Annex B

TREASURY MANAGEMENT STRATEGY STATEMENT 2017/18

INDEX

1 INTRODUCTION

Background

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

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

1.3 CIPFA defines treasury management as:

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

1.4 The Council is responsible for its treasury decisions and activity. The successful identification, monitoring and control of treasury management risk are integral to treasury management activity. The following 2017/18 TMSS sets out how the Council intends to address the most significant risks and a schedule is included at Appendix B.

Reporting Requirements

1.5 The Council is required to receive and approve Treasury Management reports during the year, including:

- **Prudential and treasury indicators and treasury strategy** (this report)
- **Quarterly update treasury management reports** – These will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.
- **An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

Scrutiny

1.6 In order to implement the strategy and monitor treasury management activity, the Council has set up a Treasury Management Panel. Chaired by the Section 151 Officer and including the Cabinet Spokesperson and Cabinet Support Member for Corporate Services, the TM Panel meets on a regular basis to ensure that the approved treasury strategy is implemented. The above reports are required to be adequately scrutinised before being recommended to the Council.

Treasury Management Strategy for 2017/18

1.7 The strategy for 2017/18 covers two main areas:

Capital Issues

- the capital plans and the prudential indicators;
- the minimum revenue provision (MRP) policy.

Treasury Management Issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- debt rescheduling;
- the investment strategy;
- creditworthiness policy; and
- policy on use of external service providers.

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Training

1.8 The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The training needs of treasury management officers are periodically reviewed and general training requirements are reported through the Council's Personal Development Review (PDR) process.

1.9 Staff members involved in treasury operations have previously completed the CIPFA-ACT International Treasury Management qualification. Ongoing training is accessed through Capita and CIPFA workshops. All training activities are recorded in accordance with Treasury Management Practice 10 – Training and Qualifications.

Treasury Management Consultants

1.10 The Council uses Capita Asset Services, Treasury Solutions as its external treasury management advisors.

1.11 The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

1.12 It also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2 CAPITAL EXPENDITURE PLANS 2017/18 – 2019/20 AND CAPITAL PRUDENTIAL INDICATORS

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

2.2 Following the reform of the HRA Subsidy system, the Council adopted the two-pool approach to debt management, maintaining separate pools for the General Fund (GF) and Housing Revenue Account (HRA).

2.3 Maintaining two pools, in theory, allows decisions on the structure and timing of borrowing to be made independently. Whilst the key issue facing the GF is one of short-term affordability, the HRA has to consider treasury management as a key risk against the viability of the 30 year business plan.

2.4 A separate borrowing strategy for the HRA has been produced which is approved by the Berneslai Homes board. A copy of this is shown at Appendix I. The Prudential Indicators below show the split between the GF and the HRA.

Combined GF/HRA Capital Expenditure

2.5 This prudential indicator is a summary of the Council's capital expenditure plans, both those agreed previously, and those forming part of this budget cycle. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure £000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund	52,401	68,217	51,182	32,274	6,931
HRA	25,091	29,905	30,004	32,975	21,888
Total	**77,492**	**98,122**	**81,186**	**65,249**	**28,819**

The above financing need excludes other long term liabilities, such as PFI and leasing arrangements which already include borrowing instruments.

2.6 These capital expenditure plans are monitored and amended by individual project leads throughout the financial year, to reflect the anticipated spend over the five years. These variances are reported formally to Cabinet each quarter, along with the suite of financial performance reports.

2.7 The table below summarises the above capital expenditure plans and how these plans are being financed by capital or revenue resources. The Authority's programme is fully approved at an individual level, including schemes to be financed from an increased borrowing need. Where the Council can generate additional funding to support capital expenditure, this will reduce its borrowing needs. Therefore levering in additional grant from funding/ regional bodies such as Sheffield City Region can have a direct impact on our capital financing costs and future levels of debt.

Financing of Capital Expenditure £000	**2015/16 Actual**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
Capital Expenditure	**77,492**	**98,122**	**81,186**	**65,249**	**28,819**
Capital Receipts	11,104	7,439	1,675	1,107	702
Capital Grants	12,567	31,484	6,246	6,024	0
Capital Reserves	0	22,444	62,815	40,414	21,808
Revenue	23,472	7,135	10,450	12,903	1,310
Net Financing Need for the year as a result of Capital Expenditure	**30,349**	**29,620**	**0**	**4,801**	**4,999**

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

2.8 The second prudential indicator is the Council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been financed from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need.

2.9 Capital expenditure not financed from internal resources (i.e. Capital Receipts, Capital Grants and Contributions, Revenue or Reserves) will produce an increase in the CFR.

