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| **DECISION-MAKER:** | | GOVERNANCE COMMITTEE<br>COUNCIL | | |
| **SUBJECT:** | | TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL LIMITS 2018/19 TO 2021/22 | | |
| **DATE OF DECISION:** | | 12 FEBRUARY 2018<br>21 FEBRUARY 2018 | | |
| **REPORT OF:** | | SERVICE DIRECTOR FINANCE AND COMMERCIALISATION (S151) | | |
| **<u>CONTACT DETAILS</u>** | | | | |
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**STATEMENT OF CONFIDENTIALITY**

NOT APPLICABLE

**BRIEF SUMMARY**

With overall annual expenditure in excess of £600M and an extensive capital programme, the Council is required to actively manage its cash-flows on a daily basis. The requirement to invest or to borrow monies to finance capital programmes, and to cover daily operational needs is an integral part of daily cash and investment portfolio management.

This report explains the context within which the Council's treasury management activity operates and sets out a proposed strategy for the coming year in relation to the Council's cash flow, investment and borrowing, and the management of the numerous risks related to this activity.

The core elements of the 2018/19 strategy are :

- To continue to make use of short term variable rate debt to take advantage of the current market conditions of low interest rates.
- To constantly review longer term forecasts and to lock into longer term rates through a variety of instruments as appropriate during the year, in order to provide a balanced portfolio against interest rate risk.
- To secure the best short term rates for borrowing and investments consistent with maintaining flexibility and liquidity within the portfolio.
- To invest surplus funds prudently, the Council's priorities being:
    - Security of invested capital
    - Liquidity of invested capital
    - An optimum yield which is commensurate with security and liquidity.
- To approve borrowing limits that provide for debt restructuring opportunities and to pursue debt restructuring where appropriate and within the Council's risk boundaries.

- To approve the 2018 Minimum Revenue Provision (MRP) Statement

**RECOMMENDATIONS:**

**GOVERNANCE COMMITTEE**

**It is recommended that Governance Committee:**

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| | (i) | Endorse the Treasury Management (TM) Strategy for 2018/19 as outlined in the report. |
| | (ii) | Endorse the 2018 Minimum Revenue Provision (MRP) Statement as detailed in paragraphs 85 to 94. |
| | (iii) | Note that the indicators as reported have been set on the assumption that the recommendations in the Capital update report will be approved by Council on 21 February 2018. Should the recommendations change, the Prudential Indicators may have to be recalculated. |
| | (iv) | Note that due to the timing of this report, changes may still be required following the finalisation of capital and revenue budgets and therefore any significant changes to this report will be highlighted in the final version that is presented to Full Council. |

**COUNCIL**

**It is recommended that Council:**

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| | (i) | Approve the Council's Treasury Management (TM) Strategy and Prudential Indicators for 2018/19, 2019/20, 2020/21 and 2021/22, as detailed within the report. |
| | (ii) | Approve the 2018 Minimum Revenue Provision (MRP) Statement as detailed in paragraphs 85 to 94 and to delegate authority to the Chief Financial Officer (CFO) to approve any changes necessary that aid good financial management whilst maintaining a prudent approach. |
| | (iii) | Approve the Annual Investment Strategy as detailed in paragraphs 43 to 66. |
| | (iv) | Note that at the time of writing this report the recommendations in the Capital update report, submitted to Council on the 21 February 2018, have not yet been approved. The indicators in the report are based on the assumption that they will be approved, but should the recommendations change, the Prudential Indicators may have to be recalculated. |
| | (v) | Continue to delegate authority to the Chief Financial Officer (CFO) to approve any changes to the Prudential Indicators, Minimum Revenue Provision or borrowing limits that will aid good treasury management. For example, agreeing an increase in the percentage for variable rate borrowing to take advantage of the depressed market for short term rates. Any amendments will be reported to cabinet as part of quarterly financial and performance monitoring and in revisions to the TM Strategy. |

**REASONS FOR REPORT RECOMMENDATIONS**

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| 1. | In order to comply with Part 1 of the Local Government Act 2003, and the established TM procedures that have been adopted by the Council, each year the |

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| | Council must set certain borrowing limits and approve TM Strategy which includes:<br>• Treasury Management Strategy for 2018/19:<br>  o Borrowing – Paragraphs 30 to 41,<br>  o Debt Rescheduling – Paragraph 42<br>  o Investments – Paragraphs 43 to 66<br>• Treasury Management Indicators – Paragraphs 67 to 83<br>• MRP Statement – Paragraphs 85 to 94<br>• Other Prudential Indicators – Paragraphs 95 to 117 |
| **ALTERNATIVE OPTIONS CONSIDERED AND REJECTED** | |
| 2. | Alternative options for borrowing would depend on decisions taken on the review of the General Fund & Housing Revenue Account Capital Strategy and Programme update report being taken at Full Council on 21 February 2018. |
| **DETAIL (Including consultation carried out)** | |
| | **CONSULTATION** |
| 3. | The proposed General Fund & Housing Revenue Account Capital Strategy and Programme Update report on which this report is based has been subject to separate consultation processes. |
| | **BACKGROUND** |
| 4. | The Local Government Act 2003 introduced a system for borrowing based largely on self-regulation by local authorities themselves. The basic principle of the new system is that local authorities will be free to borrow as long as their capital spending plans are affordable, prudent and sustainable. |
| 5. | As per the requirements of the Prudential code, the Council adopted the CIPFA Treasury Management Code at its Council meeting on 19 February 2003 and all its subsequent updates. The latest one being *Treasury Management in the Public Services: Code of Practice 2011 Edition* in February 2012. |
| 6. | CIPFA published revised editions of the Treasury Management and Prudential Codes in December 2017.<br>The Council is currently considering the changes from the 2011 Code for incorporation into future Treasury Management Strategies and monitoring reports. However, Minimum Revenue Provision (MRP) changes have been incorporated into the Medium Term Financial Strategy & Budget report which will be reported to Council February 2018, as the changes result in a pressure in 2018/19 and future years. |
| 7. | In addition, the Ministry of Housing, Communities and Local Government (MHCLG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an investment strategy before the start of each financial year. |
| 8. | This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA code and the MHCLG guidance. |
| 9. | Overall responsibility for treasury management remains with the Council. No TM activity is without risk; the effective identification and management of risk are integral to the Council's treasury management objectives. The council has |

