



2016/17

**Treasury Management
Policy, Statement & Indicators**

and the

**Annual
Minimum Revenue Provision
Policy**

TREASURY MANAGEMENT POLICY STATEMENT

1. Definition

1.1 The Council defines its treasury management activities as:

- the management of the Council's investments, cash flows, banking, money market and capital market transactions.
- the effective control of the risks associated with the Medium Term Financial Strategy (MTFS), Commercial Investment Strategy (CIS) and the pursuit of optimum performance consistent with those risks.

2. Risk management

2.1 The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. The analysis and reporting of treasury management activities will focus on their risk implications for the MTFS and CIS.

3. Value for money

3.1 The Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. This includes the use of investment vehicles to make a return in order to finance the MTFS. To a larger extent this also includes the CIS which aims over the life of the MTFS to make a significant contribution to the funding of the Council's service objectives.

4. Borrowing policy

4.1 The Council needs to balance a number of elements in its borrowing policy for funding capital expenditure and the CIS:

- Utilising a mixture of borrowing periods to reduce the overall impact of changes in interest rates.
- Using different types of loans, including maturity and repayment loans. The CIS in particular will be using repayment loans.
- Minimising the long term cost of any borrowing.
- Ensuring that short term costs are as low as possible.
- Using the Council's own reserves on a temporary basis

4.2 The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the treasury management strategy report each year.

5. Investment policy

5.1 All investment decisions, both general decisions and CIS, need to follow a risk assessment which takes account of the need to protect the principal sums invested from loss, ensuring adequate liquidity so that funds are available to fund expenditure when needed, and the generation of investment income to support the provision of local services.

6. Loans to Organisations

6.1 The Council may make loans to:

- Local organisations, if this will allow the organisation to provide services that will further the Council's own objectives, and where the business case makes this appropriate the earning of a margin on the amounts loaned, or
- Organisations where no service benefits are involved, but with the objective of earning a margin on the amounts loaned, and
- In either case loans will only be made where all risks have been considered, appropriate safeguards are in place, and that have a yield commensurate with the risk involved.

7. Commercial Investment Strategy

7.1 The CIS approved by Cabinet in December 2015, proposes further investment in commercial assets totalling £50m. The aim of this investment is to generate future income streams, in order to mitigate the potential for increased cuts in government funding. The CIS investments will generally be focused on targeting a return on equity (ROE) of between 6% and 9%. A minimum revenue provision policy specific to the CIS has been added to the MRP policy.

8. Governance

8.1 The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the treasury management strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation. The Treasury and Capital Management Group (TCMG) will be monitoring and reviewing decisions relating to both the capital programme and the CIS.

TREASURY MANAGEMENT STRATEGY 2016/17

1.0 STRATEGIC TREASURY MANAGEMENT

The Council hold funds, both to manage its cash flows, and also by virtue of the investments made via the Commercial Investment Strategy (CIS). These are placed with various financial institutions, banks, and funds. In order that the implications of these investments can be both assessed and understood, the outlook in the economic, credit and interest rate environments must be monitored. This ensures that the correct investment decisions are made in order to yield the Council the best return within acceptable risk parameters.

1.1 Economic Outlook

Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Low oil and commodity prices were a notable feature of 2015, and contributed to annual CPI inflation falling to 0.1% in October. Wages are growing at 3% a year, and the unemployment rate has dropped to 5.4%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 81st consecutive month at its meeting in November 2015. Quantitative easing (QE) has been maintained at £375bn since July 2012.

The outcome of the UK general election, which was largely fought over the parties' approach to dealing with the deficit in the public finances, saw some big shifts in the political landscape and put the key issue of the UK's relationship with the EU at the heart of future politics. Uncertainty over the outcome of the forthcoming referendum could put downward pressure on UK GDP growth and interest rates.

China's growth has slowed and its economy is performing below expectations, reducing global demand for commodities and contributing to emerging market weakness. US domestic growth has accelerated but the globally sensitive sectors of the US economy have slowed. Strong US labour market data and other economic indicators, however, suggest recent global turbulence has not knocked the American recovery off course. The Federal Reserve did not raise rates at its meetings in October and November, but the statements accompanying the policy decisions made a rate hike in December 2015 a real possibility, which was confirmed at the Federal Reserve's December meeting. In contrast, the European Central Bank finally embarked on QE in 2015 to counter the perils of deflation.

How Does This Impact on the Council's Medium Term Financial Strategy

Low inflation rates are a benefit to the Council's Medium Term Financial Strategy (MTFS) by reducing the cost of borrowing but also by lowering Budget Managers expectations on budgetary increase from RPI. The result of this is that investment opportunities yielding an adequate rate of return in the general market are limited, hence the decision to look elsewhere for investment opportunities, by adopting the CIS. Over the life of the MTFS there is limited inflation and growth built into the income streams as the Council is taking a prudent approach to this area and will make adjustments in future years when there is more certainty.

1.2 Credit Outlook

The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK Banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union have followed suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Council; returns from cash deposits however remain stubbornly low.

How Does This Impact on the Council's Medium Term Financial Strategy

Whilst the credit outlook remains uncertain over the initial years of the MTFs, the Council is adopting a policy of investing in highly liquid assets such as Money Market Funds, and overnight call accounts. This is combined with the CIS which will be investing in assets, through the routes of property purchase, property funds and share based investments, which are backed by property assets.

1.3 Interest Rate Outlook

The Council's treasury advisor Arlingclose projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in Europe mean that the risks to this forecast are weighted towards the downside.