2.10 The CFR does not increase indefinitely, as there is a statutory obligation for the Authority to set aside an annual revenue charge, the minimum revenue provision (MRP). This broadly reduces the borrowing need in line with each assets' life. A separate statement on the Council's policy on MRP is shown at Appendix F.

2.11 In addition, the Authority is able to make voluntary contributions towards reducing its CFR as it sees fit.

2.12 The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes. The Council currently has £239M of such schemes within the CFR.

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

Capital Financing Requirement £000	**2015/16 Actual**	**2016/17 Estimate**	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**
CFR – GF	654,779	680,030	675,658	675,925	676,566
CFR – HRA	282,511	280,561	278,532	276,423	274,228
Total CFR	**937,290**	**960,591**	**954,190**	**952,348**	**950,794**

3 BORROWING

3.1 The capital expenditure plans set out in Section 2 provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes of practice, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

Current Portfolio Position

3.2 The Council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the **General Fund's** actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing.

General Fund: £000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt:					
Capital Financing Requirement	654,779	680,030	675,658	675,925	676,566
Less: Other Long-Term Liabilities (OLTL)	(241,027)	(239,285)	(237,838)	(236,348)	(235,185)
Borrowing CFR	**413,752**	**440,745**	**437,820**	**439,577**	**441,381**
Less Existing Profile of Debt	(262,399)	(282,335)	(271,044)	(248,312)	(209,605)
Cumulative Maximum External Borrowing Requirement	151,353	158,410	166,776	191,265	231,776
Usable Reserves *	116,126	86,799	41,961	36,503	25,222
Cumulative Net Borrowing Requirement	**35,227**	**71,611**	**124,815**	**154,762**	**206,554**

* The above table assumes that the Authority's current level of "banked" reserves will be utilised over the planning period, except for reserves totalling £25M relating to a

minimum working balance and other statutory functions . It also does not assume any replenishment of these reserves, on a prudent basis.

3.3 The GF has a significant ongoing borrowing requirement as shown in the table above. This is as a result of the strategy of internal rather than external borrowing (using internal balances to minimise credit risk and avoid the cost of holding cash in the current climate of low investment returns) to fund major capital schemes such as the Building Schools for the Future Programme and the markets and town centre development.

3.4 As at 31st March 2017 the level of un-funded CFR exceeds the available balances and reserves, illustrated by the positive net cumulative borrowing requirement of £64M. This position will be monitored throughout the financial year and the borrowing options available to the Authority are discussed in greater detail from section 3.33 of the report.

3.5 The following table shows the level of internal borrowing as a percentage of the Capital Financing Requirement for both the GF and HRA. The average internal borrowing across Capita's local authority clients is approximately 15%:

Internal Borrowing as a % of CFR	**2016/17**	**2017/18**	**2018/19**	**2019/20**
GF CFR	680,030	675,658	675,925	676,566
GF Usable Reserves	86,799	41,961	36,503	25,222
%	**12.8%**	**6.2%**	**5.4%**	**3.7%**
HRA CFR	280,561	278,532	276,423	274,228
HRA Usable Reserves	37,000	27,000	17,000	10,000
%	**13.2%**	**9.7%**	**6.1%**	**3.6%**

3.6 This position is subject to change as factors such as capital slippage, working capital and investments will all impact on the borrowing requirement. Officers will monitor the Council's cash position to ensure sufficient liquidity is maintained.

3.7 Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

3.8 As per the Local Government Act 2003, a local authority may borrow money either for capital purposes or for the purposes of the prudent management of its financial affairs. Accordingly, the Authority may consider borrowing during

2017/18 for such purposes, including, for example, upfront repayment of its pension deficit for the next three years, as it is financially beneficial to do so.

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

Treasury Indicators: Limits to Borrowing Activity

3.10 The Operational Boundary. This is the limit beyond which external debt is not normally expected to exceed. This limit is set to match the Capital Financing Requirement as shown in the table at 2.11.

