Hinckley & Bosworth
Borough Council

FORWARD TIMETABLE OF CONSULTATION AND DECISION MAKING

Joint Scrutiny Commission / Finance and Performance Scrutiny	1 February 2018
Council	22 February 2018

WARDS AFFECTED: ALL WARDS

THE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES SETTING OF PRUDENTIAL INDICATORS 2017/18 - 2020/21 AND TREASURY MANAGEMENT STRATEGY 2017/18-2020/21

Report of Head of Finance

1. PURPOSE OF REPORT

1.1 This report outlines the Council's prudential indicators for 2017/18 - 2020/21 and sets out the expected treasury operations for this period. It fulfils four key legislative requirements:

- The reporting of the **Prudential Indicators,** setting out the expected capital activities (as required by the CIPFA Prudential Code for Capital Finance in Local Authorities). The treasury management prudential indicators are now included as treasury indicators in the CIPFA Treasury Management Code of Practice;

- The Council's **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year (as required by Regulation under the Local Government and Public Involvement in Health Act);

- The **Treasury Management Strategy Statement** which sets out how the Council's treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators. The key indicator is the **Authorised Limit**, the maximum amount of debt the Council could afford in the short term, but which would not be sustainable in the longer term. This is the Affordable Borrowing Limit required by s3 of the Local Government Act 2003.

- The **Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss. This strategy is in accordance with the CLG Investment Guidance.

The above policies and parameters provide an approved framework within which the officers undertake the day to day capital and treasury activities.

2. RECOMMENDATIONS

Members approve the key elements of these reports:

2.1 The Prudential Indicators and Limits for 2017/18 to 2020/21 contained within 3.28 & 3.29 of the report, including the Authorised Limit Prudential Indicator.

2.2 The Minimum Revenue Provision (MRP) Statement contained paragraphs 3.13 & 3.14 which set out the Council's policy on MRP.

2.3 The Treasury Management Strategy 2017/18 to 2020/21 and the Treasury Prudential Indicators (paragraph 3.21 onwards of the report)

2.4 The Investment Strategy contained in the Treasury Management Strategy and the detailed strategy in Appendix 1.

3. BACKGROUND TO THE REPORT

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

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

CIPFA defines treasury management as:

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

The Capital Prudential Indicators 2017/18 - 2020/21

Introduction

3.2 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce prudential indicators. Each indicator either summarises the expected capital activity or introduces limits upon that activity, reflecting the outcome of the Council's underlying capital appraisal systems.

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

3.3 Within this overall prudential framework there is an impact on the Council's treasury management activity because it will directly impact on borrowing or investment activity. As a consequence the treasury management strategy for 2017/18 to 2020/21 is included in section C to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

Where the Council is acting as accountable body and is required to keep fund separate from its main treasury activities, cashflow and treasury management implications will be reported separately at the appropriate level.

The Capital Expenditure Plans

3.4 The Council's capital expenditure plans are summarised below and this forms the first of the prudential indicators. A certain level of capital expenditure is grant supported by the Government; any decisions by the Council to spend above this level will be considered unsupported capital expenditure. This unsupported capital expenditure needs to have regard to:

- Service objectives (e.g. strategic planning);
- Stewardship of assets (e.g. asset management planning);
- Value for money (e.g. option appraisal)
- Prudence and sustainability (e.g. implications for external borrowing and whole life costing);
- Affordability (e.g. implications for the council tax and rents);
- Practicality (e.g. the achievability of the forward plan).

3.5 The revenue consequences of capital expenditure, particularly the unsupported capital expenditure, will need to be paid for from the Council's own resources.

3.6 This capital expenditure can be paid for immediately (by applying capital resources such as capital receipts, capital grants etc., or revenue resources), but if these resources are insufficient any residual capital expenditure will add to the Council's borrowing need.

3.7 The key risks to the plans are that the level of Government support has been estimated and is therefore subject to change. Similarly some estimates for other sources of funding, such as capital receipts, may also be subject to change over this timescale. For instance anticipated asset sales may be postponed due to the poor condition of the property market.

