.1 Current Investment & Borrowing Position

During 2017/18, the Council had average investments of £260 million, and the forecast for the year end is around £255 million. The forecast average interest rate for the year is 0.60%, bank base rate was increased to 0.50% on 2nd November 2017. The investments will provide investment income of approximately £1.5 million in 2017/18.

The Council's long-term external borrowing (excluding PFI and finance lease arrangements) is projected to be £270.8m at 31 March 2018 with the majority sourced from the Public Works Loan Board (PWLB) at fixed interest rates of between 2.6% - 8.5%, with a weighted average rate of 4.81%. 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 December 2017, showing the outstanding level of loans each year, is shown in **Graph 1** below:



5.2 Prospects for Interest Rates

The Council has appointed Link 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 our central view.

Table 1		Bank Rate %		PWLB Borrowing Rates % (including certainty rate adjustment)		
				5 year	25 year	50 year
Dec 2017		0.50		1.50	2.80	2.50
Mar 2018		0.50		1.60	2.90	2.60
Jun 2018		0.50		1.60	3.00	2.70
Sep 2018		0.50		1.70	3.00	2.80
Dec 2018		0.50		1.80	3.10	2.90
Mar 2019		0.75		1.80	3.10	2.90
Jun 2019		0.75		1.90	3.20	3.00
Sep 2019		0.75		1.90	3.20	3.00
Dec 2019		1.00		2.00	3.30	3.10
Mar 2020		1.00		2.10	3.40	3.20
Jun 2020		1.00		2.10	3.50	3.30
Sep 2020		1.25		2.20	3.50	3.30
Dec 2020		1.25		2.30	3.60	3.40
Mar 2021		1.25		2.30	3.60	3.40

The Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November 2017. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

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 more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to 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 in November 2016 has called into question whether the previous trend may go into reverse, especially now the Federal Reserve has taken the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature.

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

- Investment returns are likely to remain relatively low during 2018/19 and beyond;

- Borrowing interest rates increased sharply after the result of the general election in June and then also after the September MPC meeting when financial markets reacted by

accelerating their expectations for the timing of Bank Rate increases. Apart from that, there has been little general trend in rates during the current financial year. 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 the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of 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 £7.9m for 2018/19. 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** (on page 6) 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 year in order to reduce the cost of carry at a time when investment returns are low and counterparty risks continue to be relatively high.

5.3.1 Strategy for 2018/19

The Council's Draft Revenue Budget and Capital Programme 2018/19 to 2021/22 forecasts £294m of capital investment over the next four years with £219m met from existing or new resources. The amount of new borrowing required over this period is therefore £75m as shown in **Table 2** below.

2017/18 Projected	**Table 2**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**Total**
£m		**£m**	**£m**	**£m**	**£m**	**£m**
92	Capital Expenditure	93	89	65	47	**294**
	Financed by:					
(74)	Capital Reserves, Capital Grants, Capital Receipts, Revenue Contributions	(75)	(59)	(41)	(44)	**(219)**
18	**Borrowing Need**	**18**	**30**	**24**	**3**	**75**

As existing and forecast future resources are insufficient to meet the level of spend, the borrowing need of £75m will initially be met from internal borrowing. This is to use the Council's own surplus funds until external borrowing is required. Internal borrowing reduces borrowing costs and risk as there is less exposure of external investments. The benefits of internal borrowing need to be monitored and weighed against deferring new external borrowing into future years when long-term borrowing rates could 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	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
	£m	**£m**	**£m**	**£m**	**£m**
Borrowing at 1 April	276	271	266	282	295
add new borrowing	-	-	20	15	-
less loan maturities	(5)	(5)	(4)	(2)	(4)
Borrowing at 31 March	**271**	**266**	**282**	**295**	**291**
CFR at 1 April	242	252	262	283	298
Net Capital Expenditure	18	18	30	24	3
MRP	(8)	(8)	(9)	(9)	(9)
CFR at 31 March	**252**	**262**	**283**	**298**	**292**
Under / (Over) borrowing	**(19)**	**(4)**	**1**	**3**	**1**

The Council is currently maintaining an over-borrowed position as it previously took advantage of historic low borrowing rates. As at the end of 2017/18, the Council is projected to be over borrowed by £19m, moving to an over borrowed position of £4m by 2018/19 and then only moving around the margin until 2021/22. This means that the capital financial requirement has been financed by existing resources and loan debt.

