7. TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2017/18 TO 2019/20

REPORT OF:	Head of Corporate Resources
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Wards Affected:	None
Key Decision	No
Report to:	Audit Committee
Date:	15 March 2017

PURPOSE OF REPORT

1.0 This report sets out the Council's investment and borrowing strategy for the forthcoming three years and reports the counterparty list with which investments may be made. It also sets out the Prudential Limits that provide the parameters for approved future lending and borrowing, including the incidental cost of so doing. The Audit Committee is asked to provide advice on these matters to Council.

SUMMARY

2.0 The purchase of the Orchard Shopping Centre head lease in November necessitated an increase in the Council's Capital Financing Requirement of £25m, which had not been anticipated in the Strategy for 2016-17 to 2018-19. Consequently the revision of some of the Prudential Indicators, such as the authorised borrowing limit, was approved in November. The borrowing comprised £22m from other Local Authorities and the balance from internal funds. The external borrowing will be repaid as Council fixed term deposit investments mature over the next 5 years (see 3.1). Lending is restricted to the same counterparties and within the same limits as approved in the previous strategy approved in March 2016.

RECOMMENDATONS

3.0 The Audit Committee is asked to recommend to Council:

i) the proposed Treasury Management Strategy Statement (TMSS) for 2017/18 and the following two years;

ii) the Annual Investment Strategy (AIS) and the Minimum Revenue Provision Statement (MRP) as contained in Sections 4 and 2.3 respectively of the report;

iii) the Prudential Indicators contained within this report.

BACKGROUND

4.0 The Council applies and upholds the Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the "CIPFA TM Code"). CIPFA has defined Treasury Management as:

BACKGROUND

"the management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks."

5.0 The Code requires local authorities to produce an annual Treasury Management Strategy Statement (TMSS), which documents the Council's approach to capital financing and investments for the forthcoming financial year (2017/18) and the following two years. This report fulfils that requirement.

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

7.0 Additionally, the Act and its subsequent Investment Guidance require the Council to set out its treasury management strategy for borrowing, and to prepare an Annual Investment Strategy (AIS). The Council's borrowing position is reported in Section 3, with arrangements for making Statutory Provisions for Repayment of Debt explained in Section 2.3. The AIS is contained in Section 4 of this report, and describes the Council's policies for managing its investments, and for giving priority to the security and liquidity of those investments.

8.0 Statute requires that the AIS, MRP Statement, and Prudential Indicators are approved by full Council before the start of the new financial year.

POLICY CONTEXT

9.0 Providing transparency and approval of the strategies contained in this report is an important part of the Council's statutory role. Treasury Management has become increasingly topical given the nature of the world's financial markets in recent years, and Members are expected to have a basic understanding of how the Council uses its reserves and cash flows which are in the stewardship of the Head of Corporate Resources.

OTHER OPTIONS CONSIDERED

10. None – this report is statutorily required.

FINANCIAL IMPLICATIONS

11. This report has no quantifiable financial implications. Interest payable and interest receivable arising from treasury management operations, and annual revenue provisions for repayment of debt, form part of the revenue budget but are not required to support the provision of services.

RISK MANAGEMENT IMPLICATIONS

12. This report has no specific implications for the risk profile of the Authority.

EQUALITY AND CUSTOMER SERVICE IMPLICATIONS

13. None.

OTHER MATERIAL IMPLICATIONS

14. This report is not considered to have any other material implications.

BACKGROUND PAPERS

- Treasury Management Strategy Statement & Annual Investment 2016/17 to 2018/19 (March 2016), and Review of Treasury Management Activity 1 April – 30 September 2016 (Nov. 2016).

- Treasury Management in the Public Services: Code of Practice and Cross Sectoral Guidance Notes (CIPFA, November 2011).

- The Prudential Code for Capital Finance in Local Authorities (CIPFA, May 2013).