3.8 The Council is asked to approve the summary capital expenditure projections below. This forms the first prudential indicator:

Capital Expenditure £'000	**2016/17 Actual £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Non-HRA	4,424	3,544	5,305	5,339	2,032
HRA	5,812	7,094	7,496	4,746	4,103
Total	10,236	10,638	12,801	10,085	6,135
Financed by:					
Capital receipts	307	950	1,015	933	831
Capital grants	1,086	1,068	925	455	455
Capital reserves	6,254	7,756	8,723	5,106	4,462
Revenue	150	14	10	10	10
Net financing need for the year	**2,439**	**850**	**2,128**	**3,581**	**377**

The Council's Borrowing Need (the Capital Financing Requirement)

3.9 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. The capital expenditure above which has not immediately been paid for will increase the CFR.

3.10 The Council is asked to approve the CFR projections below:

£'000s	2016/17 Actual £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Capital Financing Requirement					
CFR - Non Housing	37,059	37,037	42,186	44,868	44,181
CFR - Housing	70,320	70,320	70,320	70,320	70,320
Total CFR	**107,379**	**107,357**	**112,506**	**115,188**	**114,501**
Movement in CFR					

Movement in CFR represented by					
Fleet Lease Debt		0	3,900	0	0
Net financing need for the year (above)		**850**	**2,128**	**3,581**	**377**
Less MRP/ VRP and other financing movements		-872	-879	- 899	-1064
Movement in CFR		**-22**	**5,149**	**2,682**	**-687**

3.11 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). No revenue charge is required for the HRA.

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

Minimum Revenue Provision (MRP) Policy Statement.

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

Existing Practice - MRP will follow the existing practice outlined in former CLG Regulations (Option 1);

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

3.14 From 1 April 2008 for all unsupported borrowing (including Finance Leases) the MRP policy will be:-

Asset Life Method – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction).

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

The Use of the Council's Resources and the Investment Position

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

Table 3

£'000	2016/17 Actual £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Fund balances	2,629	3,015	2,685	2,694	2,584
Capital receipts	2,642	2,049	3,744	3,914	3,821
Earmarked reserves	17,684	16,158	13,075	9,942	8,647
Provisions	955	500	500	500	500
Contributions unapplied	3,341	1,000	500	500	500
Total Core Funds	**27,251**	**22,722**	**20,504**	**17,550**	**16,052**
Working Capital*	1,000	1,000	1,000	1,000	1,000
Under borrowing	26,251	21,722	19,504	16,550	15,052
Expected Investments	**0**	**0**	**0**	**0**	**0**

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

Affordability Prudential Indicators

3.16 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:

3.17 **Actual and Estimates of the 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.

Table 4

%	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Non-HRA	8.85	12.30	11.72	12.78
HRA	27.99	30.80	32.08	34.42

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

3.19 **Estimates of the incremental impact of capital investment decisions on the 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

£	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000
Council Tax - Band D	£6.09	£0.00	£0.00	£3.70

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

Table 6
Incremental impact of capital investment decisions - Housing Rent levels.
There is no additional borrowing budgeted for the HRA

£	Latest Budget 2017/18	Forward Projection 2018/19	Forward Projection 2019/20	Forward Projection 2020/21
Weekly Housing Rent levels	£0.00	£0.00	£0.00	£0.00

Treasury Management Strategy 2017/18 – 2018/19

3.21 Treasury Management is an important part of the overall financial management of the Council's affairs. The prudential indicators in this section consider the affordability and impact of capital expenditure decisions, and set out the Council's overall capital framework. The treasury service considers the effective funding of these decisions. Together they form part of the process which ensures the Council meets its balanced budget requirement under the Local Government Finance Act 1992.

3.22 The Council's treasury activities are strictly regulated by statutory requirements and a professional code of practice (the CIPFA Code of Practice on Treasury Management). This Council adopted the Code of Practice on Treasury Management on 30 June 2003.