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| | borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. Our current policy is shown in appendix 1. This report covers treasury activity and the associated monitoring and control of risk. |
| 10. | The purpose of this Treasury Management Strategy (TMS) is to allow Council to approve:<br>• Treasury Management Strategy for 2018/19<br>• Annual Investment Strategy 2018/19<br>• Prudential Indicators for 2018/19 to 2021/22<br>• 2018 MRP Statement |
| 11. | The strategy takes into account the impact of the Council's Revenue Budget and Capital Programme on the Balance Sheet position, the Prudential Indicators and the current and projected Treasury position (Appendix 2). The outlook for interest rates (Appendix 3) has also been taken into account in developing this strategy |
| 12. | The Council acknowledges that effective TM 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 TM, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management. To aid the Council in carrying out its TM function, it has appointed TM Advisors (Arlingclose), who advise the Council on strategy and provide market information to aid decision making. However it should be noted that the decisions are taken independently by the CFO taking into account this advice and other internal and external factors. |
| 13. | In accordance with the MHCLG Guidance, the Council will be asked to approve a *revised Treasury Management Strategy Statement* should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates; material change to the Council's capital programme or in the level of its investment balance.<br>It should be noted that once the arrangements regarding the Local Authority Trading Company (LATCo) have been finalised it is expected that the strategy will need to be updated. |
| 14. | The MHCLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Council believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below. |

| Options | Impact on income and expenditure | Impact on risk management |
|---|---|---|
| Invest in a narrower range of counterparties and/or for shorter times | Interest income will be lower | Lower chance of losses from credit related defaults, but any such losses may be greater |
| Invest in a wider range of counterparties and/or for longer times | Interest income will be higher | Increased risk of losses from credit related defaults, but any such losses will be smaller |

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| Borrow additional sums at long-term fixed interest rates | Debt interest costs will rise; this is unlikely to be offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain |
| Borrow short-term or variable loans instead of long-term fixed rates | Debt interest costs will initially be lower | In the medium term, increases in debt interest costs will be broadly offset by rising investment income in but long term costs will be less certain |
| Reduce level of borrowing | Saving on debt interest is likely to exceed lost investment income | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain |

**Economic Background**

15. The major external influence on the Council's treasury management strategy for 2018/19 will be the UK's progress in negotiating it's exit from the European Union and agreeing future trading arrangements.

16. The domestic economy has remained relatively robust since the outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

17. Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

18. In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

**Credit Outlook**

19. High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

20. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ring-fence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

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| 21. | The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain very low. |
| | **<u>Interest Rate Forecast</u>** |
| 22. | The Council's treasury management advisor's, Arlingclose, central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent. |
| 23. | Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. |
| 24. | A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix 3 |
| 25. | For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.39% for short term and 4.50% for long term (average of 2.8%) , and that new long-term loans taken over the period of the strategy will be borrowed at an average rate of 2.92%. |
| | **BALANCE SHEET SUMMARY AND FORECAST** |
| 26. | The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. |
| 27. | At 31/12/2017 the Council held £321M of debt (£244M borrowing plus £77M other long term liabilities) and £69M investments which is set out in further detail in Appendix 2. |
| 28. | Forecast changes in these sums are shown in the balance sheet analysis in **Table 1** below. |
| 29. | **Table 1** shows that the Council will:<br>• Comply with this recommendation;<br>• That the Council has an increasing CFR due to the impact of the capital programme;<br>• Decreasing investments; and<br>• Will need to borrow over the forecast period. |
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**Table 1: Balance sheet Summary and Forecast**

| | 31/03/2018 Forecast £M | 31/03/2019 Forecast £M | 31/03/2020 Forecast £M | 31/03/2021 Forecast £M | 31/03/2022 Forecast £M |
|---|---|---|---|---|---|
| General Fund CFR | 334.87 | 357.07 | 352.06 | 360.69 | 380.54 |
| Housing CFR | 171.84 | 182.69 | 181.40 | 182.25 | 180.93 |
| **Total Opening CFR (*see Table 11*)** | **506.71** | **539.76** | **533.46** | **542.94** | **561.47** |
| Less Other Long Term Liabilities* | (74.97) | (72.51) | (69.13) | (65.60) | (61.66) |
| **Borrowing CFR** | **431.74** | **467.25** | **464.33** | **477.34** | **499.81** |
| Less External Borrowing | | | | | |
| Long Term | (217.81) | (206.34) | (169.88) | (150.60) | (147.87) |
| Short Term | (48.54) | | | | |
| **Internal Borrowing** | **165.39** | **260.91** | **294.45** | **326.74** | **351.94** |
| Less Usable Reserves | (122.52) | (117.51) | (112.51) | (107.51) | (102.51) |
| Less Working Capital | (42.87) | (42.87) | (42.87) | (42.87) | (42.87) |
| **Underlying need to borrow** | **0.00** | **100.53** | **139.07** | **176.36** | **206.56** |

** finance leases, PFI liabilities and transferred debt which form part of the Council's total debt*

## BORROWING STRATEGY

30. The Council currently holds £244M of loans a decrease of £16M since the 31st March 2017 and reflects the current strategy of only borrowing when cash flows dictate, thus lowering both borrowing costs and investment risk. The estimated forecast as shown in Appendix 4, table 4 is that based on the current capital programme and expected cash flows, the Council expects to borrow £266M by 31st March 2018, this is an additional £22M (see appendix 2) and a further £41M in 2018/19 bringing estimated borrowing to £307M.