A shallow upward path for medium term gilt yields is forecast, as continuing concerns about the Eurozone, emerging markets and other geo-political events weigh on risk appetite, while inflation expectations remain subdued. Arlingclose projects the 10 year gilt yield to rise from its current 2.0% level by around 0.3% a year. The uncertainties surrounding the timing of UK and US interest rate rises are likely to prompt short-term volatility in gilt yields.

How Does This Impact on the Medium Term Financial Strategy

The immediate effect on the MTFs of an increase in the UK bank rate is an increase in the cost of borrowing. This will directly impact on the revenue budgets through the net interest budget and the minimum revenue provision, the forecast for which reflect the rates shown in **Table 1**. It is recognised that all assumptions about the speed with which rates will begin to rise is problematic.

Table 1	2016/17	2017/18	2018/19	2019/20	2020/21
MTFS Interest Rate Assumptions	%	%	%	%	%
Temporary investments	0.70	1.20	1.65	1.75	2.00
PWLB 20 year borrowing (EOY)	3.40	3.55	3.70	3.85	4.00
Temporary borrowing	0.75	1.00	1.50	1.50	1.75

Against the background of low interest rates and reducing revenue and capital balances the Council has sought to maximise the returns from its investments whilst minimising the risks of investing with a borrower that is, or may become, unable to repay. It therefore adopted a strategy for 2015/16 that concentrated on highly rated institutions, and the larger Building Societies and Money Market Funds. Investments in liquidity or call accounts, which offer repayment the same day were maximised to further reduce risk.

The 2015/16 Strategy allowed for borrowing in anticipation of need to fund capital expenditure although that option has not so far been used this year. It is envisaged that a similar allowance will be included in the 2016/17 strategy.

2.0 BORROWING AND INVESTMENT FORECAST 31st MARCH 2016

The Council manages investments through-out the year. A proportion of the investments and borrowing will be short-term to manage cash-flow on a day to day basis, in order to make payments to for example precepts or suppliers. The remainder of the investments and borrowing will be long-term, to finance capital expenditure and to seek yield to support the MTFS.

2.1 Breakdown of Forecast

In order to manage the achievement of the MTFS and CIS objectives and to maintain the necessary cash-flows, the Council will need to seek short-term and long-term borrowing. **Table 2** below is an estimate of the forecast investments and borrowing as at 31st March 2016, broken down between CIS balances and general programme activities.

Table 2	CIS	General Programme	Total
Investing and Borrowing at 31/03/16	£m	£m	£m
Investments Short-Term	0	0	0
Investments Long-Term	7.5 ^A	3.5	11.0
Total Investments	7.5	3.5	11.0
Borrowing- Short-Term	5.0	1.0	6.0
Borrowing- Long-Term	0	13.4	13.4
Total Borrowing	5.0	14.4	19.4

Notes ^ACCLA Property Fund and share based investments

2.2 Interest Forecast 2015/16

The 2015/16 year-end forecast for net interest is now £0.373m, which will be a saving of £0.104m against the budget of £0.477m.

3.0 BORROWING AND INVESTMENT FORECAST 2016/17 TO 2020/21

3.1 Medium Term Financial Strategy Capital Programme and CIS

Over the period of the MTFS the Council has budgeted to spend significant sums on both its general capital programme (to enhance current assets and acquire new assets) and the capital investment programme enshrined within the CIS. **Table 3** below shows net amounts included within the MTFS in respect of the general capital programme and the CIS.

Table 3 Forecast Programmes	2015/16 £m	2016/17 £m	2017/18 £m	2018/19 £m	2019/20 £m	2020/21 £m
Capital	6.4	9.5	2.7	1.6	2.5	1.9
CIS	10.0	20.0	15.0	*	*	*
Total	16.4	29.5	17.7	1.6	2.5	1.9

Note The CIS is not forecast beyond 2017/18, this is a period of consolidation and development of risk shared development options.

3.2 Borrowing Strategy

For the general capital and CIS programmes shown in **Table 3**, the Council does not hold sufficient funds to finance this from its own internal resources. As a result it must borrow to meet this requirement.

This borrowing strategy sets out the long-term borrowing parameters within which the Council can borrow, in order to facilitate the financing of the general capital programme and the CIS over the MTFS period. **Table 4** below shows the total borrowing requirements for both the general capital programme and the CIS; by 2020/21 the Council is expecting to have borrowing in excess of £53m (“Must Borrow”). If however, the Council chose not to use reserves to finance capital, borrowings would increase to £57m by 2020/21 (“May Borrow”).

Annex C provides further detail in respect of the borrowing and investments relating to both the general programme and the CIS.

Table 4 Borrowing Strategy Whole Programme	2016/ 2017 £m	2017/ 2018 £m	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m
Expenditure					
Capital Expenditure					
Brought Forward	(39.0)	(65.5)	(78.8)	(75.3)	(72.5)
Movement in Year	(26.5)	(13.3)	3.5	2.8	3.3
Capital Financing Requirement	(65.5)	(78.8)	(75.3)	(72.5)	(69.2)
Fixed Term Investment (EOY)	0.0	0.0	0.0	0.0	0.0
Total Capital to be Financed	(65.5)	(78.8)	(75.3)	(72.5)	(69.2)
Financing					
Forecast long term borrowing (at 31/03/16 borrowing over MTFS)	13.4	13.2	13.1	12.9	12.7
Average Revenue Reserves	4.1	5.4	5.1	3.6	1.0
Earmarked Reserves	8.6	5.9	4.1	2.6	1.8
Total Reserves	12.7	11.3	9.2	6.2	2.8
Total Financing Available	26.1	24.5	22.3	19.1	15.5
Net Unfinanced Capital “Must Borrow”	(39.4)	(54.3)	(53.0)	(53.4)	(53.7)
If Reserves are not used to Finance Capital: “May Borrow”	(52.1)	(65.6)	(62.2)	(59.6)	(56.5)
Funding in Advance					
May Borrow a further	0.0	0.0	0.0	3.1	0.0
Need For Further Borrowing- Loans To Organisations	15.0	15.0	15.0	15.0	15.0