3.23 As a result of adopting the Code the Council also adopted a Treasury Management Policy Statement (30 June 2003).

3.24 The Constitution requires an annual strategy to be reported to Council outlining the expected treasury activity for the forthcoming 3 years. A key requirement of this report is to explain both the risks, and the management of the risks, associated with the treasury service. A further treasury report is produced after the year-end to report on actual activity for the year, and a new requirement of the revision of the Code of Practice is that there is a mid-year monitoring report.

This strategy covers:

- The Council's debt and investment projections;

- The Council's estimates and limits on future debt levels;
- The expected movement in interest rates;
- The Council's borrowing and investment strategies;
- Treasury performance indicators;
- Specific limits on treasury activities;

BORROWING

3.25 The capital expenditure plans set out above 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 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 approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy

3.26 The Council's treasury portfolio position at 31 March 2017, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

£'000	2017/18 Revised	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
External Debt				
Debt at 1 April	75,952	76,802	82,830	86,411
Fleet Lease Debt	0	3,900	0	0
Expected change in debt	850	**2,128**	**3,581**	**377**
Debt at 31 March	76,802	82,830	86,411	86,788

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

Treasury Indicators: limits to borrowing activity

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

Table 8

Operational boundary £000's	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Debt	107,357	112,506	115,188	114,501
Total	107,357	112,506	115,188	114,501

3.29 **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.
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.
The Council is asked to approve the following authorised limit:

Authorised limit £000s	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
General Fund	38,537	43,686	46,368	45,681
HRA	71,915	71,915	71,915	71,915
Total	110,452	115,601	118,283	117,596

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently: no change

HRA Debt Limit £m	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
HRA debt cap	72.0	72.0	72.0	72.0
HRA CFR	70.3	70.3	70.3	70.3
HRA headroom	1.7	1.7	1.7	1.7

3.30 **Expected Movement in Interest Rates**

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

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Dec 2017	0.50	1.50	2.80	2.50
Mar 2018	0.50	1.60	2.90	2.60
Jun 2018	0.50	1.60	3.00	2.70
Sep 2018	0.50	1.70	3.00	2.80
Dec 2018	0.75	1.80	3.10	2.90
Mar 2019	0.75	1.80	3.10	2.90
Jun 2019	0.75	1.90	3.20	3.00
Sep 2019	0.75	1.90	3.20	3.00
Dec 2019	1.00	2.00	3.30	3010
Mar 2020	1.00	2.10	3.40	3.20
Jun 2020	1.00	2.10	3.50	3.30
Sep 2020	1.25	2.20	3.50	3.30
Dec 2020	1.25	2.30	3.60	3.40
Mar 2021	1.25	2..30	3.60	3.40

A detailed economic commentary is given in Appendix 1

BORROWING STRATEGY

3.31 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded

with loan debt as cash supporting the Council's reserves, balances and cash flow have been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is an issue that need to be considered.

3.32 Against this background and the risks within the economic forecast, caution will be adopted with the 2018/19 treasury operations. The Head of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- *if it was felt that there was a significant risk of a sharp FALL in long and short term rates,* e.g. due to a marked increase of risks around relapse into recession or risks of deflation, then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

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

Borrowing In Advance

3.33 The Council will not borrow more than or in advance of its needs, purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds.
Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the current reporting mechanism.

Debt Restructuring

3.34 As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:
- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

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

INVESTMENT STRATEGY

3.36 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.

3.37 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 ratings used to monitor counterparties are Short Term and Long Term ratings.

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

3.39 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.

