

HUNTINGDONSHIRE DISTRICT COUNCIL

Title/Subject Matter:	Treasury Management Strategy 2018/19
Meeting/Date:	Cabinet – 8th February 2018
Executive Portfolio:	Executive Member for Strategic Resources: Councillor J A Gray
Report by:	Head of Resources
Wards affected:	All Wards

Executive Summary:

The Council is required by law to approve, on an annual basis a Treasury Management Strategy; this requirement is within the relevant Codes of Practice issued by the Chartered Institute of Public Finance and Accountancy (CIPFA) and other guidance issued by Central Government.

The aim of the Treasury Management Strategy (TMS) is to manage the Council's investments, cash flows, banking, money market and capital market transactions, loans and borrowings within the requirements of an effective control environment but coupling this with the pursuit of optimum performance and yield and at the same time managing the portfolio's risk profile.

Highlights of the 2018/19 TMS includes:

- The operation of the strategy within an economic climate that is weakening, where inflation is likely to rise, business confidence is low because of the EU negotiation uncertainty and interest rates that have moved upward slightly but are forecast to remain low although possibly rising slowly into the medium term.
- The continuation of the Council's policy to:
 - use mainly short-term investments which are highly liquid and as a consequence are lower risk. This includes the use of call accounts and money market funds.
 - the provision of loans to organisations that meet either service objectives or support local organisations in their development where risk is mitigated by appropriate financial security and a business case for proceeding can be demonstrated.
 - the continuation of the Commercial Investment Strategy (CIS), and the related asset purchases and borrowing profile. The CIS is expected to refocus on local assets and housing property during the proposed MTFS.

- The method by which the Minimum Revenue Provision (MRP), the charge to revenue for the repayment of debt is calculated, and the inclusion within this strategy of the different MRP approaches for the general capital programme, loans to organisations, and the CIS. For 2018/19 an MRP policy has been amended, this will be used to where maturity loans are used to finance expenditure on housing provision.

Recommendations:

That the Cabinet agrees the report and recommends to Council the approval of:

1. The Treasury Management Policy, Appendix 2.
2. The Treasury Management Strategy, Appendix 3.
3. The Prudential, Treasury Management and CIS Indicators, Appendix 4.
4. The Annual Minimum Revenue Provision Policy 2018/19, Appendix 5

1. WHAT IS THIS REPORT ABOUT?

1.1 The aim of the Treasury Management Strategy is to provide strategic guidance on how the Council shall conduct its Treasury Management activity. The Strategy shall:

- Include relevant policies, objectives and treasury/prudential indicators; as well as illustrating its approach to risk management.
- Comply with the Code or Practice for Treasury Management and the Prudential Code for Capital Finance (as issued by the Chartered Institute of Public Finance and Accountancy, CIPFA) and reflect published Government advice.
- Approve the way in which the Minimum Revenue Provision is calculated.

1.2 The Strategy is a key element of the Councils Code of Financial Management, of which an extract is attached in **Appendix 1**.

1.3 In addition to complying with CIPFA's Treasury Management in the Public Services: Code of Practice 2011 Edition, the Council must also comply with the MHCLG's Guidance on Local Authority Investments (2010), both of which require the approval of an annual investment strategy before the start of each financial year. This strategy fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the MHCLG Guidance. New CIPFA codes for 2017 have been issued, though guidance on their application has yet to be issued. In addition MHCLG's guidance has been consulted on but has not been issued yet. Should there be a requirement to update this strategy a further report will be brought to Council.

2. WHY IS THIS REPORT NECESSARY/BACKGROUND

2.1 To seek Council approval for the:

i. Treasury Management Policy and Treasury Management Strategy, as attached at **Appendix 2** and **3**, along with the required indicators at **Appendix 4**. The aim of the:

- investment strategy is to provide a framework through which the Council will invest any surplus funds that balances the risk of default by the borrower against a fair rate of interest.
- borrowing strategy is to permit borrowing for cash flow purposes and for the funding of current and future capital expenditure over whatever periods are in the Council's best interests.