- Notes**
- Forecast general revenue reserves is the average reserves for the year.
 - Earmarked reserves includes the special reserve, repairs and renewals reserves, and capital investments. These are forecast to diminish over the life of the MTFS, as the balances in these reserves are used to fund expenditure. It is assumed that there are no additional earmarked reserves.
 - There would be a cash flow benefit; however due to its natural volatility, it is excluded from this analysis.

3.3 **Investment Strategy**

The guidance on Local Authority Investments categorises investments as 'specified' and 'non-specified'.

Specified investments are expected to offer relatively high security and/or liquidity. They must be:

- In sterling (avoiding exchange rate fluctuations) and,
- Due to be repaid within 12 months (minimising capital value fluctuations on gilts and CDs and minimising the period within which a counterparty might get into difficulty) and not defined as capital expenditure in the capital finance regulations 2003 (e.g. equities and corporate bonds though there is current consultation on removing bonds from the capital constraint) and,
- With a body that the Council considers is of high credit quality or with the UK Government or a local authority, (minimising the counterparty risk), this includes Money Market Funds where the Council has set minimum criteria.

No investment that counts as Capital expenditure will be undertaken, without Cabinet approval or for the CIS, the Treasury and Capital Management Group, as it effectively transfers revenue funds into capital when the investment is repaid which has significant impacts on the Council's financial flexibility.

Non-specified investments include longer deposits and other types of investment e.g. corporate bonds and equities.

The Council may use the following non-specified investments:

- Time Deposits of longer than 12 months with banks and building societies.
- UK government bonds, supranational bank bonds.
- Loans to other local authorities and other organisations (further definition of the latter is shown below) over 12 months to maturity.
- Corporate Bonds over 12 months to maturity, if returns are clearly better than time deposits, but such investments will only be made following a risk assessment and consultation on the proposed limits, procedures and credit ratings with the Treasury and Capital Management Group (TCMG). Use would be limited to Bonds that could be held to maturity thus avoiding fluctuations in capital value.
- Property funds, share based investments and Property.

4.0 **OTHER TREASURY ACTIVITIES**

Whilst the Council will be making borrowing and investing decisions in relation to its general capital and CIS programmes, there is also a requirement to make other decisions that do not relate directly to these programmes but are required to meet corporate objectives.

4.1 **Loans to Support the Achievement of Service Objectives**

Opportunities will arise from time to time for the Council to further its objectives by making loans to local organisations or businesses. Such loans are considered to be investments as defined in this strategy. All such loans would be subject to a due diligence process, and the identification of relevant risks pertaining to the loan. Such

investments can be administratively cumbersome to set-up and consequently will only be undertaken once a detailed business case has been approved by Cabinet. These loans would not be subject to the 5 year investment limit.

4.2 Loans with Security

The Localism Act potentially enables the Council to benefit from its low cost of borrowing to earn a margin by providing a loan to other bodies where no service benefits are involved. Due consideration will be given to the impact of state aid regulations, and where security of the investment can be made through a legal charge on an adequate value of asset(s) to protect the Council from the possibility of default. Such investments can be administratively cumbersome to set-up and consequently will only be undertaken once a detailed business case has been approved by Cabinet. These loans would not be subject to the 5 year investment limit.

4.3 Policy on using Financial Derivatives

Local authorities have previously made use of financial derivatives embedded in loans and investments both to reduce interest rate risk, and to reduce costs or increase income at the expense of greater risk (e.g. lenders option/borrowers option (LOBO) loans). The Localism Bill 2011 includes a general power competence that removes the uncertain legal position over local authorities' use of standalone financial derivatives. Any decision to make use of financial derivatives will be subject to further reports to cabinet. Considering the Council's commitment to developing a CIS portfolio, it is unlikely that Financial Derivatives will be used.

4.4 Treasury Advisors

Arlingclose are the Councils appointed advisors. The Advisor carries out the following role:

- Advice on investment decisions,
- Notification of credit ratings and changes,
- Advice and guidance on relevant policies, strategies and reports,
- Training courses.

4.5 Management and Governance

The Responsible Financial Officer and their staff will manage and monitor investments and borrowing. The Treasury and Capital Management Group (TCMG) consists of three councillors and relevant officers. This group oversees and monitors treasury, CIS and capital activities.

4.6 Reporting and Scrutiny

The Treasury Management Strategy is reported to Council each year in February so that the strategy can take into account the latest MTFS and the critical factors affecting the treasury function including, the economy, interest rates and the credit outlook. In November a 6 month report on the performance of the fund is reported to Cabinet and in June a report on the annual performance of the funds is reported.

4.7 **Changes to the Strategy**

The strategy is not intended to be constricting, but a definition of the upper limit of the level of risk that it is prudent for the Council to take in maximising the return on its net investments. Any changes that are:

- Broadly consistent with this strategy and/or,
- Reduce or only minimally increase the level of risk and/or,
- Supported by the Council's Treasury Management Advisors.

are delegated to the Responsible Financial Officer, after consultation with the TCMG. All other changes to the strategy must be approved by the full Council.