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

3.41 **Creditworthiness Policy**

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

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and
- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

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

3.43 Credit rating information is supplied by Link Asset Services our treasury advisors, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to officers almost immediately after they occur and this information is considered before dealing. For instance, a negative rating watch applying to counterparty at the minimum Council criteria will be suspended from use, with all others being reviewed in light of market conditions. Additional background in the approach taken is attached at Appendix 2

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

- **Banks 1 - Good Credit Quality** – the Council will only use banks which:

i) Are UK banks; or

ii) Are non-UK and domiciled in a country which has a minimum Sovereign long term rating of AA**-.**

And have, as a minimum, the following Fitch, Moody's and Standard and Poors credit ratings (where rated):

i) Short Term – F1

ii) Long Term – A-

Banks 2 – **Part Nationalised UK Banks** – These banks will be included if they continue to be part nationalised or they meet the ratings criteria in Bank 1 above

- Banks 3 **-** The Council's own banker for transactional purposes if the bank falls below the above criteria, although in this case balances will be minimised in both monetary size and time.
- **Bank Subsidiary and treasury operations –** the Council will use these where the parent bank has the necessary ratings outlined above or has provide an appropriate guarantee.
- **Building Societies** – the Council will use all Societies which:

  i) Have a minimum rating short term rating of F1 and long term rating of A-
  Or :
  iii) Have assets in excess of £500m.
- **Money Market Funds –** AAA
- **Enhanced Money Market Funds.**
- **UK Government** (including gilts and the DMADF)
- **Local Authorities, Parish Councils, PCC's, Fire Authorities etc**
- **Supranational institutions**
- **Property fund and Corporate Bonds –** The Council will these funds if they meet the creditworthiness criteria. No decision will be made on the use of these funds without further Council approval**.**

3.45 **Use of additional information other than credit ratings** – Additional requirements under the Code of Practice requires the Council to supplement credit rating information. Whilst the above criteria relies primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use, additional operational market information will be applied before making any specific investment decision from the agreed pool of counterparties. This additional market information (for example Credit Default Swaps, negative rating watches/outlooks) will be applied to compare the relative security of differing investment counterparties.

3.46 **Time and Monetary Limits applying to Investments** - The time and monetary limits for institutions on the Council's Counterparty List are as follows (these will cover both Specified and Non-Specified Investments):

	Fitch (or equivalent)	Money Limit	Time Limit
Bank 1 Category	A-	£6m	1yr

Bank 2 Category	A-	£6m	1yr
Bank 3 Councils Own Bank	A-	£6m	1yr
Other Institution Limits (approval needed)	N/A	£6m	1yr
Building Societies	A- or £500m base	£5m	1yr
Local Authorities,PCC & Fire Authorities	N/A	£7m	1yr
Money Market Funds	AAA	£6m	liquid
DMADF	N/A	£6m	6 months

3.47 **Country and sector considerations** –

Due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the Sovereign state in Banks 1 above. In addition:

- limits in place above will apply to Group companies;
- Sector limits will be monitored regularly for appropriateness.

3.48 **In-house funds.** Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).
Investment returns expectations. Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts for financial year ends (March) are:

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

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 3 months during each financial year are as follows:

2017/18	0.40%
2018/19	0.60%
2019/20	0.90%
2020/21	1.25%
2021/22	1.50%
2022/23	1.75%
2023/24	2.00%
2024/25	2.00%
Later years	2.75%

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

3.49 **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.

3.50 **Investment Risk Benchmarking**

These benchmarks are simple guides to maximum risk and so may be breached from time to time, depending on movements in interest rates and counterparty criteria. The purpose of the benchmark is that officers will monitor the current and trend position and amend the operational strategy to manage risk as conditions change. Any breach of the benchmarks will be reported, with supporting reasons in the Mid-Year or Annual Report.

ii. **Security** - The Council's maximum security risk benchmark for the current portfolio, when compared to these historic default tables, is:

iii. **Liquidity** – In respect of this area the Council seeks to maintain:

- Bank overdraft – £0.250m (if required)
- Liquid short term deposits of at least £1m available with a week's notice.
- Weighted Average Life benchmark is expected to be 0.5 years, with a maximum of 1 year.

3.51 **Yield** - Local measures of yield benchmarks are

- Investments – internal returns above 7 day LIBID
- Investments – internal returns above 30 day LIBID

Performance Indicators

3.52 The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators, as opposed to the prudential indicators, which are predominantly forward looking. Examples of performance indicators often used for the treasury function are:

- Debt - Borrowing - Average rate of borrowing for the year compared to average available
- Debt - Average rate movement year on year
- Investments - Internal returns above the 7 day LIBID rate

The results of these indicators will be reported in the Treasury Annual Report.