The Treasury Management Strategy also takes into account the Commercial Investment Strategy (CIS) Business Plan that was approved by Cabinet in December 2015. The plan in the proposed MTFS is that local commercial and housing assets will become a focus.

ii. Annual Minimum Revenue Provision Policy 2018/19 which is attached as **Appendix 5**. This policy outlines the way in which the charges to revenue for repayment of debt will be calculated.

2.2 For 2018/19, the Council is anticipating having a total capital financing requirement (which is both past and new capital expenditure) of £74.8m (falling

to £72.1m by 2022/23), of which £30.0m will be new capital expenditure relating to the CIS. Of the £75.5m the Council will be required to borrow at least £47.5m and potentially up to £60.1m if the Council chooses not to apply reserves. It should be noted that the Minimum Revenue Provision applicable to this capital programme is fully funded and included in next year's budget and the MTFs.

- 2.3 The authority has and will borrow and invest substantial sums of money and is therefore exposed to financial risks including the loss of funds and the revenue effect of changes in interest rates. The identification, monitoring and control of such risks are central to the Council's Treasury Management Strategy.
- 2.4 In accordance with MHCLG guidance, the Council will be asked to approve a revised Treasury Management Strategy, should the assumptions on which it is based change significantly. Such circumstances could include an unexpected change in interest rates, a change in the capital programme or in the level of investment balance.

3. OPTIONS CONSIDERED/ANALYSIS

- 3.1 The Treasury Management Strategy is a statutory requirement, thus it has to be considered in its entirety. However, the Strategy must not be viewed as a straightjacket; it is a framework within which the Council will conduct its Treasury activity.

4. KEY IMPACTS/RISKS? HOW WILL THEY BE ADDRESSED?

- 4.1 The emphasis of this report is to recognise the risks inherent in achieving a yield from investments, and the management of that risk.

5. COMMENTS OF OVERVIEW & SCRUTINY PANEL

- 5.1 The comments of Overview & Scrutiny Panel (Finance and Performance) will be included in this section prior to its consideration by Cabinet.

6. WHAT ACTIONS WILL BE TAKEN/TIMETABLE FOR IMPLEMENTATION

- 6.1 When approved this strategy will be used as an operational document for Treasury Management.

7. LINK TO CORPORATE PLAN

- 7.1 Treasury Management comes under the "Ensuring we are a customer focused and service led council delivering value for money services" aspect of the Corporate Plan, and enabling the Council to "*Become more business-like and efficient in the way we deliver services*".

8. CONSULTATION

- 8.1 No consultation has taken place.

9. LEGAL IMPLICATIONS

9.1 No direct, legal implications arise out of this report.

10. RESOURCE IMPLICATIONS

10.1 The resource implications are included within the report.

11. OTHER IMPLICATIONS

11.1 No other implications.

12. REASONS FOR RECOMMENDED DECISIONS

- 12.1 The Council is required, by law, to approve on an annual basis a:
- Treasury Management Policy & Strategy. The purpose of both is to provide the framework within which the Council can operate its Treasury related activity.
 - Policy in respect of its Minimum Revenue Provision so it can prudently account for the revenue impacts of capital investment decisions.

13. LIST OF APPENDICES INCLUDED

Appendix 1: Code of Financial Management (extract)

Appendix 2: Treasury Management Policy Statement

Appendix 3: Treasury Management Strategy 2018/19

Appendix 4: CIPFA Prudential Code For Capital Finance In Local Authorities; Prudential Indicators And Treasury Management Indicators For 2018/19 and the Commercial Investment Strategy Indicators 2018/19.