5.0 **TREASURY MANAGEMENT, PRUDENTIAL AND CIS INDICATORS**

The Council's Treasury Management and Prudential Indicators are attached at **Appendix 4**. They are based on data included in the budget report and this Strategy. They set various limits that allow officers to monitor its achievement, and are there to guide members and officers when treasury management decisions are being made. A new section for this year's strategy is the CIS indicators these will be used to monitor the success of the CIS programme, using a set of ratios and metrics specifically designed for that programme.

These indicators must be approved by the Council and can only be amended by the Council.

DEFINITION OF CREDIT RATINGS

ANNEX A

Fitch	Rating	Definition	Examples of counterparties
Short term	F1	Indicates the strongest intrinsic capacity for timely payment of financial commitments; may have an added “+” to denote any exceptionally strong credit feature.	Handelsbanken F1+ Nationwide Building Society Bank of Scotland Barclays Bank Santander
	F2	Good rated intrinsic capacity for timely payment of financial commitments.	Royal Bank of Scotland NatWest (The Council’s Bank) Nottingham Building Society
	F3	Fair rated intrinsic capacity for timely payment of financial commitments.	
Long-term	AAA	Highest credit quality organisations, reliable and stable. 'AAA' ratings denote the lowest expectation of default risk . They are assigned only in cases of exceptionally strong capacity for payment of financial commitments.	Germany, Sweden, USA, Switzerland. Money Market Funds
	AA	Very high credit quality. 'AA' ratings denote expectations of very low default risk . They indicate very strong capacity for payment of financial commitments. This capacity is not significantly vulnerable to foreseeable events.	United Kingdom AA+, France
	AA-		HSBC Bank, Handelsbanken
	A	High credit quality. 'A' ratings denote expectations of low default risk . The capacity for payment of financial commitments is considered strong. This capacity may, nevertheless, be more vulnerable to adverse business or economic conditions than is the case for higher ratings.	Bank of Scotland A+, Lloyds Bank A+, Barclays Bank, Santander, Nationwide Building Society, Coventry Building Society
	A-		Leeds Building Society, Yorkshire Building Society.

	BBB	Good credit quality. BBB ratings indicate expectations of low default risk . The capacity for payment of financial commitments is considered adequate, but adverse business or economic conditions are more likely to impair this capacity.	Royal Bank of Scotland BBB+, NatWest BBB+, Spain BBB+
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Notes

The modifiers “+” or “-“ may be appended to a rating to denote relative status within major rating categories.

The credit ratings quoted above are based on those issued by Fitch, a Credit Rating Company.

FUND MANAGEMENT (IF NO FURTHER BORROWING)
ANNEX B

<p>The following limits do not apply to the CIS, as the CIS is intended to be a medium to long term investment vehicle. Properties and other investments may be held onto for a number of years, dependent on the Risk associated with each individual investment and the wider portfolio itself.</p>		
Duration of investments	<p>No investment shall be longer than 5 years. Maximum duration for a Building Society with no rating is 1 month.</p>	
Types of investments	<p>Fixed term Deposits Deposits at call, two or seven day notice Corporate bonds Money market funds UK Government bonds and Supranational Bank bonds Loans to Organisations Pooled Property Funds Shares Based Investments (subject to separate approval of the Treasury & Capital Management Group)</p>	
Credit Ratings	<p>Building Societies All Building Societies with ratings of BBB or above. Building Societies with no ratings. (maximum duration 1 month) Money Market Funds AAA credit rating Local Authorities or UK Government No rating required Non-Building Societies Short term rating F2 by Fitch or equivalent. Long-term rating of AA- by Fitch or equivalent if the investment is longer than 1 year.</p> <p>Loans to Organisations These will not require a specific credit rating but will be subject to individual approval by Cabinet (these will be for longer than 5 years).</p>	
Maximum limits per counterparty (group), country or non-specified category	<p>F1+ or have a legal position that guarantees repayment for the period of the investment</p> <p>F1</p> <p>Building Society with assets over £2bn in top 25 (Currently 10)</p> <p>Building Society with assets over £1bn if in top 25 (Currently 3)</p> <p>Building Society with assets under £1bn in top 25</p> <p>Liquidity (Call) Account with a credit rating of F2 or with a legal position that guarantees repayment or a Building Society</p>	<p>£5M</p> <p>£4M</p> <p>£5M</p> <p>£4M</p> <p>£3M</p> <p>£5M</p>

	<p>BUT total invested with counterparty/group shall not exceed</p> <p>Money market fund AAA Credit rating</p>	<p>£8M</p> <p>£4M</p>
	<p>Limit for Non-specified investments</p> <ul style="list-style-type: none"> - £10M in time deposits more than one year - £5M in corporate bonds - £10M in any other types. - £10M Pooled Property funds e.g. CCLA - £15M in total <p>Country limits</p> <ul style="list-style-type: none"> - UK - unlimited - £5M in a country outside the EU - £10M in a country within the EU (excluding UK) - £20M in EU countries combined (excluding UK) - Country of Domicile for Money Market Funds – unlimited, providing the fund is AAA. <p>Except for Money Market Funds, no investment will be made in country with a sovereign rating of less than AA.</p> <p>These limits will be applied when considering any new investment from 24 February 2016. Lower limits may be set during the course of the year or for later years to avoid too high a proportion of the Council's funds being with any counterparty.</p> <p>Loans to Organisations</p> <p>No limit in value or period but will be subject to approval by Cabinet, of a detailed business case.</p> <p>Commercial Investment Strategy</p> <p>Investments made through the CIS will subject to the parameters and limits set out in that strategy.</p>	
Benchmark	LGC 7 day rate	