Operational Boundary £000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	721,306	716,352	716,000	715,609
Other Long Term Liabilities	239,285	237,838	236,348	235,185
Total	**960,591**	**954,190**	**952,348**	**950,794**

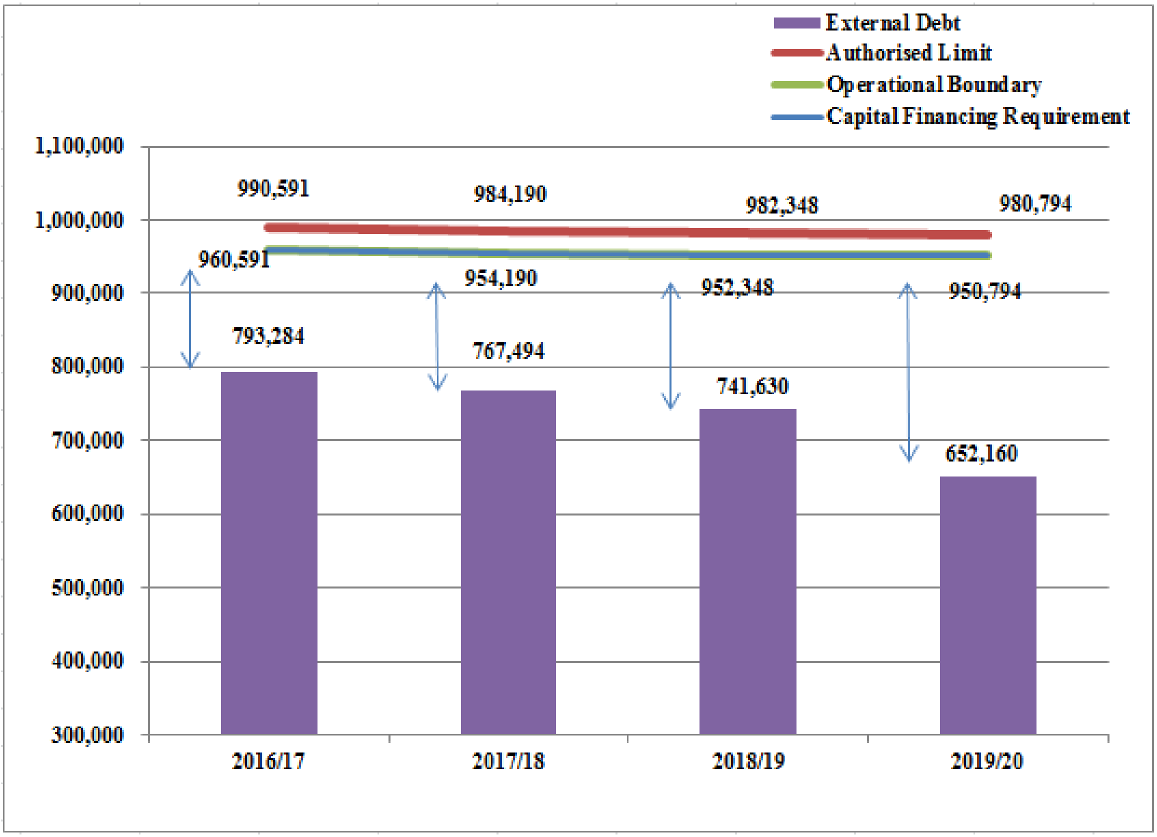
3.11 The Authorised Limit for External Debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. The Authorised Limit has been set at £30M above the Operational Boundary.

3.12 This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

3.13 The Council is asked to approve the following authorised limit:

Authorised Limit £000	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	751,306	746,352	746,000	745,609
Other Long Term Liabilities	239,285	237,838	236,348	235,185
Total	**990,591**	**984,190**	**982,348**	**980,794**

3.14 The following graph illustrates the profiles of the GF and HRA in terms of current debt, CFR, Operational Boundary and Authorised Limit.



3.15 External debt, represented by the bars, has already been spent on funding capital expenditure. The CFR line shows the amount in the programme which needs to be funded. Therefore, the area highlighted represents internal borrowing (capital spend not supported by direct funding).

3.16 The above graph estimates the level of temporary borrowing facility at £75m in 2016/17 and 2017/18 and £55m thereafter.

3.17 Separately, the Council is also limited to a maximum HRA CFR through the HRA self-financing regime. This limit is currently:

HRA Debt Limit £m	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
HRA Debt Cap	301,000	301,000	301,000	301,000
HRA CFR	277,000	271,000	264,000	257,000
HRA Headroom	**24,000**	**30,000**	**37,000**	**44,000**

3.18 The HRA Borrowing Strategy 2017/18 is included at Appendix I.

Interest Rate Risk

3.19 The risk profile of the GF has altered significantly following the apportionment of debt resulting from the implementation of self-financing. The GF loan pool is now subject to a much greater degree of interest rate risk, as shown below (estimated at 31.3.17):

Borrowing Method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB - Fixed	144	33	No
Market Fixed	27	6	No
PWLB – Variable	34	8	Yes
Temporary Borrowing	75	17	Yes
Other Local Authority	2	1	No
Internal Borrowing / Borrowing Requirement	159	36	Yes
TOTAL	**441**	**100**	

Note – although market loans are viewed as fixed rate borrowing, there is a potential interest rate risk attached to these instruments should the lender exercise the call option.