Treasury Management Advisers

3.53 The Council uses Link Asset Services as its treasury management advisers. The company provides a range of services which include:

- Technical support on treasury matters, capital finance issues and the drafting of Member reports;

- Economic and interest rate analysis;
- Debt services which includes advice on the timing of borrowing;
- Debt rescheduling advice surrounding the existing portfolio;
- Generic investment advice on interest rates, timing and investment instruments;
- Credit ratings/market information service comprising the three main credit rating agencies.

3.54 Whilst the advisers provide support to the internal treasury function, under current market rules and the CIPFA Code of Practice the final decision on treasury matters remains with the Council. This service is subject to regular review.

4. EXEMPTIONS IN ACCORDANCE WITH THE ACCESS TO INFORMATION PROCEDURE RULES

4.1 Report to be taken in open session

5. FINANCIAL IMPLICATIONS [IB]

5.1 These are contained in the body of the report.

6. LEGAL IMPLICATIONS [AR]

6.1 These are contained in the body of the report.

7. CORPORATE PLAN IMPLICATIONS

7.1 Treasury Management and Prudential Indicators indirectly impacts on all Corporate Plan targets

8. CONSULTATION

8.1 None

9. RISK IMPLICATIONS

9.1 It is the Council's policy to proactively identify and manage significant risks which may prevent delivery of business objectives.
It is not possible to eliminate or manage all risks all of the time and risks will remain which have not been identified. However, it is the officer's opinion based on the information available, that the significant risks associated with this decision / project have been identified, assessed and that controls are in place to manage them effectively.

The following significant risks associated with this report / decisions were identified from this assessment:

Management of Significant (Net Red) Risks		
Risk Description	Mitigating Actions	Owner
That the Council has insufficient resources to meet its aspirations and cannot set a balanced budget	A budget strategy is produced to ensure that the objectives of the budget exercise are known throughout the organisation. The budget is scrutinised on an ongoing	A Wilson

	basis to ensure that assumptions are robust and reflective of financial performance. Sufficient levels of reserves and balances are maintained to ensure financial resilience	

10. KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS

10.1 Schemes in the Capital Programme cover all services and all areas of the Borough including rural areas.

11. CORPORATE IMPLICATIONS

11.1 By submitting this report, the report author has taken the following into account:

- Community Safety implications
- Environmental implications
- ICT implications
- Asset Management implications
- Procurement implications
- Human Resources implications
- Planning implications
- Data Protection implications
- Voluntary Sector

Background papers:
Capital Programme 2017/18 to 2020/21
Revenue Budget 2018/19

Contact Officer: Ilyas Bham, Accountancy Manager ext 5924

Executive Member: Cllr M Hall

Appendix 1

Treasury Management Practice (TMP) 1 – Credit and Counterparty Risk Management

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

The key intention of the Guidance is to maintain the current requirement for Councils to invest prudently, and that priority is given to security and liquidity before yield. In order to facilitate this objective the guidance requires this Council to have regard to the CIPFA publication Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. This Council adopted the Code on 30 June 2003 and will apply its principles to all investment activity. In accordance with the Code, the Head of Finance has produced its treasury management practices (TMPs). This part, TMP 1(5), covering investment counterparty policy requires approval each year.

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

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

2. The investment policy proposed for the Council is:

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

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

3. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity).
4. Supranational bonds of less than one year's duration.
5. A local authority, parish council or community council.
6. Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency. For category 4 this covers pooled investment vehicles, such as money market funds, rated AAA by Standard and Poor's, Moody's or Fitch rating agencies.
7. A body that is considered of a high credit quality (such as a bank or building society). For category 5 this covers bodies with a minimum short term rating of F1 (or the equivalent) as rated by Standard and Poor's, Moody's or Fitch rating agencies.