INVESTMENT LIMITS FOR BORROWING IN ADVANCE

	Level of Borrowing in Anticipation		Rating Constraints
from	£5M	£11M	
to	£10M	£20M	
BUILDING SOCIETIES			
Assets over £2bn	£5M	£5M	
Assets over £1bn	£4M	£4M	
Rest of top 25 by assets	£3M	£3M	
BANKS & OTHER INSTITUTIONS			
F2+ or legal status	£5M	£5M	AA- if more than 1 year
F2	£4M	£4M	AA- if more than 1 year
LIQUIDITY ACCOUNTS			
Limit in liquidity account	£5M	£6M	F2 or legal status
Limit with any other investments in institution	£8M	£9M	
NON-SPECIFIED INVESTMENTS			
Time Deposits over 1 year in total	£20M	£30M	
Corporate Bonds in total	£5M	£8M	Not yet determined
TERRITORIAL LIMITS			
UK	Unlimited		
EU (excluding UK)	£20M	£20M	
EU Country (other than UK)	£10M	£10M	
Any other Country	£5M	£5M	

BREAKDOWN OF BORROWING AND INVESTING FORECAST 2016/17 to 2020/21

1. COMMERCIAL INVESTMENT STRATEGY BORROWING FORECAST

Borrowing Strategy CIS	2016/ 2017 £m	2017/ 2018 £m	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m
Expenditure					
Capital Expenditure					
Brought Forward	0.0	(19.1)	(32.2)	(29.8)	(27.4)
Movement in Year (a)	(19.1)	(13.1)	2.4	2.4	2.4
Capital Financing Requirement	(19.1)	(32.2)	(29.8)	(27.4)	(25.0)
Fixed Term Investment (EOY)	0.0	0.0	0.0	0.0	0.0
Total Capital to be Financed	(19.1)	(32.2)	(29.8)	(27.4)	(25.0)
Financing					
Forecast long term borrowing (at 31/03/16 borrowing over MTFS)	0.0	0.0	0.0	0.0	0.0
Average Revenue Reserves	0.0	0.0	0.0	0.0	0.0
Earmarked Reserves	0.0	0.0	0.0	0.0	0.0
Total Reserves	0.0	0.0	0.0	0.0	0.0
Total Financing Available	0.0	0.0	0.0	0.0	0.0
Net Unfinanced Capital "Must Borrow"	(19.1)	(32.2)	(29.8)	(27.4)	(25.0)
If Reserves are not used to Finance Capital:					
May Borrow	(19.1)	(32.2)	(29.8)	(27.4)	(25.0)

Note: (a) These numbers represent the net for actual spend less Minimum Revenue Provision.

Cash Flow

The Council will be making investments through the CIS. Initially investments will be made using reserves, however due to the cash flow impacts of council tax and precept payments there may not be on a day to day basis, sufficient cash. In the event of this circumstance the council will look to borrow on a short-term basis.

Borrowing – Long Term

As the CIS develops and investments are made, borrowing will be required. It is expected that this will be from the Public Works Loans Board (PWLB). The type of loan is expected to be repayment, whereby repayments are made to the lender on a regular basis.

2. GENERAL CAPITAL PROGRAMME BORROWING FORECAST

Borrowing Strategy General Capital Programme	2016/ 2017 £m	2017/ 2018 £m	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m
Expenditure					
Capital Expenditure					
Brought Forward	(39.0)	(46.4)	(46.6)	(45.5)	(45.1)
Movement in Year	(7.4)	(0.2)	1.1	0.4	1.0
Capital Financing Requirement	(46.4)	(46.6)	(45.5)	(45.1)	(44.1)
Total Capital to be Financed	(46.4)	(46.6)	(45.5)	(45.1)	(44.1)
Financing					
Forecast long term borrowing (at 31/03/16 borrowing over MTFS)	13.4	13.2	13.1	12.9	12.7
Average Revenue Reserves	4.1	5.4	5.1	3.6	1.0
Earmarked Reserves	8.6	5.9	4.1	2.6	1.8
Total Reserves	12.7	11.3	9.2	6.2	2.8
Total Financing Available	26.1	24.5	22.3	19.1	15.5
Net Unfinanced Capital “Must Borrow”	(20.3)	(22.1)	(23.2)	(26.0)	(28.6)
If Reserves are not used to Finance Capital: “May Borrow”	(33.0)	(33.4)	(32.4)	(32.2)	(31.4)
Funding in Advance					
May Borrow a further	0.0	0.0	0.0	3.1	0.0
Need For Further Borrowing- Loans To Organisations	15.0	15.0	15.0	15.0	15.0

Cash Flow

In addition to the fundamental movements described above there are day-to-day impacts due to the flow of funds into and out of the Council. For instance, the dates on which the County Council is paid its portion of the Council Tax and Business Rate receipts will be different to the days the money is physically received from Council Tax and Business payers. These cash flows will sometimes leave the Council with several million pounds to borrow, or invest, either overnight or for a few weeks depending on the next precept date.

Authorities are permitted to borrow short term for this purpose and all borrowing decisions will be made on the most economically advantageous rates for the period that is required to be covered. If rates are particularly high on a particular day then the sum may be borrowed overnight to see if rates are lower the following day for the remainder of the period.

Loans to Organisations

The amounts shown are indicative at this stage and any such loans to organisations would be subject to separate approval by Cabinet. The number of loans of this nature are, likely to be limited as the CIS is likely to produce higher yields and a better risk profile.