- Department for Communities & Local Government Investment Guidance (Revised) April 2010)

- Capita Asset Services report template (January 2017)

1.0 INTRODUCTION

1.1 Background

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

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

1.2 Reporting requirements

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

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

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

The approval of the Treasury Management Strategy and Annual Investment Strategy is the function of the Council, however the Head of Corporate Resources shall also report to the Audit Committee on treasury management activity performance as follows:

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision. The report will be submitted as soon after 30 September as practically possible.

An annual treasury report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy. The report will be submitted no later than 30 September after the financial year end.

1.0 INTRODUCTION

Scrutiny - The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Audit Committee, which may make recommendations regarding any aspects of treasury management policy and practices it considers appropriate in fulfilment of its scrutiny role. Such recommendations, as may be made, shall be incorporated within the above named reports and submitted to meetings of the Council for consideration at the next available opportunity.

The Council's Scheme of Delegations is set out in Appendix 4

1.3 Treasury Management Strategy for 2017/18

The strategy for 2017/18 covers two main areas:

Capital issues

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

Treasury management issues

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

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

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training. This especially applies to members responsible for scrutiny. During 2016/17 appropriate treasury management training has been provided to the Audit Committee by LG Futures.

1.0 INTRODUCTION

1.5 External Service Providers

The Council obtains treasury management services under a Shared Services Arrangement (SSA) from the in-house treasury management team formed out of the partnership working between Adur District and Worthing Borough Councils. The operation for all three councils' treasury management is based at Worthing Town Hall, utilising similar banking arrangements.

The SSA is provided under a Service Level Agreement (SLA) that commenced in October 2016 and which defines the respective roles of the client and provider authorities for a period of three years. In making this arrangement the Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that reliance beyond the terms and arrangements specified in the SLA is not placed upon the shared service providers.

The Council will ensure that the terms of the appointment of the shared services providers, and the methods by which their value will be assessed, are properly agreed and documented and subjected to regular review.

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019 /20

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

2.1 Capital expenditure

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

Capital expenditure	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m	£m
General Fund	3.629	28.173	2.784	1.656	0.854

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

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

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2016/17 – 2019/20

2.1 Capital expenditure

Capital expenditure	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m	£m
Total	3.629	28.173	2.784	1.656	0.854
Financed by:					
Capital receipts	0.156	0.0	10.900	10.000	0
Capital grants, Contributions & S106 receipts	1.105	0.852	1.213	0.846	0.600
General Reserves, Specific Reserves & Revenue Contr	2.368	2.461	1.571	0.810	0.254
Net financing need for the year	0	24.860	-10.900	-10.000	0

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

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

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

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

The Council is asked to approve the CFR projections below:

Capital Financing Requirement	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	£m	£m	£m	£m
Total CFR	1.283	25.874	14.595	4.368	4.135
Movement in CFR	(0.259)	24.591	(11.279)	(10.227)	(0.233)
Movement in CFR represented by:					
Net financing need for the year (above)	0	24.860	(10.900)	(10.000)	(0.0)
Less MRP and other financing movements	(0.259)	(0.269)	(0.379)	(0.227)	(0.233)
Movement in CFR	(0.259)	24.591	(11.279)	(10.227)	(0.233)

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019/20

2.3 Minimum revenue provision (MRP) policy statement

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

CLG regulations have been issued which require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement*:*

The Council's policy for MRP relating to capital expenditure prior to 2016/17 is to provide for MRP on an annuity basis over the life of the loans. As an annuity is a fixed annual sum comprising interest and principal, the MRP for repayment of debt will increase each year over the asset life as the proportion of interest calculated on the principal outstanding reduces as the debt is repaid.

The purchase of the Orchard Shopping Centre head lease increased the Capital Financing Requirement by £24.86m. The Council is expecting capital receipts of £20.9m (£10.9m in 2017/18 and £10m in 2018/19), so it will only provide MRP on the balance. This will be done on a level basis of £100,000 per year.

Repayments included in finance leases are applied as MRP.