Appendix 5: Annual Minimum Revenue Provision Policy 2018/19

BACKGROUND PAPERS

Working papers held in Finance

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CODE OF FINANCIAL MANAGEMENT (EXTRACT)

Treasury Management

All treasury management activities will be undertaken in accordance with the Council's annual TMS, which includes the policies, objectives, risk management approach, and the prudential, treasury management and commercial investment strategy indicators. The strategy will comply with the Code of Practice for Treasury Management and the Prudential Code for Capital Finance, both published by the Chartered Institute of Public Finance and Accountancy (CIPFA), and reflects any published Government advice. The execution and administration of treasury management is delegated to the DRFO.

The Council shall have overall responsibility for treasury management and will formally approve the annual TMS and receive an annual and mid-year report on treasury management activities.

The Cabinet will be responsible for the implementation and regular monitoring of treasury management activity. The Treasury and Capital Management Group will include:

- The Leader, Deputy Leader and the Executive Councillor for Strategic Resources. Other members can be co-opted onto the group at the discretion of the Executive Leader.
- the RFO and the DRFO, and as and when necessary the Managing Director and/or Corporate Director (Services). Other officers can be co-opted onto the group at the discretion of the Managing Director or the RFO.

The Overview and Scrutiny Panel (Performance and Customers) will be responsible for the scrutiny of treasury management.

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 maturity 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 corporate 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 up to £30m. 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 monitor and review decisions relating to both the capital programme and the CIS.

1.0 STRATEGIC TREASURY MANAGEMENT

The Council hold funds which through both the need to manage its cash flows and also through the investments made via Commercial Investment Strategy (CIS) which are placed with various financial institutions and organisations. 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

The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in December 2017 (reduced from 3.1% in November 2017) as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

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

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

In the past few years inflation rates have been low, and this has benefited the Council's MTFS by lowering expectation for budgetary savings or growth, arising from increases in prices rather than increased demand. Inflation has now increased and this pressure will feed into budgetary pressure for budget growth with the consequent requirement to find further savings or income opportunities.

Growth forecasts are becoming more pessimistic. A slowdown in growth could potentially have an impact on the Council's ability to raise revenue from services

where consumers or businesses may cut back. For example, leisure, parking (consumer activity), development control (house building), or commercial estates.

1.2 Credit Outlook

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

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

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very 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 and property funds which are backed by property assets.

The regulatory changes in the EU have been aimed at ensuring the strength of financial institutions is improved in the event of an economic recession.

1.3 Interest Rate Outlook

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and ongoing decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

How Does This Impact on the Medium Term Financial Strategy

When the bank rate was increased, there was a slight upward movement in interest rates, as a result there is a small increase in the expected interest income received.

The result of low interest rates 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.

One effect on the MTFS of an increase in the UK bank rate is an increase in the cost of borrowing, however PWLB lending is based on gilt yields and as these are forecast to remain stable across the medium term, it is reasonable to assume the Council will be able to continue to borrow at low rates.

This will directly impact on the revenue budgets through the net interest budget, the forecast for which reflect the rates shown in **Table 1**.

Table 1	2017/18	2018/19	2019/20	2020/21	2021/22
MTFS Interest Rate Assumptions	%	%	%	%	%
Temporary investments	0.50	0.50	0.50	0.50	0.50
PWLB 20 year borrowing (EOY)	3.00	3.00	3.50	4.00	4.50
Temporary borrowing	0.30	0.32	0.34	0.36	0.38

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 2016/17 that concentrated on highly rated institutions, and the larger Building Societies, Money Market Funds and Local Authority investments. Investments in liquidity or call accounts, which offer repayment the same day were maximised to further reduce risk.

The 2018/19 Strategy allows for borrowing in anticipation of need to fund capital expenditure.

2.0 BORROWING AND INVESTMENT FORECAST 31st MARCH 2018

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 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 2018, broken down between CIS balances and general programme activities.

Table 2 Investing and Borrowing at 31/03/18	CIS £m	General Programme £m	Total £m
Investments Short-Term	0	2.0	2.0
Investments Long-Term	4.0 ^A	0.0	4.0
Total Investments	4.0	2.0	6.0
Borrowing- Short-Term	0.0	1.0	1.0
Borrowing- Long-Term	30.0	15.7	45.7
Total Borrowing	30.0	16.7	46.7

Notes ^ACCLA Property Fund and share based investments
The above table excludes loans to other organisations which are not used to manage cash flows

2.2 Interest Forecast 2017/18

The 2017/18 year-end forecast for net interest is now £0.282m, which will be a saving of £0.110m against the budget of £0.384m.