3.20 Assuming an estimated borrowing CFR of £441M (CFR less long-term liabilities) at the end of 2016/17, 61% (£268M) of the GF loan pool is exposed to short-term interest rate movements and in the case of temporary borrowing, refinancing risk.

3.21 Exposure to variable interest costs will be offset to some extent by maintaining a level of variable rate investments. Assuming investments of £40M, net interest rate exposure is reduced from 61% to 52%.

3.22 Retaining a relatively high level of exposure has clear benefits in reduced interest costs. The GF's share of existing PWLB variable rate loans (£35M) continues to represent excellent value with an interest rate of approximately 0.42% and the average rate payable on temporary borrowing is 0.57% (Dec 16).

3.23 There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments;
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

3.24 The Council is asked to approve the following treasury indicators and limits:

£m	2017/18	2018/19	2019/20
Interest Rate Exposures – (GF)			
	Upper	**Upper**	**Upper**
Upper Limit on Fixed Interest Rates based on Net Debt (GF)	90%	90%	90%
Upper Limit on Variable Interest Rates based on Net Debt (GF)	25%	25%	25%
Maturity Structure of Fixed Interest Rate Borrowing 2017/18 - (GF)			
		Lower	**Upper**
Under 12 months		0%	50%
12 months to 2 years		0%	25%
2 years to 5 years		0%	25%
5 years to 10 years		0%	25%
10 years to 20 years		0%	75%
20 years to 30 years		0%	75%
30 years to 40 years		0%	75%
40 years to 50 years		0%	75%

Refinancing Risk

3.25 The strategy of using inexpensive temporary borrowing to fund capital expenditure does expose the Council to a degree of refinancing risk. Whilst there is limited PWLB borrowing maturing in the next five years, approximately £55M of temporary borrowing from other local authorities is set to mature within the next 12 months. This source of funding is not guaranteed and rates are dictated to some extent by supply and demand, which represents an ongoing risk.

3.26 Low interest rates mean the Council's £63M of LOBOs loans (GF share of £27M) are unlikely to be called in 2017/18. The interest rate of 4.75% is above current market rates and therefore the refinancing risk in respect of these loans is low when taking into account prevailing market conditions. The Council will take the option to repay the LOBO loans at no cost should the opportunity arise to do so. In addition, the Council is also exploring the option (with specialist advisers) to repay the debt on more favourable terms in order to take advantage of prevailing low interest rates. The extent to which this will present an opportunity will depend upon the level of penalties that the current funders are likely to charge to break the loan conditions.

Prospects for Interest Rates

3.27 The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

3.28 Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Director of Finance will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

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

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

Any decisions will be reported to the Treasury Management Panel at the next available opportunity.

Borrowing Strategy for 2017/18

3.29 High internal borrowing and variable rate debt creates a high level of risk. However, the strategy continues to pay dividends and support budget savings in the current economic environment. By postponing borrowing, the Council has greatly benefitted from an unexpected fall in fixed borrowing rates, which mitigates this risk to some degree.

3.30 The PWLB variable debt, combined with internal borrowing creates a very cheap position, but at risk of an uplift in interest rates. With interest rates at a record low, there is an option to fix out a proportion of the Authority's GF debt portfolio to remove a degree of refinancing risk. Conversely, a high proportion of the HRA portfolio is fixed rate debt, so there could be a potential to switch this to variable.

3.31 A Debt Options analysis has been carried out to assess the current position of the GF and requirements over the next 5 years. It is important to ascertain the right approach in a difficult climate. An analysis has been completed to project the impact of taking various decisions and how this feeds through to the Capital Financing Budget.

3.32 In addition to the Council's CFR repayment, the Council also has a number of loans due to mature over the next 5 years. The loans that have been identified as dropping out of the portfolio over the next 5 years are shown in the table below. This includes fixed and variable rate loans.

Maturing Loans	**Principal £M**	**Rate %**	**Financial Year**
Jan-17	2,100	8.625	2016/17
May-17	3,200	8.625	2017/18
May-17	5,400	7.375	2017/18
Nov-19	1,300	9.375	2019/20
Total Fixed	**12,000**		
Nov-19	21,400	0.700	2019/20
Mar-20	13,200	0.430	2019/20
Total Variable	**34,600**		
TOTAL	**46,600**		

Options to Consider

3.33 **Municipal Bond Agency** – This has been established to offer an alternative source of borrowing for local authorities to the PWLB. The Agency aims to provide cheaper capital finance to local authorities,undercutting the PWLB, via periodic bond issues. The Authority is a shareholder in the Agency, together with 55 other local auhorities and the Local Government Association.