2.4 Affordability prudential indicators

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

2.5 Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	%	%	%	%	%
Ratio	-1.34%	-1.01%	-0.22%	-2.14%	-4.71%

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

2.0 THE CAPITAL PRUDENTIAL INDICATORS 2017/18 – 2019/20

2.6 Incremental impact of capital investment decisions on Council Tax

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

Incremental impact of capital investment decisions on the band D Council Tax

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council Tax - band D	-£0.28	-£9.38	-£18.97	-£3.04	-£0.28

3.0 BORROWING

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

3.1 Current portfolio position

The Council's treasury portfolio position at 31 March 2016, with forward projections, is summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. The Council's debt comprises one loan from the Public Works Loan Board (PWLB), which matures on 1 March 2023 and several loans with other local authorities, totalling £22m, for between 7 months and 5 years, to fund the purchase of the Orchard Shopping Centre head lease. The local authority loans are at rates lower than those available from the PWLB, ranging from 0.35% to 1.1%, and they will be repaid using capital receipts (£20.9m) and maturing investments. The "other long term liability" is in respect of capital assets acquired by finance leases.

3.0 BORROWING

3.1 Current portfolio position

External Debt	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
	£m	**£m**	**£m**	**£m**	**£m**
Debt at 1 April	1.047	0.936	22.820	12.698	7.571
Expected change in Debt	(0.111)	21.884	(10.122)	(5.127)	(0.133)
Other long-term liabilities (OLTL)	0.458	0.310	0.157	0.0	0.0
Expected change in OLTL	(0.148)	(0.153)	(0.157)	0.0	0.0
Actual gross debt at 31 March	1.246	22.977	12.698	7.571	7.438
The Capital Financing Requirement	1.283	25.874	14.595	4.368	4.135
Under/(over) borrowing	0.037	2.897	1.897	(3.203)	(3.303)

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

The Head of Corporate Resources reports that the Council complied with this prudential indicator in the current year and does not envisage difficulties for the future, although the respective timing of capital receipts and repayment of debt results in a projected over borrowing position in 2018/19 and 2019/20, which will be corrected in 2020/21. This view takes into account current commitments, existing plans, and the proposals in this budget report.

3.2 Treasury Indicators: limits to borrowing activity

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

Operational Boundary	2016/17	2017/18	2018/19	2019/20
	£m	**£m**	**£m**	**£m**
Debt	£28.0m	£28.0m	£28.0m	£28.0m
Other long term liabilities	£1.0m	£1.0m	£1.0m	£1.0m
Total	**£29.0m**	**£29.0m**	**£29.0m**	**£29.0m**

3.0 BORROWING

3.2 Treasury Indicators: limits to borrowing activity

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

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

2. The Council is asked to approve the following authorised limit:

Authorised Limit	2016/17	2017/18	2018/19	2019/20
	£m	**£m**	**£m**	**£m**
Debt	£30.0m	£30.0m	£30.0m	£30.0m
Other long term liabilities	£1.0m	£1.0m	£1.0m	£1.0m
Total	**£31.0m**	**£31.0m**	**£31.0m**	**£31.0m**

The Head of Corporate Resources has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported to the next meeting of the Council at the earliest opportunity.

3.3 Prospects for interest rates and the economy

This section contains a commentary for the economic outlook provided by the Council's shared service provider's treasury management consultants, Capita Asset Services. This includes a central view of forecast interest rates as follows:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

3.3 Prospects for interest rates and the economy

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

3.3 Prospects for interest rates and the economy

Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. 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 overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise.

3.3 **Prospects for interest rates and the economy**

Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

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

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

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

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 4.12.16 resulted in a ‘No’ vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.

3.0 BORROWING

3.3 **Prospects for interest rates and the economy**

- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.

- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.

- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.

- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

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

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

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

3.0 BORROWING

3.4 Borrowing strategy

The financing of the capital programme forms part of the Prudential Indicators. The Council does not anticipate any new borrowing within the capital programme up to 2019/20 inclusive.

Treasury management limits on activity

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

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates for both debt and investments

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

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

The limits below provide the necessary flexibility to make decisions based on the expectations of anticipated interest rate movements as set out in the Council's treasury management strategy. The maturity structure limits were breached in 2016/17 due to the borrowing for the purchase of the Orchard Shopping Centre head lease.