5.3.2 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. 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 at the lender's discretion. The Council's debt portfolio contains £29.45m of these products (see **Graph 1**), £6.45m of that portfolio could be "called" during 2018/19. The interest paid on our LOBO debt is between 3.75 - 4.39%.

5.3.3 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.

5.3.4 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.

5.3.5 Continual Review

Treasury officers continue to review the need to borrow taking into consideration the potential increases in borrrowing 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 2018/19 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 2018/19 to 2021/22

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 2018/19 to 2021/22 are set out in **Table 4** below:

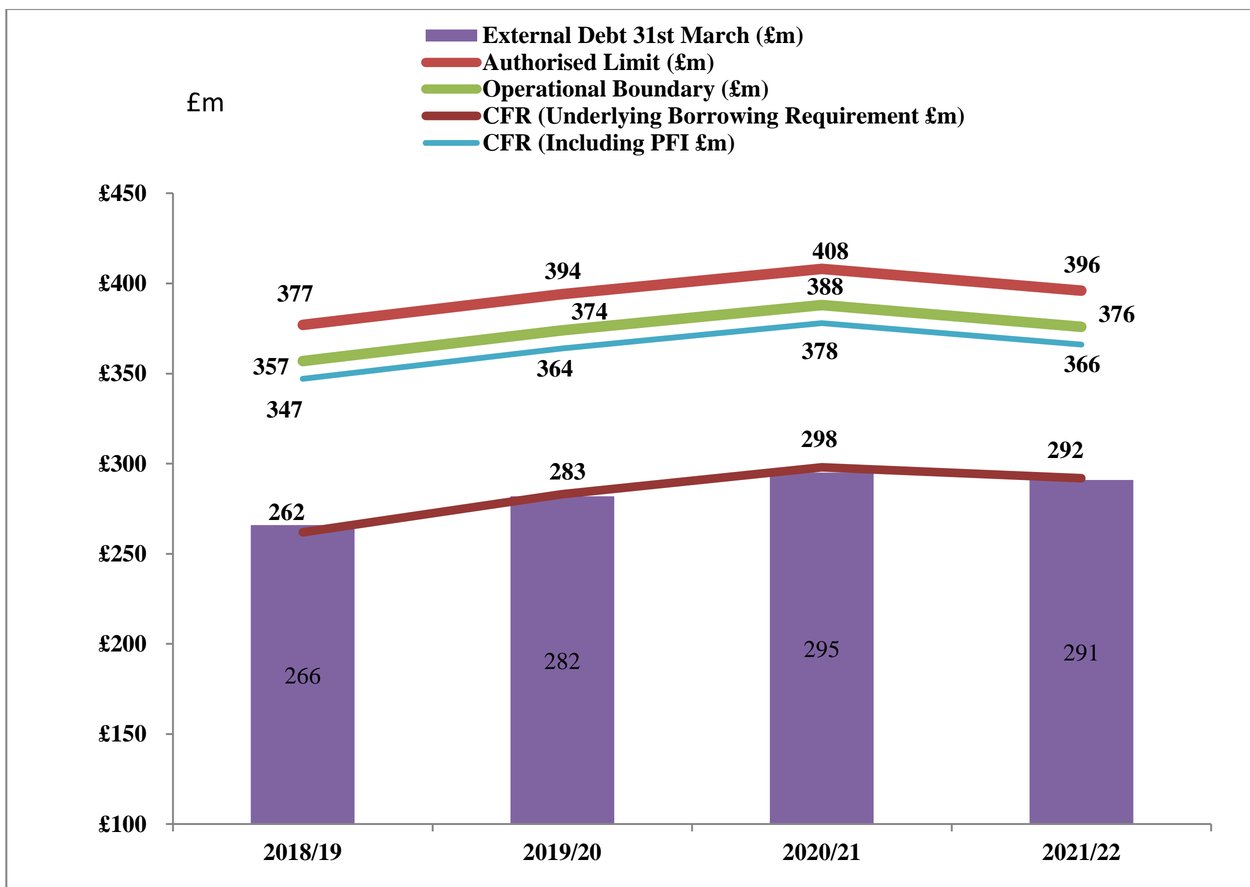
Table 4	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**
Capital Expenditure £m (gross) Council's capital expenditure plans	£93m	£89m	£65m	£47m
Capital Financing Requirement £m Measures the underlying need to borrow for capital purposes (including PFI & Leases)	£347m	£364m	£378m	£366m
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	*tbc*	*tbc*	*tbc*	*tbc*
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	*tbc*	*tbc*	*tbc*	*tbc*