If it was cost effective the Council could also borrow additional sums to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing.

### Objectives

31. The Council's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

### Strategy

32. Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

33. Affordability and the "cost of carry" remain important influences on the Council's borrowing strategy alongside the consideration that, for any borrowing undertaken ahead of need, the proceeds would have to be invested in the money markets at rates of interest significantly lower than the cost of borrowing. As short-term interest rates are likely to remain, at least over the period of 2017/18 and 2018/19, lower than long-term rates, the Council determines it will be more cost effective in the short-term to use internal resources and will look to

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| | borrow short-term loans instead From 2019/20 the Medium Term Financial Strategy assumes that the majority of new borrowing will be on a long term basis. |
| 34. | By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal and short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Council with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term. |
| 35. | Alternatively, the Council may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.<br>In addition, the Council may borrow further short-term loans to cover unexpected cash flow shortages. |
| | **Sources** |
| 36. | The approved sources of long-term and short-term borrowing are:<br>• Public Works Loan Board (PWLB) and any successor body<br>• any institution approved for investments (see below)<br>• any other bank or building society authorised to operate in the UK<br>• UK public and private sector pension funds (except HCC Pension Fund)<br>• capital market bond investors<br>• UK Municipal Bonds Agency plc and other special purpose companies created to enable local Council bond issues |
| 37. | In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:<br>• operating and finance leases<br>• hire purchase<br>• Private Finance Initiative<br>• sale and leaseback |
| 38. | The Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local Council loans and bank loans which may be available at more favourable rates. |
| 39. | UK Municipal Bonds Agency plc (MBA) was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons:<br>• Borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local Council borrowers default on their loans; and<br>• There will be a lead time of several months between committing to borrow and knowing the interest rate payable. |

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| | A report setting out in full the details, options and risks of the MBA was considered by full Council on 10 February 2016 and any initial proposal to borrow from the Agency will therefore need to be the subject of a separate report to both Governance Committee and Full Council. |
| | **<u>Lender's Option Borrower's Option Loans (LOBOs)</u>** |
| 40. | The Council holds £9M of LOBO loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2018/19 and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so. |
| | **<u>Short Term and Variable Rates</u>** |
| 41. | Included within the PWLB portfolio is £35M of variable rate Loans, which are currently averaging 0.45% and are helping to keep the overall cost of borrowing down. Whilst in the current climate of low interest rates this remains a sound strategy, these loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators (paragraph 70), the Council review these regularly and if appropriate will switch into fixed rate loans. |
| | **<u>Debt Rescheduling</u>** |
| 42. | The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk. |
| | **INVESTMENT STRATEGY** |
| 43. | The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. During the financial year the Council's investment balances have ranged between £58M and £101M and are currently £69M as at 31st December 2017. Projected balances indicate that on present levels of spend balances will be lower than last year, but this will be dependent on any borrowing decisions taken. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond. |
| 44. | As a result of the second Markets in Financial Instruments Directive (MiFID II), from 3rd January 2018 local authorities will be treated as retail clients but can "opt up" to professional client status, providing that they meet certain criteria which includes having an investment balance of at least £10 million and the person(s) authorised to make investment decisions on behalf of the Council have at least a year's relevant professional experience. In addition, the regulated financial services firms to whom this directive applies must assess that |

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| | that person(s) have the expertise, experience and knowledge to make investment decisions and understand the risks involved. The Council has met the conditions to opt up to professional status and has done so in order to maintain its MiFID II status prior to January 2018. As a result, the Council will continue to have access to products including money market funds, pooled funds, treasury bills, bonds, shares and to financial advice. |
| | **Objectives** |
| 45. | Both the CIPFA Code and the MHCLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested, however it should be noted that a lower rate is an acceptable offset for higher credit and less risk, for example a covered bond. |
| | **Negative Interest Rates** |
| 46. | If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested. |
| | **Strategy** |
| 47. | Given the increasing risk and very low returns from short-term unsecured bank investments, the Council aims to continue to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the estimated £40M that is available for longer-term investment. Appendix 2 shows the makeup of the Council's current investments. |
| | **Approved Counterparties** |
| 48. | The Council may invest its surplus funds with any of the following counterparty types, subject to the cash limits (per counterparty) and time limits detailed below. This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO. |

**Table 2: Approved Investment counterparties and Limits**

| Credit Rating | Banks Unsecured £M | Banks Secured £M | Government & Local Authorities £M | Corporates £M | Registered Providers £M |
|---|---|---|---|---|---|
| UK Govt | n/a | n/a | £ Unlimited 50 years | n/a | n/a |
| AAA | £5M 5 years | £10M 20 years | £10M 50 years | £5M 20 years | £5M 20 years |
| AA+ | £5M 5 years | £10M 10 years | £10M 25 years | £5M 10 years | £5M 10 years |
| AA | £5M 4 years | £10M 5 years | £10M 15 years | £5M 5 years | £5M 10 years |
| AA- | £5M 3 years | £10M 4 years | £10M 10 years | £5M 4 years | £5M 10 years |
| A+ | £5M 2 years | £10M 3 years | £5M 5 years | £5M 3 years | £5M 5 years |
| A | £5M 13 months | £10M 2 years | £5M 5 years | £5M 2 years | £5M 5 years |
| A- | £5M 6 months | £10M 13 months | £5M 5 years | £5M 13 months | £5M 5 years |
| None | £1M 6 months | n/a | £10M 25 years | £0.5M 5 years | £5M 5 years |
| Pooled funds | £10M per fund for MMFs, other funds (e.g. CCLA) subject to specific advice | | | | |

*This table must be read in conjunction with the notes below.*

49. **Credit Rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

50. **Banks Unsecured:** 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. See paragraph 56 for arrangements relating to operational bank accounts.