Non-Specified Investments – Non-specified investments are any other type of investment (i.e. not defined as Specified above). The identification and rationale supporting the selection of these other investments and the maximum limits to be applied are set out below. Non specified investments would include any sterling investments with:

	Non Specified Investment Category	Limit (£)
a.	**3. The Council's own banker if it fails to meet the basic credit criteria. In this instance balances will be minimised as far as is possible.**	£6m
a.	**Building societies not meeting the basic security requirements under the specified investments**. The operation of some building societies does not require a credit rating, although in every other respect the security of the society would match similarly sized societies with ratings. The Council may use such building societies which were originally considered Eligible Institutions and have a minimum asset size of £500m, but will restrict these type of investments to £5m	£6m
b.	Any **bank or building society** that has a minimum long term credit rating of A, for deposits with a maturity of greater than one year (including forward deals in excess of one year from inception to repayment).	£6m
c.	Any **non rated subsidiary** of a credit rated institution included in the specified investment category. These institutions will be included as an investment category subject to a limit of £2m for a period of 6 months	£2m

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

Appendix 2

Security, Liquidity and Yield Benchmarking

8. **Benchmarking and Monitoring Security, Liquidity and Yield in the Investment Service** A proposed development for Member reporting is the consideration and approval of security and liquidity benchmarks.

These benchmarks are targets and so may be breached from time to time. Any breach will be reported, with supporting reasons in the Annual Treasury Report.

9. Yield - These benchmarks are currently widely used to assess investment performance. Local measures of yield benchmarks are:

- Investments - Internal returns above the 7 day LIBID rate
- Investments - Internal returns above the 30 day LIBID rate

10. Security and liquidity benchmarks are already intrinsic to the approved treasury strategy through the counterparty selection criteria and some of the prudential indicators. However they have not previously been separately and explicitly set out for Member consideration. Proposed benchmarks for the cash type investments are below and these will form the basis of future reporting in this area. In the other investment categories appropriate benchmarks will be used where available.

11. Liquidity - This is defined as "having adequate, though not excessive cash resources, borrowing arrangements, overdrafts or standby facilities to enable it at all times to have the level of funds available to it which are necessary for the achievement of its business/service objectives" (CIPFA Treasury Management Code of Practice). In respect of this area the Council seeks to maintain:

- Bank overdraft - £0.250m
- Liquid short term deposits of at least £1m available with a week's notice.

12. The availability of liquidity and the term risk in the portfolio can be benchmarked by the monitoring of the Weighted Average Life (WAL) of the portfolio – shorter WAL would generally embody less risk. In this respect the proposed benchmark is to be used:

- WAL benchmark is expected to be 0.75 years, with a maximum of 1 year**.**

13. Security of the investments - In context of benchmarking, assessing security is a much more subjective area to assess. Security is currently evidenced by the application of minimum credit quality criteria to investment counterparties, primarily through the use of credit ratings supplied by the three main credit rating agencies (Fitch, Moody's and Standard and Poors). Whilst this approach embodies security considerations, benchmarking levels of risk is more problematic. One method to benchmark security risk is to assess the historic level of default against the minimum criteria used in the Council's investment strategy. The table beneath shows average defaults for differing periods of investment grade products for each Fitch/Moody's Standard and Poors long term rating category over the last 20 years.

Appendix 3

Economic Background

UK. After the UK surprised on the upside with strong economic growth in 2016, **growth in 2017 has been disappointingly weak**; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the **manufacturing sector** which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the **Monetary Policy Committee, (MPC), meeting of 14 September 2017** managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that **the amount of spare capacity in the economy was significantly diminishing** towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

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

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

It is also worth noting the **contradiction within the Bank of England** between action in 2016 and in 2017 **by two of its committees**. After the shock result of the EU referendum, the **Monetary Policy Committee (MPC)** voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was

necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the **Financial Policy Committee (FPC)** of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that **some consumers may have over extended their borrowing** and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. Economic growth in the eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in November inflation was 1.5%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.3%. Unemployment in the US has also fallen to the lowest level for many years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with four increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its $4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

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

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