3.0 BORROWING AND INVESTMENT FORECAST OVER 2018/19 TO 2022/23

3.1 Medium Term Financial Strategy Capital Programme and CIS

Over the period of the MTFS the Council is budgeted to be spending 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	2016/17 Actual £m	2017/18 Forecast £m	2018/19 Budget £m	2019/20 Budget £m	2020/21 Budget £m	2021/22 Budget £m
Capital	7.8	10.3	3.7	2.7	2.1	2.1
CIS	9.2	30.0	0.0	0.0	0.0	0.0
Total	17.0	40.3	3.7	2.7	2.1	2.1

Note The CIS purchases are 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 in 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 2022/23 the Council is expecting to have borrowing in excess of £47m (“Must Borrow”). If however, the Council chose not to use reserves to finance capital, borrowings would increase to £54m by 2022/23 (“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	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m	2021/ 2022 £m	2022/ 2023 £m
Expenditure					
Capital Expenditure					
Brought Forward	(74.8)	(75.5)	(75.0)	(73.9)	(72.9)
Movement in Year	0.7	(0.5)	(1.1)	(1.0)	(0.8)
Capital Financing Requirement	(75.5)	(75.0)	(73.9)	(72.9)	(72.1)
Fixed Term Investment (EOY)	0.0	0.0	0.0	0.0	0.0
Total Capital to be Financed	(75.5)	(75.0)	(73.9)	(72.9)	(72.1)
Financing					
Forecast long term borrowing (at 31/03/18 borrowing over MTFS)	15.4	18.2	17.9	17.7	17.4
Average Revenue Reserves	2.6	2.6	2.7	2.7	2.7
Earmarked Reserves	10.0	10.0	10.0	10.0	5.0
Total Reserves	12.6	12.6	12.7	12.7	7.7
Total Financing Available	28.0	30.8	30.6	30.4	25.1
Net Unfinanced Capital “Must Borrow”	(47.5)	(44.2)	(43.3)	(42.5)	(47.0)
If Reserves are not used to Finance Capital: “May Borrow”	(60.1)	(56.8)	(56.0)	(55.2)	(54.7)
Funding in Advance					
May Borrow a further	0.0	0.0	0.0	0.0	0.0
Need For Further Borrowing- Loans To Organisations	(15.0)	(15.0)	(15.0)	(15.0)	(15.0)

Notes

1. Forecast general reserves is the average reserves for the year
2. Earmarked reserves include 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.
3. There would be a cash flow benefit; however due to its natural volatility, it is excluded from this analysis.

It is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead. By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal or short-term borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. The council may borrow additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Council may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Council will borrow short-term to cover unplanned cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues

Also capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

The Authority has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates.

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 of A-, 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 (Table 5 gives the limits):

- 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.

Table 5 Non-Specified Investments	£m
Total Long-Term Investments	15
Total Investments without Credit Ratings or rated below A-	15
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below AA+	15
Total non-specified investments	15

3.4 Operational Banking Requirements

The Council will incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £1m per bank. The Bank of

England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Council maintaining operational continuity.