51. **Banks Secured:** Covered bonds, reverse repurchase agreements and other

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| | collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments. |
| 52. | **Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years. |
| 53. | **Corporates:** Loans, bonds and commercial paper 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. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £1M per company as part of a diversified pool in order to spread the risk widely. |
| 54. | **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed. |
| 55. | **Pooled Funds:** Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.<br>Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.<br>The Council has invested £27M in property funds. These offer the potential for enhanced returns over the longer term, but may be more volatile in the shorter term and are managed by professional fund managers which allows the Authority to diversify into asset classes. |
| 56. | **Operational bank accounts**: The Council may incur operational exposures, for example though current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept to a |

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| | minimum. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity. |
| 57. | The Chief Financial Officer (CFO), under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported quarterly to Cabinet. |
| | **Risk Assessment and Credit Ratings** |
| 58. | Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:<br>• no new investments will be made,<br>• any existing investments that can be recalled or sold at no cost will be, and<br>• full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.<br>Where a credit rating agency announces that a rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating. |
| | **Other Information on the Security of Investments** |
| 59. | The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria. |
| 60. | When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested. |
| | **Specified Investments** |

61. The MHCLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local Council, parish council or community council, or
  - a body or investment scheme of “high credit quality”.

The Council defines “high credit quality” organisations as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

**Non-Specified Treasury Investments**

62. Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified Treasury investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 3 below.

**Table 3 – Non Specified Investment Limits**

| | Cash Limit |
|---|---|
| Total long-term investments | £20M |
| Total investments without credit ratings or rated below A- | £30M |
| Total investments in foreign countries rated below AA+ | £5M |
| | |
| **Total non-specified investments** | **£55M** |

63. **Investment Limits:** The Council’s revenue reserves and balances available to cover investment losses (excluding Schools, capital and HRA) are forecast to be £69.7M at 31st March 2018. In order that there is no immediate pressure on available reserves in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government and property funds) will be £10M. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors in table 4 below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

**Table 4 –Investment Limits**

| | Cash limit |
|---|---|
| Any single organisation, except the UK Central Government and property funds (subject to specific advice) | £10M each* |
| UK Central Government | unlimited |
| Any group of organisations under the same ownership | £10M per group* |
| Any group of pooled funds under the same management | 25% per manager unless under specific advice |
| Negotiable instruments held in a broker's nominee account | £30M per broker |
| Foreign countries | £10M per country |
| Registered Providers | £5M in total |
| Unsecured investments with Building Societies | £5M in total |
| Loans to unrated corporates | £1M in total |
| Money Market Funds** | £10M* per fund and no more than 0.50% of any investments fund in total for non-government funds |

**This is the absolute limit and the working limit will be monitored against actual cash flows and movement on reserves together with advice from our financial advisors and will be adjusted each quarter as necessary in agreement with the CFO.*

***We would not normally invest more than 50% of our overall investment portfolio in MMF on the advice of our advisors, however as part of our revised strategy to reduce short term investments and move into longer term investments, there will be occasions as bonds mature when this limit is exceeded. This advice is with regards to cash flow risk, however we feel this is mitigated by spreading over a number of funds and not just the highest yielding ones and having funds in other instant access accounts. In addition money can be borrowed short term from the market on the day.*

## Liquidity Management

64. The Council undertakes high level cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

## Non Treasury Investments

65. Although not classed as treasury management activities and therefore not covered by the existing CIPFA Code or the MHCLG Guidance, the Council may

also purchase property for investment purposes and may also make loans and investments for service purposes. As part of the new code which is being considered by the Council there will be a need to include indicators for these investments in future reports.

66. Such loans and investments will be subject to the Council's normal approval processes for revenue and capital expenditure and at the time of writing need not comply with this treasury management strategy.

## TREASURY MANAGEMENT INDICATORS

67. The Council measures and manages its exposure to treasury management risks using the following indicators.

### Security

68. The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

| | Target |
|---|---|
| Portfolio average credit rating | A |

### Liquidity

69. The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments and has set a £10M minimum threshold on cash available in instant access accounts, if balances were to fall below this limit we would consider taking short term loans which are available without given prior notice and at competitive rates.

### Interest Rate Exposure

70. This indicator is set to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

**Table 5– Upper Limits for Fixed and Variable Interest Rate Exposure**

| | 2018/19 Estimate % | 2019/20 Estimate % | 2020/21 Estimate % | 2021/22 Estimate % |
|---|---|---|---|---|
| **Upper Limit for Fixed Interest Rate Exposure** | 100 | 100 | 100 | 100 |
| **Upper Limit for Variable Interest Rate Exposure** | 50 | 50 | 50 | 50 |

### Maturity Structure of Borrowing

71. This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of borrowing as set out in **Table 6**.

**Table 6 – Maturity Structure**

| | Lower Limit % | Upper Limit % |
|---|---|---|
| Under 12 Months | 0 | 45 |
| 12 months and within 24 months | 0 | 45 |
| 24 months and within 5 years | 0 | 50 |
| 5 years and within 10 years | 0 | 55 |
| 10 years and within 20 years | 0 | 60 |
| 20 years and within 30 years | 0 | 65 |
| 30 years and above | 0 | 75 |

72. Time periods start on the first day of each financial year and the maturity date of borrowing is the earliest date on which the lender can demand repayment. Although all LOBOs are now in their call options they are not expected to be called in the near future so are shown at their maturity date in table below.

73. **Table 7** details the level of our current debt and shows that all debt is within existing limits.