Investments – High Credit Quality

The Council, following Department of Communities and Local Government (DCLG) guidance on credit worthiness of financial institutions, follows their guidance to ensure the high quality of the credit rating. The detail of this is shown in Annex A. Whilst the Council will take some account of such additional information the main criteria for judging credit quality will be:

- Short term credit ratings, and long-term credit ratings for any investment over 1 year.
- The top 25 Building Societies by asset size irrespective of any credit rating they may hold subject to the comments below.
- Credit Default Swap prices obtained from our advisors.
- Counter party list provided by Arlingclose on a monthly basis.

Investments – Risk Mitigation

Credit quality can never be absolutely guaranteed so to further mitigate risks there is a need to spread investments in a number of ways:

- By counterparty, including any institutions that are linked in the same group.
- By country.

These limits need to be a practical balance between safety and administrative efficiency and need to cope with the uncertainty of the amount of borrowing in anticipation. A schedule is therefore included in Annex B which shows the investment limits for different levels of forward borrowing.

Investments - Periods

Once a time deposit is made there is no requirement for the borrower to repay until the end of the agreed period. Thus a borrower who has a high credit rating on the investment day could be in serious financial difficulties in the future. As a result significant use is made of liquidity accounts which currently give an attractive interest rate but also allow repayment of our investment the same day.

The Council will register with a selection of money market funds with AAA ratings which also allow same-day withdrawal of funds. The domicile for some of these funds can be in a low rated country; however, as it is stipulated that the fund itself has to be AAA rated, this is acceptable.

These funds will be used as appropriate taking account of comparative security and yields. During 2015/16, the Council used the following money market funds:

- Public Sector Deposit Fund, operated by Church's, Charities and Local Authorities.
- Federated Sterling Fund, operated by Federated Investors.
- Insight Liquidity Fund, operated by Insight Liquidity Funds PLC.
- Standard Life Liquidity Fund, operated by Standard Life Investments.
- Legal and General Fund, operated by Legal and General Investment Management.
- Blackrock Sterling Liquidity Fund, operated by BlackRock Investment Management.

If during 2016/17, where it becomes advantageous, further funds may be used.

Investments - Management

Taking account of the Credit Quality and Spreading the Risk sections above, Annex B outlines the criteria and limits for making investments.

There may be limited occasions, based on detailed cash flow forecasts, where some investments of more than a year might be made that do not relate to borrowing in anticipation.

Risk of counterparty failure can also be minimised by shortening the period of any time deposit. At the current time, partly reflecting the current interest rate structure, time deposits are generally kept below one month. The criteria also differentiates the duration of investments based on credit rating e.g. the maximum duration of investments with building societies with no rating will be 1 month.

A new investment category for 2016/17 onwards is "shares-based investments". Such investments can be considered higher-risk because, as well as their performance being dependent on the companies etc. concerned, their performance is also dependent on the wider stock (or similar) market. However, they are a very liquid investment vehicle and are an option that will be considered within the CIS.

No Funding Activity

The amount of capital borrowing up until March 2016 will be dependent upon the actual levels of revenue spending which will determine the level of the Council's own reserves that can be used and the level of capital spending which will determine the total sum required. The period of borrowing will reflect the current and anticipated interest rate profile. If short term interest rates began to rise, consideration would be given to whether long term rates were attractive enough to support long term borrowing. If rates remain low it is much more difficult to justify long term borrowing.

Funding in Advance

Funding in advance would require longer term borrowing rates to be at levels that appeared to be attractive when compared with rates that were expected over the remainder of that period. It would also need to take account of the difference

between the borrowing rates and the currently, much lower, investment rates that would be received pending the use of the money for funding capital from sufficiently secure counterparties. A risk assessment will be carried out before undertaking any advance borrowing, and agreement would also be sought from the external auditors.

Profile

The Council will be balancing two different aspects when deciding on the period it will borrow for:

- **Stability.** Avoid the risk of adverse market movements affecting the cost of borrowing. To do this the logical option is to borrow the money for as long as needed.
- **Lowest Cost.** Minimise the overall cost of borrowing which, at the present time, might result in very short borrowing because of the very low interest rates available.

Any long term borrowing will tend to be from the Public Works Loans Board (PWLB) which is a Government Agency providing funds to local authorities at interest rates linked to the cost of central government borrowing rates.

**CIPFA PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES
PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT INDICATORS FOR
2016/17 AND THE COMMERCIAL INVESTMENT STRATEGY INDICATORS 2016/17.**

The relevant Prudential and Treasury Management indicators that need to reflect the potential borrowing to finance funding in advance and loans to organisations have been amended. Where no requirement is shown, the indicator only reflects what is included in the Council's Medium Term Financial Strategy.

All decisions relating to loans to organisations will be subject to approval by the Cabinet. Where these decisions will affect the relevant prudential or treasury indicators noted below, other than Item 7: "the authorised limit for external debt, retrospective approval will sought of Council at either the mid-year or full year reporting periods.

PRUDENTIAL INDICATORS

1. Actual and Estimated Capital Expenditure

		2014/15 Actual £m	2015/16 Forecast £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Capital Programme	Gross	7.5	9.9	10.5	3.5	2.4
	Net	3.2	6.4	9.5	2.7	1.6
CIS	Gross	0.0	10.0	20.0	15.0	0.0
	Net	0.0	0.0	20.0	15.0	0.0

1.1 Where it is determined that loans to organisations are for capital purposes, this will be treated as capital expenditure and would be in addition to the current capital programme.

1.2 The CIS estimated expenditure is subject to change, subject to further investments meeting the required rates of return.

2. The proportion of the budget financed from government grants and council tax that is spent on interest and the provision for debt repayment.