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 following 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 following 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 Councils 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 the Leader, Deputy Leader, the Executive Member for Strategic Resources 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)
	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, Netherlands. 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, France, Handelsbanken
	AA-		HSBC Bank.
	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 A+, Santander A+, Nationwide Building Society A+, 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+, Clydesdale Bank BBB+

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>		
<p>Duration of investments</p>	<p>No investment shall be longer than 5 years. The duration of an investment should be limited to the duration indicated by the latest Arlingclose counterparty advice. Maximum duration for a Building Society with no rating is 1 month.</p>	
<p>Types of investments</p>	<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 and Asset Funds Shares Based Investments (subject to separate approval of the Treasury & Capital Management Group)</p>	
<p>Credit Ratings</p>	<p>Building Societies All Building Societies with ratings of BBB or above. Building Societies with no ratings. (maximum duration 1 month)</p> <p>Money Market Funds AAA credit rating</p> <p>Local Authorities, Police Authorities, Fire Authorities or UK Central Government, No rating required</p> <p>Banks and Corporate Entities 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>	
<p>Maximum limits per counterparty (group), country or non-specified category</p>	<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>£5M</p> <p>£4M</p> <p>£5M</p> <p>£4M</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>UK Central Government</p> <p>Money market fund AAA Credit rating and Pooled Property and Asset Funds</p>	<p>£3M</p> <p>£5M</p> <p>Unlimited</p> <p>£4M</p>
	<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 21 February 2018. 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	

ANNEX C

BREAKDOWN OF BORROWING AND INVESTING FORECAST 2018/19 to 2021/22

1. COMMERCIAL INVESTMENT STRATEGY BORROWING FORECAST

Borrowing Strategy CIS	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m	2021/ 2021 £m	2022/ 2023 £m
Expenditure					
Capital Expenditure					
Brought Forward	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)
Movement in Year (a)	0.0	0.0	0.0	0.0	0.0
Capital Financing Requirement	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)
Fixed Term Investment (EOY)	0.0	0.0	0.0	0.0	0.0
Total Capital to be Financed	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)
Financing					
Forecast long term borrowing (at 31/03/19 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"	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)
If Reserves are not used to Finance Capital:					
May Borrow	(30.0)	(30.0)	(30.0)	(30.0)	(30.0)

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	2018/ 2019 £m	2019/ 2020 £m	2020/ 2021 £m	2021/ 2022 £m	2022/ 2023 £m
Expenditure					
Capital Expenditure					
Brought Forward	(44.8)	(45.5)	(45.0)	(43.9)	(42.9)
Movement in Year	(0.7)	0.5	1.1	1.0	0.8
Capital Financing Requirement	(45.5)	(45.0)	(43.9)	(42.9)	(42.1)
Total Capital to be Financed	(45.5)	(45.0)	(43.9)	(42.9)	(42.1)
Financing					
Forecast long term borrowing (at 31/03/19 borrowing over MTFS)	15.4	18.2	17.9	17.7	17.4
Average Revenue Reserves	2.6	2.6	2.7	2.7	2.7
Earmarked Reserves	10.0	10.0	10.0	10.0	5.0
Total Reserves	12.6	12.6	12.7	12.7	7.7
Total Financing Available	28.0	30.8	30.6	30.4	25.1
Net Unfinanced Capital “Must Borrow”	(17.5)	(14.2)	(13.3)	(12.5)	(17.0)
If Reserves are not used to Finance Capital: “May Borrow”	(30.1)	(26.8)	(26.0)	(25.2)	(24.7)
Funding in Advance					
May Borrow a further	0.0	0.0	0.0	0.0	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 (MHCLG) 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 Triple A, this is acceptable.

These funds will be used as appropriate taking account of comparative security and yields. During 2016/17, 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 2018/19, 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 was "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 2017 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.

APPENDIX 4

CIPFA PRUDENTIAL CODE FOR CAPITAL FINANCE IN LOCAL AUTHORITIES PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT INDICATORS FOR 2018/19 AND THE COMMERCIAL INVESTMENT STRATEGY INDICATORS 2018/19.

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

		2016/17 Actual £m	2017/18 Forecast £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Capital Programme	Gross	9.0	11.9	5.5	3.9	3.4
	Net	7.8	10.3	3.7	2.7	2.1
CIS	Gross	9.2	30.0	0.0	0.0	0.0
	Net	9.2	30.0	0.0	0.0	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.