**Table 7 - Current Debt**

| | Lower Limit % | Upper Limit % | Actual Debt as at 31/12/2017 £M | Average Rate as at 31/12/2017 % | % of Overall Debt as at 31/12/2017 | Compliance with set Limits? |
|---|---|---|---|---|---|---|
| Under 12 months | 0 | 45 | 29.11 | 1.45 | 11.92 | Yes |
| 12 months and within 24 months | 0 | 45 | 11.50 | 3.23 | 4.71 | Yes |
| 24 months and within 5 years | 0 | 50 | 55.69 | 2.61 | 22.81 | Yes |
| 10 years and within 20 years | 0 | 55 | 6.00 | 4.94 | 2.46 | Yes |
| 20 years and within 30 years | 0 | 65 | 18.00 | 4.67 | 7.37 | Yes |
| 30 years and within 40 years | 0 | 75 | 84.10 | 3.81 | 34.45 | Yes |
| 40 years and within 50 years | 0 | 75 | 39.75 | 3.55 | 16.28 | Yes |
| | | | **244.15** | **3.30** | **100.00** | |

**<u>Principal Sums Invested for Periods Longer than 364 days</u>**

74. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end is shown in **Table 8**.

**Table 8 – Principal Sums Invested for Periods Longer than 364 days**

| | Current £M | 2018/19 £M | 2019/20 £M | 2020/21 £M | 2021/22 £M |
|---|---|---|---|---|---|
| Limit on principal invested beyond year end | 40.60 | 37.60 | 33.00 | 30.00 | 30.00 |

**OTHER ITEMS**

75. There are a number of additional items that the Council is obliged by CIPFA or MHCLG to include in its Treasury Management Strategy.

**Policy on Use of Financial Derivatives**

76. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

77. The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to.

Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

78. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

**Housing Revenue Account Self-Financing**

79. On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account.

80. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance. This balance will be measured and interest transferred between the General Fund and HRA at an agreed rate. Housing Legislation does not allow impairment losses to be charged to the HRA and consequently any credit related losses on the Council's

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| | investments will be borne by the General Fund alone. It is therefore appropriate that the General Fund is compensated for bearing this risk, and all interest transferred to the HRA should be adjusted downwards. The rate will be based on investments with the Debt Management Office. The rate of return on comparable investments with the government is lower and often referred to as the risk-free rate. |
| | **Training** |
| 81. | CIPFA's Code of Practice requires the CFO to ensure that all Members tasked with TM responsibilities, including scrutiny of the TM function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.<br>The Council adopts a continuous performance and development programme to ensure staff are regularly appraised and any training needs addressed. Relevant staff also attend regular training sessions, seminars and workshops which ensure their knowledge is up to date. Details of training received are maintained as part of the performance and development process. |
| | **Treasury Management Advisors** |
| 82. | The MHCLG's Guidance on local government investments recommends that the Investment Strategy should state:<br>Whether and, if so, how the Council uses external contractors offering information, advice or assistance relating to investment and<br>How the quality of any such service is controlled.<br>The Council has a contract in place with Arlingclose Limited as<br>treasury advisory service and receives the following services:<br>• Credit advice<br>• Investment advice<br>• Technical advice<br>• Economic & interest rate forecasts<br>• Workshops and training events<br>• HRA support<br>• Ad hoc advice<br>The Council maintains the quality of the service with its advisors by holding quarterly meetings and tendering periodically. It should also be noted that decisions are taken independently by the CFO taking into account this advice and other internal and external factors. |
| | **Investment of Money Borrowed in Advance of Need** |
| 83. | The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit for the period. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with |

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| | particular items of expenditure. |

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| | **FINANCIAL IMPLICATIONS** |
| 84. | The budget for borrowing costs in 2018/19 is £14.6M. This is made up of borrowing of £8.2M based on an average debt portfolio of £310.5M at an average interest rate of 2.63% plus MRP and other costs of £6.4M. Investment income for 2018/19 is budgeted at £1.4M based on an average portfolio of £50M at an average of 2.80%.<br>If actual levels of investments and borrowing, and/or interest rates differ from those forecast, performance against budget will be correspondently different. |
| | **2018/19 MINIMUM REVENUE PROVISION (MRP) STATEMENT** |
| 85. | Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the MHCLG Guidance) most recently issued in 2012. |
| 86. | The broad aim of the MHCLG guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. This guidance is currently subject to consultation and any subsequent amendments required will be built into future reports. |
| 87. | The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year. For borrowing prior to the prudential regime we use the regulatory method (over a 50 year life) and for prudential borrowing the asset life method. |
| 88. | The exception to this is investment properties acquired as part of the Property Investment Fund which have been purchased with a view to generating long term rental income streams to support the delivery of Council services in the future and reduce dependence on Central Government funding, in this case we have adopted the depreciation method.<br>As investment properties these assets are valued each year and any downward movement in the value for the year (i.e. depreciation) will be spread over the remaining life of the asset as a charge to revenue in lieu of MRP.<br>Following the update of the Treasury Management Code of Practice, which comes into effect from 2018/19, it will no longer be possible to charge a 'nil' MRP for these properties. The assets will revert back to the regularity method detailed in paragraph 87 above. The Financial impact of this has been built into the update of the Medium Term Financial Strategy and Budget Update report being reported to Council in February 2018. |
| 89. | We will continue to review MRP and it is proposed that delegated powers should be given to the CFO to change the proposed methods to aid good financial |

