



Hinckley & Bosworth
Borough Council

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FORWARD TIMETABLE OF CONSULTATION AND DECISION MAKING

COUNCIL 23 FEBRUARY 2017

WARDS AFFECTED: ALL WARDS

**THE PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES –
SETTING OF PRUDENTIAL INDICATORS 2016/17 - 2019/20 AND TREASURY
MANAGEMENT STRATEGY 2016/17 - 2019/20**

Report of Head of Finance

1. **PURPOSE OF REPORT**

1.1 This report outlines the Council's prudential indicators for 2016/17 - 2019/20 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. This is in accordance with the CIPFA Code of Practice on Treasury Management and the CIPFA Prudential Code;
- 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 2016/17 to 2019/20 contained within 3.2 to 3.20 of the report, including the Authorised Limit Prudential Indicator.
- 2.2 The Minimum Revenue Provision (MRP) Statement contained in paragraphs 3.13 & 3.14 which set out the Council's policy on MRP.
- 2.3 The Treasury Management Strategy 2016/17 to 2019/20 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 2016/17 - 2019/20 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 2016/17 to 2019/20 is included in section 3.21 to complement these indicators. Some of the prudential indicators are shown in the treasury management strategy to aid understanding.

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 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 table below is a summary of the Councils capital expenditure plans and financing. Members are requested to approve the expenditure forecast and note the financing implications.

Table 1

Capital Expenditure £'000	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Non-HRA	18,520	6,673	2,851	2,134	1,395
HRA	4,555	6,563	6,766	4,276	4,276
Total	23,075	13,236	9,617	6,410	5,671
Financed by:					

Capital receipts	2,239	495	793	727	727
Capital grants	6,809	1,192	983	446	431
Capital reserves	1,152	7,941	7,445	4,868	4,136
Revenue	49	20	0	0	0
Net financing need for the year	12,826	3,588	396	369	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. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

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

Table 2

£'000s	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Capital Financing Requirement					
CFR - Non Housing	35,679	39,162	39,204	36,322	36,684
CFR - Housing	70,320	70,320	70,320	70,320	70,320
Total CFR	105,999	109,482	109,524	106,642	107,004
Movement in CFR					

Movement in CFR represented by					
Net financing need for the year (above)	N/A	3,588	396	369	377
Less MRP/ VRP and other financing movements	N/A	-105	-354	-3,251	-15
Movement in CFR	N/A	3,483	42	-2,882	362

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	2015/16 Actual £000	2016/17 Estimate £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000
Fund balances	2,506	2,448	2,552	2,397	2,260
Capital receipts	683	1,458	1,677	1,926	1,573
Earmarked reserves	16,127	13,654	12,680	12,892	10,122
Provisions	500	500	500	500	500
Contributions unapplied	2,996	1,000	500	500	500
Total Core Funds	22,812	19,060	17,909	18,215	14,955
Working Capital*	1,000	1,000	1,000	1,000	1,000
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

%	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
Non-HRA	8.99	13.11	13.10	13.08
HRA	51.89	49.51	53.83	58.99

- 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.

Table 5

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

£	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £
Council Tax - Band D	£2.15	£7.93	-£0.46	-£0.48

- 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

£	Latest Budget 2016/17	Forward Projection 2017/18	Forward Projection 2018/19	Forward Projection 2019/20
Weekly Housing Rent levels	-£0.01	-£0.09	£0.00	£0.00

Treasury Management Strategy 2016/17 - 2017/18

- 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). This adoption is the requirements of one of the prudential indicators.
- 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 appropriate 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 2016, 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.