	2016/17 Actual	2017/18 Forecast	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Programme	8.1%	10.1%	13.0%	14.9%	14.8%
CIS	4.4%	9.4%	10.1%	10.3%	10.0%
Total	12.5%	19.5%	23.1%	25.1%	24.9%

- 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 from 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.

		2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Programme	Variation	£2.61	£5.70	£6.47
	Cumulative	£2.61	£7.63	£14.77
CIS	Variation	(£0.33)	(£0.14)	£0.04
	Cumulative	(£0.33)	(£0.48)	(£0.44)

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.

	31/3/17 Actual £m	2017/18 Forecast £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m	2022/23 Estimate £m
Capital Programme	38.8	43.1	43.8	43.3	42.2	41.2	40.4
CIS	0	26.4	24.5	22.6	20.7	18.8	16.9
Total	38.8	69.5	68.3	65.9	62.9	60.0	57.3

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.

	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Borrowing - General	15.7	15.4	18.2	17.9
Borrowing - CIS	30.0	30.0	30.0	30.0
Total	45.7	45.4	48.2	47.9

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.

	2017/18 Limit £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m
Short term	26	26	26	26
Long term	45	45	45	45
Other long-term liabilities (leases)	6	7	8	9
Total - No Funding Activity	77	78	79	80
Long Term based on the maximum borrowing in advance	0	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	30	30	30	30
Total	122	123	124	125

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.

	2017/18 Limit £m	2018/19 Limit £m	2019/20 Limit £m	2020/21 Limit £m
Short term	21	21	21	21
Long term	45	45	45	45
Other long-term liabilities (leases)	6	7	8	9
Total – No Funding Activity	72	73	74	75
Plus long term borrowing in advance	0	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	30	30	30	30
Total	117	118	119	120

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. Interest Rate Exposures

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

Interest Rate Exposure Limits	2017/18 £m	2018/19 £m	2019/20 £m
Upper limit on fixed interest rate exposure	70.0	80.0	90.0
Upper Limit on variable interest rate exposure	30.0	35.0	40.0

10. Borrowing Repayment Profile

- 10.1 The proportion of borrowing in place during 2016/17 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 £15.8m long term borrowing at the end of 2016/17, 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	79%	0%
12 months and within 24 months	79%	0%
24 months and within 5 years	79%	0%
5 years and within 10 years	80%	1%
10 years and above	100%	20%

- 10.3 This may be affected by any funding in advance, Loans to Organisation or the CIS programme.

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.

	2018/19 £m	2019/20 £m	2020/21 £m
Capital Programme; Limit on investments over 364 days as at 31 March each year.	68.2	63.0	63.3

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

COMMERCIAL INVESTMENT STRATEGY (CIS) SPECIFIC LOCAL INDICATORS

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	
2017/18	3,179	628	19.7
2018/19	3,179	628	19.7
2019/20	3,179	628	19.7
2020/21	3,179	628	19.7

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

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 £m	Asset Value £m	
2017/18	30.0	64.0	47
2018/19	28.1	64.5	44
2019/20	26.2	65.0	40
2020/21	24.3	65.5	37

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.

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 £3.0m by the end of 2018/19; this gives a ROE of 8%.

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.

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

1.0 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 MHCLG Guidance) most recently issued in 2012.
- 1.2 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.
- 1.3 The MHCLG Guidance requires the Council to approve an Annual MRP Statement, and recommends a number of options for calculating a prudent amount of MRP.
- 1.4 The Council has a number of MRP policies reflecting the range of capital financing options required for different service scenarios.
- 1.5 It does not cover any of the proposed changes in the consultation recently issued by CIPFA.

2.0 General MRP Policy

- 2.1 This Policy was originally approved by Cabinet on the 17th September 2009. For (iii) below, for 2017/18 there has been a slight change to clarify when the incidence of MRP will be chargeable. The following statement incorporates options recommended in the Guidance;
- 2.2 The actual Policy is:
 - i. 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.
 - ii. 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.
 - iii. In respect of:
 - capital assets; MRP will be chargeable in the year following the agreement of any final account.