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| | management whilst maintaining a prudent approach. Any changes to the original MRP Statement during the year will be reported as part of quarterly financial and performance monitoring and in revisions to the TM strategy as part of the year end and midyear reviews. |
| 90. | Following the HRA self-financing settlement, HRA debt increased from £100M to £174M with a borrowing cap of £200M. There is no requirement for the HRA to make debt repayments but it has opted to make voluntary repayments relating to debt inherited at the split and provision has been made within its business plan to show that it can pay down the remaining debt over the life of the 30 year business plan. |
| 91. | MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability. |
| 92. | Capital expenditure incurred during 2018/19 and funded from borrowing will not be subject to a MRP charge until 2019/20. |
| 93. | Based on the Council's latest estimate of its Capital Financing Requirement on 31 March 2018 the budget for MRP has been set on the assumption that we will be using the regulatory method for borrowing prior to the prudential regime (over the remainder of a 50 year life) and using the asset life method for prudential borrowing where it applies. As previously reported the Council has been taking a holiday from MRP payments due to over provision in the past, the balance of which will be used during 2018/19. |
| 94. | The current and estimated levels of MRP and CFR are shown in **Table 9** below: |

**Table 9 –Current and Estimated MRP and CFR for 2018/19**

| | 31/03/2017 Actual CFR £M | 2017/18 MRP Liability £M | 31/03/2018 Estimated CRF £M | 2018/19 Estimated MRP £M |
|---|---|---|---|---|
| Capital expenditure before 01.04.2008 | 97.78 | 1.70 | 97.78 | 1.70 |
| Unsupported capital expenditure after 31.03.2008 | 152.60 | 3.65 | 162.79 | 4.01 |
| Transferred debt | 14.92 | 0.36 | 14.55 | 0.36 |
| Finance leases and Private Finance Initiative | 62.26 | 1.84 | 60.42 | 2.10 |
| **Total General Fund CFR and MRP Liability** | **327.56** | **7.55** | **335.54** | **8.17** |
| MRP Holiday | (5.00) | (5.35) | (0.67) | (0.67) |
| **Net General Fund CFR and MRP Liability** *(Table 11)* | **322.56** | **2.20** | **334.87** | **7.50** |
| Assets in the Housing Revenue Account | 126.86 | Nil | 140.95 | Nil |
| HRA subsidy reform payment | 36.40 | 5.51 | 30.89 | 5.50 |
| **Total Housing Revenue Account** *(Table 17)* | **163.26** | **5.51** | **171.84** | **5.50** |
| **Total** | **485.82** | **7.71** | **506.71** | **13.00** |

## **MONITORING AND REPORTING ON THE ANNUAL TREASURY OUTTURN AND OTHER PRUDENTIAL INDICATORS**

| | |
|---|---|
| 95. | The Chief Financial Officer will report to the Governance Committee on TM activity / performance as follows:<br>(a) A mid-year review against the strategy approved for the year.<br>(b) An outturn report on its treasury activity, no later than 30 September after the financial year end. |
| 96. | In addition, a quarterly update will be presented to Cabinet as part of Quarterly Revenue Financial Monitoring. |

| | |
|---|---|
| | **PRUDENTIAL INDICATORS** |
| | **Background** |
| 97. | The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's Prudential Code for Capital Finance in Local Authorities (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year. |
| | **Gross Debt and the Capital Financing Requirement** |
| 98. | This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local Council should ensure that debt does not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This view takes into account current commitments, existing plans and the proposals in the approved budget. |
| 99. | There is a significant difference between the gross external borrowing requirement and the net external borrowing requirement represented by the Council's level of balances, reserves, provisions and working capital. The Council's current strategy is only to borrow to the level of its net borrowing requirement. The reasons for this are to reduce credit risk, take pressure off the Council's lending list and also to avoid the cost of carry existing in the current interest rate environment. |
| 100. | The estimated gross debt and capital financing requirement is shown in the tables below:<br><br>**Table 10 – Current and Estimated Movement in Gross Debt** |

| Gross Debt | 31/03/2017 Actual £M | 31/03/2018 Forecast £M | 31/03/2019 Forecast £M | 31/03/2020 Forecast £M | 31/03/2021 Forecast £M | 31/03/2022 Forecast £M |
|---|---|---|---|---|---|---|
| Borrowing B/Fwd | 96.40 | 96.40 | 94.51 | 124.18 | 127.55 | 144.72 |
| Maturing Debt | | (21.15) | (25.21) | (73.87) | (20.02) | (11.43) |
| New Borrowing Requirement *(Appendix 4 Table 1)* | | 19.26 | 54.88 | 77.24 | 37.19 | 40.22 |
| **Total General Fund Borrowing** | **96.40** | **94.51** | **124.18** | **127.55** | **144.72** | **173.51** |
| HRA Borrowing B/Fwd | 163.25 | 163.25 | 171.84 | 182.69 | 181.40 | 182.25 |
| Maturing Debt | | (20.35) | (34.43) | (62.78) | (9.25) | (1.32) |
| New Borrowing Requirement *(Appendix 4 Table 2)* | | 28.94 | 45.28 | 61.49 | 10.10 | 0.00 |
| **Total HRA Borrowing** | **163.25** | **171.84** | **182.69** | **181.40** | **182.25** | **180.93** |
| **Total Borrowing** | **259.65** | **266.35** | **306.87** | **308.95** | **326.97** | **354.44** |
| Finance leases and Private Finance Initiatives | 62.26 | 60.42 | 58.32 | 55.30 | 52.13 | 48.56 |
| Transferred Debt | 14.92 | 14.55 | 14.19 | 13.82 | 13.46 | 13.07 |
| **Total Debt** | **336.83** | **341.32** | **379.38** | **378.07** | **392.56** | **416.07** |