	2014/15 Actual	2015/16 Forecast	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Programme	8.2%	10.2%	10.2%	15.4%	19.1%
CIS	n/a	0.4%	4.7%	11.3%	15.0%
Total	8.2%	10.6%	14.9%	26.7%	34.1%

2.1 Assuming no borrowing in advance.

3. The impact of schemes with capital expenditure on the level of council tax

3.1 This calculation highlights the hypothetical impact on the level of Council Tax to changes from the previously approved MTFS due to capital schemes (including their associated revenue implications). The actual change in Council Tax will be significantly different due to revenue variations, spending adjustments and the use of revenue reserves.

		2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Capital Programme	Variation	£4.48	£2.82	(£1.43)
	Cumulative	£4.48	£7.30	£5.87
CIS	Variation	(£1.04)	(£4.35)	(£9.51)
	Cumulative	(£1.04)	(£5.39)	(£14.90)

4. The capital financing requirement.

- 4.1 This represents the estimated need for the Council to borrow to finance capital expenditure less the estimated provision for redemption of debt (the Minimum Revenue Provision). The table below shows the capital financing requirement split between the capital programme and the Commercial Investment Strategy.

	31/3/15 Actual £m	2015/16 Forecast £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital Programme	35.5	39.0	46.4	46.6	45.5	45.1	44.1
CIS	0	0	19.1	32.2	29.8	27.4	25.0
Total	35.5	39.0	65.5	78.8	75.3	72.5	69.2

5. Gross debt and the capital financing requirement

- 5.1 In order to ensure that, over the medium term, net borrowing will only be for a capital purpose, the Council should make sure that net external borrowing (borrowing less investments) does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current year and any specific decisions to borrow in advance or make loans to organisations.

	2015/16 Estimate £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing - General	14.0	21.7	23.7	24.7
Borrowing - CIS	0	20.1	35.1	35.1
Total	14.0	41.8	58.8	59.8

Gross and Net Debt

- 5.2 This indicator is intended to highlight the level of advance borrowing by limiting the variation between gross debt (borrowing) and net debt (borrowing less investments). The more borrowing in advance the higher the gross debt but there is no change in net debt because the borrowed sums will be invested pending them being needed to finance capital expenditure. Thus net debt as a proportion of gross debt falls as borrowing in advance occurs. Unfortunately the position is complicated by the significant variations that the Council has to contend with relating to day-to-day cash flow which can cause major fluctuations in this proportion. To achieve the equivalent result all advance borrowing will be reported to the TCMG and highlighted in the mid-year and end of year reports.

6. The authorised limit for external debt.

- 6.1 This is the maximum limit for borrowing and is based on a worst-case scenario. It reflects borrowing to fund capital rather than using reserves and the three elements (No activity, borrowing in advance and loans) will be controlled separately.

	2015/16 Limit £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Short term	18	22	20	18
Long term	46	47	47	46
Other long-term liabilities (leases)	5	5	6	7
Total - No Funding Activity	69	74	73	71
Long Term based on the maximum borrowing in advance	1	0	0	0
Plus long term borrowing to finance long term loans to organisations	15	15	15	15
Plus long term borrowing to finance loans for CIS investments delivering a commercial yield	60	19	32	30

7. The operational boundary for external debt.

- 7.1 This reflects a less extreme position. Although the figure can be exceeded without further approval it represents an early warning monitoring device to ensure that the authorised limit (above) is not exceeded.

	2015/16 Limit £m	2016/17 Limit £m	2017/18 Limit £m	2018/19 Limit £m
Short term	13	17	15	13
Long term	46	47	47	46
Other long-term liabilities (leases)	5	5	6	7
Total – No Funding Activity	64	69	68	66
Plus long term borrowing in advance	1	0	0	0
Plus long term borrowing to finance long term loans to organisations	15	15	15	15
Plus long term borrowing to finance loans for CIS investments delivering a commercial yield	60	19	32	30

8. Adoption of the CIPFA Code

- 8.1 The Council has adopted the 2011 edition of the CIPFA Treasury Management Code of Practice. The 2011 edition is still the latest version.

TREASURY MANAGEMENT INDICATORS

9. Exposure to interest rate risk as a proportion of net investments.

- 9.1 This indicator is set to control the Council's exposure to interest rate risk. Investments of less than 12 months count as variable rate.
- 9.2 If the Council does not borrow in advance it is quite possible that all investments will be of less than a year's duration and hence count as "variable rate".

		2016/17		2017/18		2018/19	
		Limits		Limits		Limits	
		Max	Min	Max	Min	Max	Min
Borrowing							
Longer than 1 year	Fixed	100%	75%	100%	75%	100%	75%
	Variable	25%	0%	25%	0%	25%	0%
Investments							
Longer than 1 year	Fixed	100%	100%	100%	100%	100%	100%
	Variable	0%	0%	0%	0%	0%	0%

10. Borrowing Repayment Profile

- 10.1 The proportion of borrowing in place during 2015/16 that will mature in successive periods. This indicator is set to control the Council's exposure to refinancing risk.
- 10.2 The Council has forecast £12.6m long term borrowing at the end of 2015/16, but the uncertainty on whether any forward borrowing will take place and the potential for short term borrowing to be the most attractive option results in the limits set out below.

Funding capital schemes	Upper limit	Lower limit
Under 12 months	91%	0%
12 months and within 24 months	91%	0%
24 months and within 5 years	91%	0%
5 years and within 10 years	92%	1%
10 years and above	100%	8%

- 10.3 This may be affected by any funding in advance or Loans to Organisations.