- other capital investments; MRP will be chargeable in the following financial year.

3.0 Loans to Organisations MRP Policy

3.1 This Policy was originally approved in 22nd February 2015. The aim of the policy is to facilitate the provision of finance to organisations, with the Council sourcing the finance from third parties, but to ensure that the incidence of debt finance is directly neutralized within the Councils balance sheet.

3.2 The actual policy is:

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.

4.0 MRP Policy – Financing Expenditure with Annuity Loans

4.1 This Policy was originally approved on 22nd February 2016 and has been amended for 2018/19. The aim of this policy is to determine the neutralization of MRP when Annuity Loans are used to finance CIS asset, and investments.

4.2 The actual policy is:

For each capital investment undertaken under the requirements of the Council's Commercial Investment Strategy, where it has been decided that an Annuity Loan is advantageous, MRP will be made that is equal to the principal repayment for any loan finance supporting the investment.

5.0 MRP Policy – Financing Expenditure with Maturity Loans

5.1 This was a new policy for 2017/18, it has now been amended to include purchases in relation to housing property purchases.

5.2 Maturity Loans are similar to interest only mortgages, in that only interest is paid during the life of the loan with the loan principal being repaid at the end of the term (by either the Council taking out a further loan or selling the asset and repaying the loan from the capital receipt; with a possible net capital gain). To undertake such financing, a new MRP Policy would be required that included some specific safeguards to ensure that the use of capital finance remained prudent.

5.2 However, the advantage of Maturity Loans for the Council is that over the life of the loan, the net benefit from the ongoing income stream would be greater as the Council would only have to repay interest on an annual basis and not meet annual principal repayments. The following example clearly demonstrates the revenue advantage of financing by Maturity Loan compared to an Annuity Loan; in that the additional revenue stream over the life of the asset is £7.0m.

- If a CIS Asset of £10m was acquired with an annual income stream of £625k (pessimistic, giving a yield of 6.2%) and held for 20 years, the net revenue stream for a:
 - Maturity Loan would be £7.2m (£359k per annum).
 - Annuity Loan would be £140k (£7k per annum).

There the benefit for a Maturity Loan is £7.0m (£352k per annum).

5.3 Any new MRP Policy to support this activity must ensure that the principles of prudence are adhered to. The principles, are noted in “i to ii” below:

- i. The CIS or housing asset would be required to be directly linked to the loan finance; this could be agreed retrospectively by Cabinet following acquisition. However, the link could only be broken by a specific decision of Full Council. The Councils Constitution would be required to be changed to reflect this.
- ii. The CIS or housing asset is valued on an annual basis, in line with the Councils Accounting Policy for Investment Assets. If it is established that the value of the asset is less than the loan, then an MRP payment will be required, based on an Annuity Loan, and the MRP payment will continue to be charged until the Asset Value is greater than the loan.

5.4 The actual policy is:

For each capital investment undertaken under the requirements of the Councils Commercial Investment Strategy, where it has been decided that a Maturity Loan is advantageous, no Minimum Revenue Provision shall be made providing that:

- i. The capital investment is directly linked to the Maturity Loan, with the stated intention that at loan maturity the asset is sold or replacement finance is provided.
- ii. Cabinet will record the decision in (i) above (this may be done retrospectively i.e. after an acquisition). The link between Asset and Loan can only be broken by a decision of Full Council.
- iii. There is annual revaluation of the CIS or housing investment in line with the Councils Accounting Policy in respect of Investment Assets. If it is established that an asset has a value less than the loan then an annual MRP amount will be calculated, based on Annuity basis and continue to be charged until the value of the asset is greater than the loan.

Capital Financing Requirement and MRP Summary

Based on the Council's latest estimate of its Capital Financing Requirement on 31st March 2018, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	2018/19 Estimated MRP £m
Capital Expenditure	43.1	2.2
Commercial Investment Strategy	5.0	1.9
Total	48.1	4.1