### Table 11 – Current and Estimated Movement in Capital Financing Requirement

| | 31/03/2017 Actual £M | 31/03/2018 Forecast £M | 31/03/2019 Forecast £M | 31/03/2020 Forecast £M | 31/03/2021 Forecast £M | 31/03/2022 Forecast £M |
|---|---|---|---|---|---|---|
| Balance Brought forward | 280.75 | 322.56 | 334.87 | 357.07 | 352.06 | 360.69 |
| Capital Spend Financed from Borrowing *(Table 12)* | 43.72 | 14.51 | 29.71 | 4.37 | 17.79 | 29.48 |
| MRP | (5.00) | (5.35) | (5.71) | (6.00) | (5.62) | (5.69) |
| Appropriations (to) from HRA | 0.98 | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| Movement in Other Liabilities | (2.89) | (2.20) | (2.47) | (3.38) | (3.54) | (3.94) |
| MRP Holiday | 5.00 | 5.35 | 0.67 | 0.00 | 0.00 | 0.00 |
| **Total General Fund Debt** | **322.56** | **334.87** | **357.07** | **352.06** | **360.69** | **380.54** |
| HRA *(see table 17 below for breakdown)* | 163.25 | 171.84 | 182.69 | 181.40 | 182.25 | 180.93 |
| **Total CFR** | **485.81** | **506.71** | **539.76** | **533.46** | **542.94** | **561.47** |

## Estimates of Capital Expenditure

101. The Council's planned capital expenditure and financing is summarised below, further detail is provided in the General Fund and HRA capital programme report submitted elsewhere on the agenda.

102. **Table 12 – Capital Expenditure**

| | Forecast 2017/18 £M | Forecast 2018/19 £M | Forecast 2019/20 £M | Forecast 2020/21 £M | Forecast 2021/22 £M |
|---|---|---|---|---|---|
| General Fund | 48.44 | 68.78 | 23.98 | 23.75 | 29.48 |
| HRA | 44.92 | 53.12 | 41.15 | 43.69 | 34.01 |
| **Total Expenditure** | **93.36** | **121.90** | **65.13** | **67.44** | **63.49** |
| Capital receipts | 7.55 | 17.56 | 0.00 | 0.96 | 1.66 |
| Capital Grants | 18.70 | 24.20 | 19.31 | 5.65 | 0.00 |
| Contributions | 5.26 | 5.95 | 0.00 | 0.00 | 0.00 |
| Major Repairs Allowance | 19.95 | 13.84 | 23.48 | 22.47 | 21.10 |
| Other Council Resources | 13.29 | 14.29 | 1.76 | 10.48 | 11.25 |
| **Total Financing** | **64.75** | **75.84** | **44.55** | **39.56** | **34.01** |
| Council Resources - Borrowing GF | 14.51 | 29.71 | 4.37 | 17.79 | 29.48 |
| Council Resources - Borrowing HRA | 14.10 | 16.35 | 16.21 | 10.09 | 0.00 |
| **Total Funding** | **28.61** | **46.06** | **20.58** | **27.88** | **29.48** |
| **Total Financing & Funding** | **93.36** | **121.90** | **65.13** | **67.44** | **63.49** |

## Ratio of Financing Costs to Net Revenue Stream

103. This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet borrowing costs. The ratio is based on the forecast of net revenue expenditure in the medium term financial model. The upper limit for this ratio is currently set at 10% and will remain so for the General Fund to allow for known borrowing decisions in the next two years and to allow for additional borrowing affecting major schemes. The table below shows the likely position based on the proposed capital programme.

104. This indicator is not so relevant for the HRA, especially since the introduction of self-financing, as financing costs have been built into their 30 year business plan, including the voluntary payment of MRP, which is the main contributor for the increase in 2019/20 and 2020/21. No problem is seen with the affordability but if problems were to arise then the HRA would have the option not to make principle repayments in the early years.

**Table 13 – Ratio of Financing Costs to Net Revenue Stream**

105.

| Ratio of Financing Costs to Net Revenue Stream | 2016/17* Actual % | 2017/18* Forecast % | 2018/19* Forecast % | 2019/20 Forecast % | 2020/21 Forecast % | 2021/22 Forecast % |
|---|---|---|---|---|---|---|
| General Fund | 8.56 | 7.79 | 8.06 | 9.74 | 9.90 | 10.26 |
| HRA | 14.12 | 15.02 | 15.86 | 33.04 | 20.96 | 9.66 |
| **Total** | **11.17** | **10.59** | **11.06** | **17.47** | **14.28** | **11.45** |

**Includes MRP due for the year to reflect true impact of borrowing, they have not been adjusted to reflect the MRP holiday taken.*

## Incremental Impact of Capital Investment Decisions

106. This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement (i.e. Interest and MRP) of the current approved capital programme with an equivalent calculation arising from the proposed programme. The incremental impact of capital investments decisions are shown below. These figures exclude any borrowing taken for Invest to Save schemes, as borrowing costs will be offset by income

generation.

**Table 14– Incremental Impact of Capital Investment Decisions**

107.

| Incremental Impact of Capital Investment Decisions | 2017/18 Forecast £ | 2018/19 Estimate £ | 2018/19 Estimate £ | 2019/20 Estimate £ | 2020/21 Estimate £ |
|---|---|---|---|---|---|
| Increase / (Decrease) per average number of equivalent band D properties for Council Tax purposes | (3.01) | (9.95) | (4.25) | 3.51 | 16.15 |
| Increase / (Decrease) in Average Weekly Housing Rents | (34.48) | (25.57) | (11.32) | (40.65) | (22.30) |

108. It should be noted that these indicators are for illustrative purposes only and show the amount per equivalent band D properties that this change would equate to since the last capital update reported in November2017.

109. As per the General Fund these indicators are illustrative as HRA rent levels are currently set under the Government's rent restructuring formula, which is independent of the level of capital investment and borrowing. The calculation of the indicator ignores this factor.

**Authorised Limit and Operational Boundary for External Debt**

110. The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing will therefore arise as a consequence of all the financial transactions of the Council and not just those arising from capital spending reflected in the CFR.