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 2018/19 to 2021/22 are set out in **Table 5** below:

Table 5	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 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.	£377m	£394m	£408m	£396m
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.	£357m	£374m	£388m	£376m

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%
Maximum 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%
Principal sums invested for longer than 365 days	£60m	£60m	£60m	£60m

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, with priority being given 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 interest rates. Investment returns expectations (i.e., Bank Rate) is forecast to stay flat at 0.50% until quarter 3 2018 and not to rise above 1.00% by quarter 3 2019. Bank Rate forecasts for financial year ends (March) are:

2017/18	2018/19	2019/20	2020/21
0.50%	0.75%	1.00%	1.25%

The following rates are achievable, as of December 2017, investing in cash deposits with a base rate of 0.50%:

1 month	6 month	1 year	2 year	3 year	4 year+
0.40%	0.55%	0.70%	1.10%	1.20%	1.30%

The overall balance of risks to these forecasts is currently skewed to the upside and are dependent on how strong gross domestic product (GDP) growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

6.2 Strategy for 2018/19

Previous Treasury Management Strategies, particularly since the banking crisis in 2008, have focused on the security of funds over liquidity and yield. The policy has been to generally invest in cash deposits that are high rated over short durations with no investments made beyond one year. The low risk based approach has ensured stability over this period but a consequence has been low yields.

Following consultation, the strategy for 2018/19 is to broaden the risk profile by reducing liquidity and to include some suitable, alternative investment products that are held for the medium (2-5 years) to longer term (5 years+). These products can generate better overall returns but there is a higher risk of volatility of performance so a longer term commitment is required. The inclusion of an investment product category in the strategy does not automatically result in investments being placed. Following due diligence, each investment decision considers the relative risks, returns and cash flow requirements within the context of the full investment portfolio.

Table 6 below summarises the changes to the 2018/19 strategy from those approved in 2017/18 and the proposal for the 2019/20 strategy. Each of the new investment products included are described in more detail in the paragraphs below.

Table 6 - Investment options	2017/18	2018/19	2019/20
Money Market Funds (Including LVNAV)	✓	✓	✓
Bank Notice Accounts	✓	✓	✓
Fixed Term Bank Deposits	✓	✓	✓
UK Local Authorities	✓	✓	✓
Enhanced Money Market Funds (VNAV)	✓	✓	✓
Building Societies	✗	✓	✓
Pooled Property Funds	✗	✓	✓
Corporate Bond Funds	✗	✓	✓
Multi Asset Funds	✗	✓	✓
Equity Funds	✗	✗	✓

6.3 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;

6.3.1 Sovereign Ratings

For 2018/19 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 (Aa2 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+ (No Country currently)

AA UK

6.3.2 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 Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three credit rating agencies.

The Link 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.