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

Interest rate exposures	2017/18	2018/19	2019/20
	Upper	Upper	Upper
Limits on fixed interest rates:			
Debt only	100%	100%	100%
Investments only	-100%	-100%	-100%
Limits on variable interest rates:			
Debt only	25%	25%	25%
Investments only	-100%	-100%	-100%

Maturity structure of fixed interest rate borrowing 2017/18		
	Lower	Upper
Under 12 months	30%	50%
12 months to 2 years	0%	40%
2 years to 5 years	25%	70%
5 years to 10 years	0%	10%
Over 10 years	0%	0%

3.0 BORROWING

3.4 Borrowing strategy

The Council has no variable interest rate borrowing		

Policy on borrowing in advance of need

The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. As stated above, there is no intention to borrow up to 2019/20.

3.5 Debt rescheduling

The Council has one loan from the Public Works Loan Board, repaid by fixed annuities over the life of the loan. As it would not be possible to prematurely repay the existing loan without incurring a premium charge for early settlement, there is currently no intention to redeem the loan early. The loans for the purchase of the Orchard Shopping Centre head lease will be repaid within 5 years and are all at competitively low interest rates.

4.0 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

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

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

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

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

4.1 **Investment policy**

The Head of Corporate Resources, under delegated powers, will undertake through the shared service arrangements the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements, and Prudential Indicators. As conditions in the financial markets remain uncertain, the proposed maximum limits for Specified and Unspecified Investments for 2017/18 are the same as for 2016/17.

Investment instruments identified for use in the financial year are listed in Appendices 1-3 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices.

4.2 **Creditworthiness policy**

The primary principle governing the Council's investment criteria through the Shared Services Arrangement (SSA) is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the SSA will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections in Appendices 1-3; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

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

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

4.2 **Creditworthiness policy**

Use of additional information other than credit ratings

Additional requirements under the Code require the Council to supplement credit rating information. Whilst the above criteria rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating Watches/Outlooks) will be applied to compare the relative security of differing investment counterparties.

The proposed criteria for specified and non-specified investments are shown in the Appendices for approval.

4.3 **Country and sector limits**

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

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of *AA*- from Fitch (or equivalent).

In addition:

- no more than 25% will be placed with any non-UK financial institutions

4.4 **Investment strategy**

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

Investment returns expectations - Bank Rate is forecast to remain unchanged at 0.25% until quarter 2 of 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 for the next three years are as follows:

2017/18	:	0.25%
2018/19	:	0.25%
2019/20	:	0.50%

4.0 ANNUAL INVESTMENT STRATEGY

4.4 **Investment strategy**

There are upside risks to these forecasts (ie start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

4.5 Investment treasury indicator and limit - total principal funds invested for greater than 364 days

These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end. In view of the interest rate outlook the Council will not lock into further long term deals unless justified where attractive rates are available with counterparties of particularly high creditworthiness (ie approved counterparties with a minimum credit rating of A- from Fitch Ratings or equivalent, or Building Societies with assets in excess of £1bn, or other local authorities) where the deals are within the risk parameters set by the Council.

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

Maximum proportion of principal sums invested > 364 days	2017/18	2018/19	2019/20
Principal sums invested > 364 days	50%	50%	50%

For its cash flow generated balances, the Council will seek to utilise its interest paying general account, money market funds and short-dated deposits (overnight to100 days) in order to benefit from the compounding of interest.

4.6 End of year investment report

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

4.7 External fund managers

The Council does not use external fund managers, but reserves the option to do so in future should this be deemed to be appropriate. Should consideration be given to exercising this option in the future, the relevant Committee will be advised of the reasons for doing so and the Cabinet requested to consider whether it wishes to proceed with the selection and appointment of external fund managers.

SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council

Specified Investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of 1 year
- meets the "high" credit criteria as determined by the Council or is made with the UK government or is made with a local authority in England, Wales and Scotland.
- the making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate).