111. The ***Authorised Limit*** sets the maximum level of external borrowing on a gross basis (i.e. excluding investments) for the Council. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements, for example a complete debt restructure which requires monies to be borrowed in advance of repayment of existing debt. The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

**Table 15 – Authorised Limit for External Debt**

112.

| Authorised Limit for External Debt | Actual 31 December 2017 £M | 2017/18 Approved £M | 2018/19 Estimate £M | 2019/20 Estimate £M | 2020/21 Estimate £M | 2021/22 Estimate £M |
|---|---|---|---|---|---|---|
| Borrowing | 244 | 817 | 785 | 657 | 650 | 794 |

| | | | | | | |
|---|---|---|---|---|---|---|
| Other Long-term Liabilities | 77 | 81 | 75 | 73 | 70 | 66 |
| **Total** | **321** | **898** | **860** | **730** | **720** | **860** |

113. The ***Operational Boundary*** is linked directly to the Council's estimates of the CFR and estimates of other day to day cash flow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit which allows for a full debt restructure if a favourable opportunity arose.

**Table 16–Operational Boundary for External Debt**

114.

| **Operational Boundary for External Debt** | **Actual 31 December 2017 £M** | **2017/18 Approved £M** | **2018/19 Estimate £M** | **2019/20 Estimate £M** | **2020/21 Estimate £M** | **2021/22 Estimate £M** |
|---|---|---|---|---|---|---|
| Borrowing | 263 | 566 | 705 | 599 | 602 | 658 |
| Other Long-term Liabilities | 78 | 81 | 75 | 73 | 70 | 66 |
| **Total** | **341** | **647** | **780** | **672** | **672** | **724** |

115. The CFO has delegated authority, within the above limits 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. Council will be notified of any use of this delegated Authority.

**HRA Limit on Indebtedness**

116. Local authorities are required to report the level of the HRA CFR compared to the level of debt which is imposed (or subsequently amended) by the MHCLG at the time of implementation of self – financing. The HRA is still within the HRA Debt Cap set by MHCLG of £199.6M.

**Table 17 – Current and Estimated Movement in HRA Indebtedness**

117.

| **HRA Limit on Indebtedness** | **2016/17 Actual £M** | **2017/18 Forecast £M** | **2018/19 Forecast £M** | **2019/20 Forecast £M** | **2020/21 Forecast £M** | **2021/22 Forecast £M** |
|---|---|---|---|---|---|---|
| Brought Forward | 155.00 | 163.25 | 171.84 | 182.69 | 181.40 | 182.25 |
| Maturing Debt | (5.60) | (20.35) | (34.43) | (62.78) | (9.25) | (1.32) |
| New Borrowing Requirement *(Appendix 4 Table 2)* | 14.83 | 28.94 | 45.28 | 61.49 | 10.10 | 0.00 |
| Appropriations (to) from HRA | (0.98) | 0.00 | 0.00 | 0.00 | 0.00 | 0.00 |
| **Carried forward** | **163.25** | **171.84** | **182.69** | **181.40** | **182.25** | **180.93** |
| HRA Debt Cap (as prescribed by CLG) | 199.60 | 199.60 | 199.60 | 199.60 | 199.60 | 199.60 |
| **Headroom** | **36.35** | **27.76** | **16.91** | **18.20** | **17.35** | **18.67** |

**RESOURCE IMPLICATIONS**

| | |
|---|---|
| **Capital/Revenue** | |
| 118. | The revenue and capital implications are considered as part of ongoing monitoring which is reported to Cabinet each quarter and as part of the budget setting process. |
| **Property/Other** | |
| 119. | None |
| | |
| **LEGAL IMPLICATIONS** | |
| **Statutory power to undertake proposals in the report:** | |
| 120. | Local Authority borrowing is regulated by Part 1, of the Local Government Act 2003, which introduced the new Prudential Capital Finance System. |

| | |
|---|---|
| 121. | From 1 April 2004, investments are dealt with, not in secondary legislation, but through guidance. Similarly, there is guidance on prudent investment practice, issued by the Secretary of State under Section 15(1) (a) of the 2003 Act.<br>A local authority has the power to invest for "any purpose relevant to its functions under any enactment or for the purposes of the prudent management of its financial affairs". The reference to the "prudent management of its financial affairs" is included to cover investments, which are not directly linked to identifiable statutory functions but are simply made in the course of treasury management.<br>This also allows the temporary investment of funds borrowed for the purpose of expenditure in the reasonably near future; however, the speculative procedure of borrowing purely in order to invest and make a return remains unlawful. |
| **Other Legal Implications:** | |
| 122. | None |
| **POLICY FRAMEWORK IMPLICATIONS** | |
| 123. | This report has been prepared having regard with the CIPFA Code of Practice on Treasury Management. |

| | |
|---|---|
| **KEY DECISION?** | No |
| **WARDS/COMMUNITIES AFFECTED:** | None |
| **SUPPORTING DOCUMENTATION** | |
| **Appendices** | |
| 1. | Policy Statement |
| 2. | Existing Investment & Debt Portfolio Position and Projections |
| 3. | Economic and Interest Outlook |
| 4. | Forecast of Long Term Borrowing Requirement and Actual Debt |
| 5. | Glossary of Treasury Terms |
| **Documents In Members' Rooms** | |
| 1. | None |
| **Equality Impact Assessment** | |
| Do the implications/subject of the report require an Equality Impact Assessment (EIA) to be carried out. | **No** |
| **Privacy Impact Assessment** | |
| Do the implications/subject of the report require a Privacy Impact Assessment (PIA) to be carried out. | **No** |
| **Other Background Documents** | |
| Title of Background Paper(s) | Relevant Paragraph of the Access to Information Procedure Rules / Schedule 12A allowing document to be Exempt/Confidential (if applicable) |

| | | |
|---|---|---|
| 1. | Prudential Limits and Treasury Management Strategy 2017/18 to 2020/21 | Item 76 |
| 2. | Prudential Limits and Treasury Management Mid Year Review 2017/18 | Item 10 |