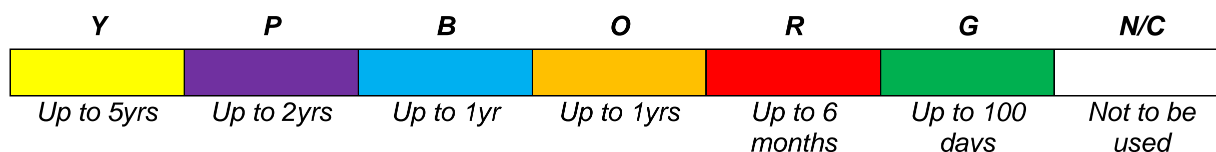
This modelling approach combines credit ratings with the following overlays:

- 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 (in addition to other due diligence consideration) will use counterparties within the following durational bands provided they have a minimum AA+ soverign 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*



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 Link 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 7 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.

6.3.3 Criteria for Specified Investments:

Table 7	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
UK Local Authorities	UK	TD	£60m	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
Nationwide Building Society	UK		£60m	1 yr
Coventry Building Society	UK		£60m	1 yr

Table 7	Country/ Domicile	Instrument	Maximum investments	Max. maturity period
Individual Money Market Funds (MMF) CNAV and LVNAV	UK/Ireland/ EU domiciled	AAA rated Money Market Funds	£60m	Instant access
VNAV MMF's and Ultra Short Dated Bond Funds	UK/Ireland/ EU domiciled	AAA Bond Fund Rating	£60m	Liquidity up to 1 yr
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
Toronto-Dominion Bank	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
Cooperatieve Rabobank	Netherlands	TD / CD's	£60m	1 yr
ING Bank NV	Netherlands	TD / CD's	£60m	1 yr
DZ Bank AG	Germany	TD / CD's	£60m	1 yr
UBS AG	Switzerland	TD / CD's	£60m	1 yr
Credit Suisse AG	Switzerland	TD / CD's	£60m	1 yr
Danske Bank	Denmark	TD / CD's	£60m	1 yr

6.3.4 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 8** below:

Table 8	Minimum credit criteria	Maximum investments	Period
UK Local Authorities	Government Backed	£60m	2 years
Corporate Bond Fund(s)	Investment Grade	£30m	2 - 5 years
Pooled Property Fund(s)	N/A	£30m	5+ years
Mixed Asset Fund(s)	Appropriate rating	£30m	2 - 5 years

The maximum amount that can be invested will be monitored in relation to the Council surplus monies and the level of reserves. The approved counterparty list will be maintained by referring to an up-to-date credit rating agency reports, and the Council will liaise regularly with brokers for updates. Counterparties may be added to or removed from the list only with the approval of the Chief Finance Officer. A detailed list of specified and non-specified investments that form the counterparty list is shown in section 10.

UK Local Authorities

Should a suitable opportunity in the market occur to lend to other Local Authorities of more than a 1 year duration, at a reasonable level of return the deal would be classed as a low risk Non-Specified Investment.

Corporate Bonds

The Department for Communities and Local Government (DCLG) now regards investment in corporate bonds as normal treasury management investment activities, rather than being classified as capital spending. In essence, companies issue bonds in order to raise long-term capital or funding, rather than issuing equity. These are non-standardised compared to other investment vehicles, each having an individual legal document known as a 'bond indenture'. The document specifies the rights of the holder and the obligations that must be met by the issuer, as well as the characteristics of that particular bond. Investing in a corporate bond usually offers a fixed stream of income (except floating rate notes), known as a coupon, payable twice a year, for a fixed, pre-determined period of time, in exchange for an initial investment of capital.

Investment in Pooled Property Fund(s)

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. Property investment 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 Funds offer 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 investment options within the area of Property Fund's and make use of them as and when sufficient due diligence has been undertaken.

Mixed Asset Fund(s)

Rather than focus on a particular asset class, these funds will look to invest across a broader range of classes in an effort to provide investors with a smoother performance on a year-to-year basis. Primarily, the asset classes will be equities and fixed income, but the latter will include both corporate and government-level investments. As with pooled property funds the Council will undergo a selection process to select a suitable fund. It is important to have a full understanding of the particular investment fundamentals are understood from the outset.