"Specified" Investments identified for the Council's use are:

- Deposits in the DMO's Debt Management Account Deposit Facility
- Deposits with UK local authorities
- Deposits with banks and building societies
- *Certificates of deposit with banks and building societies
- *Gilts : (bonds issued by the UK government)
- *Bonds issued by multilateral development banks
- AAA-rated Money Market Funds with a Constant Net Asset Value (Constant NAV)
- Other Money Market Funds and Collective Investment Schemes– i.e. credit rated funds which meet the definition of a collective investment scheme as defined in SI 2004 No 534 and SI 2007 No 573.

    1. ** Investments in these instruments will be on advice from the Council's Shared Service Provider's treasury management consultants.*

    2. *The use of the above instruments by the Council's fund managers (if appointed) will be by reference to the fund guidelines contained in the agreement between the Council and the individual manager.*

For credit rated counterparties, the minimum criteria, except for the Council's own banker and the specified building societies (see below), will be the short-term/long-term ratings assigned by various agencies which may include Moody's Investors Services, Standard & Poor's, Fitch Ratings, being:

APPENDIX 1

SPECIFIED AND NON SPECIFIED INVESTMENTS

Specified Investments identified for use by the Council

Long-term minimum: A- (Fitch, or equivalent)

Or: Short-term minimum: F1 (Fitch, or equivalent)

If the Council's own banker (currently Lloyds Bank) falls below the above criteria, it will still be used for transactional purposes, although in this case balances will be minimised in both monetary size and time.

The Council will also take into account information on corporate developments of and market sentiment towards investment counterparties.

Non Specified Investments

These are any investments which do not meet the specified investment criteria.

APPENDIX 2

APPROVED INVESTMENT INSTITUTIONS

Specified Investments identified for use by the Council

New specified investments will be made within the following limits:

(a) Banks (Approved Investment Regulation 2 (b))

Major U.K. and European Banks and their wholly-owned subsidiaries meeting the Council's approved investment criteria.

	Counterparty	Group	Individual Sum and Maximum Period	
1	HSBC Bank plc		£4m	5 years
2	The Royal Bank of Scotland Group:	£5m		
	The Royal Bank of Scotland plc		£4m	5 years
	National Westminster Bank plc		£4m	5 years
	Ulster Bank Belfast Limited		£1m	1 year
3	Lloyds Group::	£5m		
	Lloyds Bank plc		£4m	5 years
	Halifax plc		£4m	5 years
	Bank of Scotland plc		£4m	5 years
	HBOS Treasury Services plc		£4m	5 years
4	Barclays Bank plc		£4m	5 years
5	Santander UK		£4m	5 years
6	Clydesdale Bank	N/A	£4m	5 years
7	Svenska Handelsbanken AB	N/A	£4m	1 year
8	Close Brothers Ltd	N/A	£4m	5 years

APPENDIX 2

APPROVED INVESTMENT INSTITUTIONS

Specified Investments identified for use by the Council

(b) Building Societies (Approved Investment Regulation 2 (c))

(i) Building Societies (Assets in excess of £1 billion):

Rank	Name of Counterparty	Individual	
		Sum	Period
1	Nationwide	£4m	3 years
2	Yorkshire	£4m	3 years
3	Coventry	£4m	3 years
4	Skipton	£3m	3 years
5	Leeds	£3m	3 years
6	Principality	£3m	3 years
7	West Bromwich	£3m	3 years
8	Newcastle	£3m	3 years
9	Nottingham	£3m	3 years
10	Cumberland	£3m	3 years
11	Progressive	£3m	3 years
12	National Counties	£3m	3 years
13	Saffron	£3m	3 years
14	Cambridge	£3m	3 years
15	Monmouthshire	£3m	3 years

(c) Money Market Funds (Approved Investment Reg 2(2) and 2(3) (b))

Counterparty	Sum	
Invesco Aim – Sterling	£3m	For Short Term Operational Cash Flow Purposes
Blackrock Institutional Sterling Liquidity Fund	£3m	
Goldman Sachs Sterling Liquidity Reserve Fund	£3m	
Fidelity Institutional Cash Fund plc – Sterling	£3m	
Federated Short-Term Sterling Prime Liquidity Fund	£3m	

The limit for investing in any one Money Market Fund is £3 million. Total investments in Money Market Funds shall not exceed the higher of £9m or 25% of the total investment portfolio, for more than one week at any one time.