11. Investment Repayment Profile

- 11.1 Limit on the value of investments that cannot be redeemed within 364 days i.e. by the end of each financial year. The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. These limits need to allow for borrowing in advance.
- 11.2 The uncertainty about borrowing in advance results in higher limits than would otherwise be required.

	2016/17 £m	2017/18 £m	2018/19 £m
Capital Programme; Limit on investments over 364 days as at 31 March each year.	34.5	34.8	33.9

- 11.3 This may be affected by any changes to Funding in Advance, Loans to Organisations and the CIS.

COMMERCIAL INVESTMENT STRATEGY (CIS) SPECIFIC INDICATORS

12. Interest Cover Ratio (ICR)

- 12.1 This ratio determines the amount of total net income from property investments (after operating costs and any applicable taxes) compared with the interest expense of the debt. This is important so the amount of interest payable compared to income generated is proportionate.
- 12.2 Because debt commences later in the Phase 1 cycle, the profile of the ICR is shown below. It is suggested that these are initial indices reflecting the maximum debt interest to revenue at the commencement of the Business Plan (BP). If investments profiles change, the ICR ratio will change.

Initial Interest Cover Ratio (at start of CIS Business Plan)			
Year	Estimated		ICR
	Revenue cash flow £000	Cost of Interest £000	
2015/16	183	11	16.6
2016/17	292	55	5.3
2017/18	403	87	4.6
2018/19	463	95	4.9

- 12.3 The proposed range for ICR shall be between 5 and 17.

13. Loan to Value Ratio (LTV)

- 13.1 This ratio determines the amount of total debt (compared to the total value of the underlying property assets as valued from time to time). Debt in this respect is both internal and external debt, i.e. revenue financing and borrowing from the market that is used to finance the capital propositions. Although it is recognised that the primary form of finance for the CIS portfolio is debt, it is important to ensure that the proportion of debt to asset value is actively managed to ensure that the debt burden is within acceptable limits
- 13.2 In a similar way to the ICR, the LTV ratios, as shown below reflect that debt commences later in the BP cycle. It is suggested that these are initial indices reflecting the maximum debt asset value at the commencement of the BP. If investments profiles change, the ICR ratio will change.

Loan to Value Ratio (at start of CIS Business Plan)			
Year	Estimated		LTV
	Loan Value £000	Asset Value £000	
2015/16	10.0	32.9	30
2016/17	29.5	52.3	56
2017/18	43.5	69.5	63
2018/19	42.3	70.1	60

13.3 It is recognised that while the LTV is an important indices when having regard to debt repayment obligations, the ICR is the more important indices when monitoring the CIS on an on-going basis because it provides performance information that will enable the Council to determine its ability to:

- make revenue contributions that will support the delivery of Council services.
- meet its interest payments commitments on the debt within the CIS.

13.4 The proposed range for LTV shall be between 30 and 65.

14. Target Income Returns

14.1 The primary indices for measuring returns on investment is the “return on equity” (ROE) indices. This is effectively the:

Net Revenue Contribution (*1) / Equity (*2)

*1 Revenue contributions shall be calculated as net i.e. income returns after taking into account all operating and management costs, interest expense, minimum revenue provision and relevant taxes.

*2 Equity being the difference between the value of assets and borrowing.

14.2 Following extensive modelling of the proposed investment opportunities, the expected revenue contribution to the Council will be £2.5m by the end of 2018/19; this gives a ROE of 9%.

14.3 However, reflecting the income expected to be generated from the CIS will grow over time, it is best to have an ROE range for the period of the BP, this will be set between 6% and 9% per annum.

14.4 It is accepted that individual investments will contribute different levels of income return and that the target revenue contribution is an average across the CIS portfolio.

15. Portfolio & Risk Metrics

15.1 Additional indicators that would be useful to monitor the CIS, however most of these will come into play as the CIS matures. These include:

Historic and forecast income and total returns

15.2 As the CIS matures:

- It will be useful to monitor the performance of the assets to assist in informing future assets acquisitions.
- Other indices will be developed and may include:
 - Benchmarking of returns (IPD)
 - Gross & net income
 - Operating costs
 - Vacancy levels and Tenant exposures

1. Introduction

- 1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008, Councils, are in fact expected to make a prudent provision. The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's Guidance on Minimum Revenue Provision (the DCLG Guidance) most recently issued in 2012.
- 1.2 The broad aim of the DCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 1.3 The DCLG Guidance requires the Council to approve an Annual MRP Statement, and recommends a number of options for calculating a prudent amount of MRP.

2. General MRP Policy

- 2.1 The following statement incorporates options recommended in the Guidance;
- 2.2 For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets as the principal repayment on an annuity with an annual interest rate based on long-term borrowing rates, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
- 2.3 For assets acquired by finance leases or the Private Finance Initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.
- 2.4 Capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18.

3. Loans to Organisations MRP Policy

- 3.1 Where loans are made to other bodies for their capital expenditure, and the principal repayments are received at least on an annual basis, no MRP will be charged. The capital receipts generated by the annual repayments will replace the need to make a provision for MRP.
- 3.2 Capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18.

4. Commercial Investment Strategy MRP Policy

- 4.1 For each capital investment undertaken under the requirements of the Councils Commercial Investment Strategy, MRP will be made that is equal to the principal repayment for any loan finance supporting the investment.

5. Capital Financing Requirement and MRP Summary

- 5.1 Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2016, the budget for MRP has been set as follows:

	31.03.2016 Estimated CFR £m	2016/17 Estimated MRP £m
Capital Expenditure	39.0	1.6
Commercial Investment Strategy	0	0.9
Total	39.0	2.5