6.4 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.

In 2016/17, a review of MRP was undertaken and a change was made to the method of calculating MRP on debt prior to 2008 from a reducing balance to a straight line basis. The change was made to bring the calculation in line with post 2008 debt and resulted in a reprofiling of the MRP charge.

The policy from 2017/18 and in future years is therefore as follows:-

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

- Straight line basis over a maximum of 40 years.

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. A maximum useful economic life of 50 years for land and 40 years for other assets. 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 polices, 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 report 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 Link 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.

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 has worked closely with our advisors and counterparties in the run up to January 2018 the Council has elected 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 will require funds to move from Constant net asset value (CNAV) to Low Volatility net asset value (LVNAV). The reform will take affect from July 2018 and is referenced within the 2018/19 strategy.

9.6 Updates to Treasury Management & Prudential Code, DCLG guidance on investments & MRP and the introduction of IFRS 9

- **Proposals to amend the CIPFA Treasury Management and Prudential Codes**
  CIPFA is currently conducting a review of the Treasury Management Code of Practice and the Prudential Code. This review will particularly focus on non-treasury investments and especially on the purchase of property with a view to generating income. The Council has been part of the consultation process and will await CIPFA's guidance, amending where necessary for future strategies.

- **CLG Local Investment Code and MRP Provision Guidance**
  Over the past years the regulatory and economic environment has changed significantly and led some Authorities to consider more innovative types of investment activity. The government has also monitored changes in the practices used for calculating MRP. DCLG have also launched a consultation into the reporting and monitoring more innovative investment options and a review of MRP. The Council has been part of the consultation process and will await DCLG's guidance, amending where necessary for future strategies.

- **IFRS 9 – Financial Instruments**
  The introduction of this accounting standard in 2018/19 could have an impact on how the certain financial assets are classified and measured within the final accounts. The full impact will be known once the guidance has been published. There are concerns that the gains and losses for some instruments will impact on reserves and balances unless the DCLG allow a statutory override.

10. Counterparty List 2018/19

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	Aa3	P-1	A	A-1	39.04	6	6	60
Bank of Scotland	UK	A+	F1	a	5	Aa3	P-1	A	A-1	49.71	6	6	
RBS/NatWest Group:													
NatWest Bank	UK	BBB+	F2	bbb+	5	A2	P-1	BBB+	A-2	-	12	12	60
Royal Bank of Scotland	UK	BBB+	F2	bbb+	5	A2	P-1	BBB+	A-2	59.66	12	12	
HSBC Bank	UK	AA-	F1+	a+	1	Aa3	P-1	AA-	A-1+	22.03	12	12	60
Barclays Bank	UK	A	F1	a	5	A1	P-1	A	A-1	49.71	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	63.36	6	6	60
Standard Chartered Bank	UK	A+	F1	a	5	A1	P-1	A	A-1	43.55	6	6	60
Nationwide Building Society	UK	A+	F1	a	5	Aa3	P-1	A	A-1	-	6	6	60
Coventry Building Society	UK	A	F1	a	5	A2	P-1	-	-	-	6	6	60
Non UK Counterparties:													
Australia & New Zealand Banking Group	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	50.01	12	12	60
Commonwealth Bank of Australia	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	52.61	12	12	60
National Australia Bank	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	50.65	12	12	60
Westpac Banking Corporation	Australia	AA-	F1+	aa-	1	Aa3	P-1	AA-	A-1+	50.65	12	12	60
Royal Bank of Canada	Canada	AA	F1+	aa	2	A1	P-1	AA-	A-1+	-	12	12	60
Toronto Dominion	Canada	AA-	F1+	aa-	2	Aa2	P-1	AA-	A-1+	-	12	12	60
Dev. Bank of Singapore	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	12	60
Oversea Chinese Banking Corp	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	12	12	60
United Overseas Bank	Singapore	AA-	F1+	aa-	1	Aa1	P-1	AA-	A-1+	-	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)
Svenska H	Sweden	AA	F1+	aa	5	Aa3	P-1	AA-	A-1+	-	12	12	60
Nordea Bank AB	Sweden	AA-	F1+	aa-	5	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	25.53	12	12	60
ING Bank NV	Netherlands	A+	F1	a+	5	Aa3	P-1	A+	A-1	22.07	12	12	60
UBS	Switzerland	AA-	F1+	a+	5	Aa3	P-1	A+	A-1	21.28	12	12	60
Credit Suisse	Switzerland	A	F1	a-	5	A1	P-1	A	A-1	61.21	6	6	60
DZ Bank	Germany	AA-	F1+			Aa1	P-1	AA-	A-1+	-	12	12	60
Danske Bank	Denmark	A	F1	a	5	Aa3	P-1	A	A-1	28.54	6	6	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**	**Period**
UK Local Authorities	Government Backed	£60m	2 years
Corporate Bond Fund(s)	Investment Grade	£30m	2 – 5 years
Pooled Property Fund(s)	N/A	£30m	5+ years
Mixed Asset Fund(s)	Appropriate rating	£30m	2 - 5 years