Table 7

£'000	2016/17 Revised	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt				
Debt at 1 April	75,952	79,540	79,936	80,305
Expected change in debt	3,588	396	369	377
Debt at 31 March	79,540	79,936	80,305	80,682
Operational Boundary	109,482	109,524	106,642	107,004
Under Borrowing	29,942	29,588	26,337	26,322

- 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 2016/17 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	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	109,482	109,524	106,642	107,004
Total	109,482	109,524	106,642	107,004

- 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:

Table 9

Authorised limit £000s	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund	41,162	41,204	38,322	38,682
HRA	71,915	71,915	71,915	71,915
Total	113,077	113,119	110,237	110,597

Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime

HRA Debt Limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 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 2016	0.25	1.60	2.90	2.70
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90

Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00
Sep 2019	0.50	1.90	3.30	3.10
Dec 2019	0.75	2.00	3.30	3.10
Mar 2020	0.75	2.00	3.40	3.20

A detailed economic commentary is given in Appendix 2.

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 2017/18 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, perhaps 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 will 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 Welsh Government 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 determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the 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 Capita Asset Services our treasury consultants, on all active counterparties that comply with the criteria below. Any counterparty failing to meet the criteria would be omitted from the counterparty (dealing) list. Any rating changes, rating watches (notification of a likely change), rating outlooks (notification of a possible longer term change) are provided to 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) are:

- **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** (Lloyds Banking Group & Royal Bank of Scotland) – 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 use 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-	£5m	1yr
Bank 2 Category	A-	£5m	1yr
Bank 3 Councils Own Bank	A-	£5m	1yr
Other Institution Limits(approval needed)	N/A	£5m	1yr
Local Authorities,PCC & Fire Authorities	N/A	£6m	1yr
Money Market Funds	AAA	£5m	liquid
DMADF	N/A	£5m	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.

Annual Investment Strategy Approach

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 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%

The suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year for the next eight years are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	1.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressure are minimal, the start in increase in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and/or forecast for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and/or at a quicker pace

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:

- 0.24% historic risk of default when compared to the whole portfolio.

iii. **Liquidity** – 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.
- 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 Sector 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 PROCEDURES RULES

4.1 Report to be taken in open session.

5 FINANCIAL IMPLICATIONS (IB)

These are contained in the body of the report.

6 LEGAL IMPLICATIONS (AR)

These are contained in the body of the report.

7 CORPORATE PLAN IMPLICATIONS

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

8 CONSULTATION

None.

9 RISK IMPLICATIONS

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

10 KNOWING YOUR COMMUNITY – EQUALITY AND RURAL IMPLICATIONS

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

11 CORPORATE IMPLICATIONS

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

- Community Safety Implications
- Environmental Implications
- ICT Implications
- Asset Management Implications
- Human Resources Implications
- Voluntary Sector Implications

Background Papers:	Capital Programme 2016/17 to 2019/20 Revenue Budget 2017/18 Capital Report
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

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.

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:

1. The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity)
2. Supranational bonds of less than one year's duration
3. A local authority, parish council or community council
4. 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.
5. 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.	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.	£4m
b.	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 £3m	£3m
c.	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).	£5m
d.	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

ECONOMIC BACKGROUND

UK. GDP growth rates between and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.6%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%. During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC)**, meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with an additional £70bn made available.

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

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

After a fairly flat three months leading up to October, retail sales in quarter 4 grew reasonably strongly, increasing by 1.2% and added 0.1% to GDP growth. In addition, the consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, by December it had fallen back to -7 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal

increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics' GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16). This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.6% in December. However, prices paid by factories for inputs are rising very strongly although producer output prices are still lagging well behind.

Gilt yields, and consequently PwLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

USA. Growth in quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half of 2016 at a weak 1.1%. However, quarter 3 at 3.5% signalled a rebound to strong growth. The Fed, embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data

setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed, therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total, although the Republicans now have a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

EZ. In the Eurozone, **the ECB** commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. Central banks have been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ in Greece, Spain Italy and Holland. Additionally, the German Federal Election in October 2017 could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

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

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

Emerging countries. There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets. While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that \$340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017 – a 40% increase on the figure for the last three years.

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

Brexit timetable and process

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

It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.