APPENDIX 2

APPROVED INVESTMENT INSTITUTIONS

Specified Investments identified for use by the Council

(d) Local Authorities (Approved Investment Regulation 2 (i) and Schedule Part II)

(i) All the following local authorities mentioned in the Regulations

Schedule Part II Ref	Details	Individual	
		Sum	Period
1	County Councils (England and Wales)	£3m	5 years
2	District Councils in England and Wales (including Borough, City, Metropolitan Borough Councils and Unitary Councils)	£3m	5 years
3	London Borough Councils	£3m	5 years
4	The Common Council of the City of London	£3m	5 years
5	The Council of the Isles of Scilly	£3m	5 years
7	Combined Police Authorities	£3m	5 years
16	Regional, Islands, or District Councils in Scotland	£3m	5 years
17	Joint boards under s.235 (1) of LG (Scotland) Act 1973	£3m	5 years
28	District Councils in Northern Ireland	£3m	5 years
29	Police Authorities (now Police and Crime Commissioners) under s.3 Police Act 1964 as substituted by s.2 Police & Magistrates Courts Act 1994	£3m	5 years

APPENDIX 3

NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL

Having considered the rationale and risk associated with Non-Specified Investments, the following have been determined for the Council's use.

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
• Deposits with banks and building societies • Certificates of deposit with banks and building societies	√ √	 √	5 years	The higher of £10m or 50% of funds	No
Gilts and Bonds: • Gilts • Bonds issued by multilateral development banks • Bonds issued by financial institutions guaranteed by the UK government • Sterling denominated bonds by non-UK sovereign governments	√ √ √ √ (on advice from treasury advisor)	√ √ √ √	5 years	The higher of £3m or 25% of funds	No
Money Market Funds and Collective Investment Schemes (pooled funds which meet the definition of a collective investment scheme as defined in SI 2004 No. 534 and SI 2007, No. 573), but which are not credit rated.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date.	The higher of £9m or 25% of funds	No
Government guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Property Funds approved by HM Treasury and operated by managers regulated by the Financial Conduct Authority – specifically the Local Authorities' Property Fund	√	√	These funds do not have a defined maturity date.	The higher of £4m or 25% of funds	No

NON-SPECIFIED INVESTMENTS DETERMINED FOR USE BY THE COUNCIL

	In-house use	Use by Fund Managers	Maximum Maturity	Maximum % of portfolio or £m	Capital Expenditure?
Non-guaranteed bonds and debt instruments (e.g. floating rate notes) issued by corporate bodies	√ (on advice from treasury advisor)	√	5 years	The higher of £2m or 10% of funds	Subject to test
Collective Investment Schemes (pooled funds) which do not meet the definition of collective investment schemes in SI 2004 No. 534 or SI 2007, No. 573.	√ (on advice from treasury advisor)	√	These funds do not have a defined maturity date	The higher of £2m or 20% of funds	Subject to test

In determining the period to maturity of an investment, the investment is regarded as commencing on the date of the commitment of the investment rather than the date on which funds are paid over to the counterparty.

Accounting treatment of investments

The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

APPENDIX 4

TREASURY MANAGEMENT SCHEME OF DELEGATION

(i) **Full Council**

- approval of annual treasury management strategy and Annual Investment Strategy
- approval of MRP Statement

(ii) **Executive Committee (e.g. Cabinet)**

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

(iii) **Audit Committee**

Receiving and reviewing the following, and making recommendations to the Cabinet

- regular monitoring reports on compliance with the Treasury Management Strategy, practices and procedures.

(iv) **The S151 (responsible) officer**

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