11. Investment Product Glossary

Bank / Building Society: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Bank / Building Society Secured (Covered Bonds): These investments are secured on the bank's assets, which limit the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in.

Money Market Funds: An open ended fund that invests in short term debt securities, offers same-day liquidity and very low volatility.

Government: Loans, bonds and bills issued or guaranteed by UK government, local authorities and supranational banks. These investments are not subject to bail-in, and there is a minimal risk of insolvency.

Corporate Bonds: Bonds issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent.

Enhanced Cash / Bond Funds: Fund designed to produce an enhanced return over and above a Money Market Fund. The manager may use a wider range of alternative options to try and generate excess performance. These could include different counterparties, instruments as well as longer dated investments.

Pooled Property Funds: Shares in diversified property investment vehicles. Property funds offer enhanced returns over the longer term, but are more volatile in the short term. The funds have no defined maturity date, but are available for withdrawal after a notice period.

Mixed Asset Fund: Rather than focus on a particular asset class, these funds will look to invest across a broader range of classes in an effort to provide investors with a smoother performance on a year-to-year basis. Primarily, the asset classes will be equities and fixed income, but the latter will include both corporate and government-level investments.

Equity Fund: Equity funds are pooled investment vehicles that will focus investments primarily in UK equities.

APPENDIX 'C'

Link Asset Services on the Economic Background and Forward View

1. The Global Economy

1.1 **The Eurozone**. Economic growth in the EU, (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.5% in quarter 1 (2.0% y/y), 0.6% in quarter 2 (2.3% y/y) and +0.6% in quarter 3 (2.5% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in October inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

1.2 **USA.** Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.0%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.2%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and three increases since December 2016; and there could be one more rate rise in 2017, which would then lift the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

1.3 **Asia**. In China economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Whilst Japan has been struggling to stimulate consistent significant growth and to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

1.4 **The Global Outlook.** World Growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-

employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the fourth industrial revolution.

2. The UK Economy

2.1 After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.2% (+2.0% y/y), quarter 2 was +0.3% (+1.7% y/y) and quarter 3 was +0.4% (+1.6% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure.

2.2 However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

2.3 While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting MPC. (Inflation actually came in at 3.0% in September and is expected to rise slightly in the coming months.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action.

2.4 In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

2.5 At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

2.6 However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

3. Link Asset Services forward view

3.1 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. 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.

3.2 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

3.3 Downside risks currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak Capitalisation of European banks.
- Rising protectionism under President Trump.
- Monetary policy A sharp Chinese downturn and its impact on emerging market countries

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

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.
- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

3.5 **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: Initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- 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 could also exit without any such agreements in the event of a breakdown of negotiations.
- 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 full 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.