3.34 **Borrow on need** - Borrow fixed, temporary or longer dated debt as loans mature. As the outlook for rates is to remain low this is a cheap option which matches cash flow and reduces counterparty exposure and cost of carry. The use of temporary borrowing injects volatility into the portfolio in terms of interest rate and refinancing risk, but this is offset by reduced interest costs. At a time of increasing bugetary pressures, the use of tempoary borrowing is a key consideration when balancing the requirements of risk versus affordability.

3.35 **Restructure variable rate debt** - Consider switching some of the variable rate debt to fixed longer term PWLB. The variable rate debt would not incur any penalties if repaid early, will reduce variable rate risk, but clearly will introduce additional costs to refinance. Each £10m rescheduled will cost roughly £200k p.a. This option is suitable for the GF, but the high level of fixed rate debt already maitanined by the HRA means that this would not be a suitable strategy for the HRA.

3.36 **Risk spreading** - Borrow in small tranches to cover the fixed rate maturities over the next 3 years. This will spread the refinancing risk and address the borrowing need. Borrowing in smaller tranches may be beneficial due to uncertainty and volatility of rates and to hedge against rates moving even lower. This approach could be considered in terms of both the GF and HRA debt portfolios.

3.37 **Deferred loans** – There are offers in the market of deferred loans, giving the option to fix the rate now for a period of up to 5 or 6 years in advance. This would allow the Authority to continue a short term, cheap position, with the comfort of fixed rate loans being delivered in the future. The risks are, once agreed, the Authority is committed to the funds and the market rates could potentially be cheaper in 3 years' time. Arranging the loans could be quite a lengthy process involving a great deal of due diligence with commercial lenders.

Borrowing Strategy Recommendations for 2017/18

3.38 Based on the above information, it is recommended that:

- The Council borrows £10M from the Municipal Bond Agency to cover the loans due to mature in the next six months which are shown in the table above. This will enable the Authority to access funding at lower rates than the PWLB and help the Agency establish itself as an alternative source of funding for Local Authorities from the PWLB. This borrowing will be undertaken by the GF, but is an option that could be considered by the HRA in future years. The Agency is a new initiative and it is worth noting that at the time of writing it has yet to make its first bond issue. This will only go ahead with a sufficient level of commitment and interest from local authorities. Should the bond issue fail to materialise within our required timescales, the Authority will seek to use the PWLB as an alternative source of funding.

- In addition, it is recommended that a proportion of the portfolio is fixed out, to move towards fixing out temporary variable loans as a policy objective. This is suitable for the GF, but not recommended for the HRA.

- The Council will look at deferred loans to cover off the large variable loan due to mature in 2019/20. This could present an opportunity for both the GF and HRA debt portfolios.

3.39 The potential combination of these approaches should help to keep interest payments at relatively low levels, whilst gradually reducing the GF's exposure to interest rate and refinancing risk.

Policy on Borrowing in Advance of Need

3.40 The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the Council can ensure the security of such funds. Borrowing in advance of need will only be undertaken when there is a clear business case for doing so.

PFI Refinancing

3.41 The Council is currently reviewing its PFI programmes (particularly its Building Schools for the Future programme) to determine whether these can be refinanced on cheaper terms. The PFI element of the BSF programme was originally financed through commercial funders in 2009/10 and the Council is currently exploring opportunities (in conjunction with shareholders on the Barnsley Local Education Partnership) to re-finance the programme on more favourable terms taking into account potential break costs. It is envisaged that this work be completed during the 2017/18 financial year.

Source of Borrowing

3.42 As detailed in the 2016/17 Strategy, a consultation has been issued regarding the abolition of the PWLB Commissioners. HM Treasury have confirmed that despite the proposed abolition, the lending function will continue unaffected and that local authorities will continue to have access to the same range of borrowing facilities and there will be no impact on existing loans held by authorities.

3.43 The preferred method of borrowing will be through the PWLB but officers will continue to examine alternative options in 2017/18. The Authority has become a shareholder in the Local Government Agency's (LGA) Municipal Bond Agency and is looking to undertake borrowing as part of the first bond issue by the Agency.

3.44 The Council will continue to access funding from other local authorities. This source of funding is not guaranteed and is reliant on the cash flow position of other authorities. Officers will continue to assess the market to identify the level of refinancing risk.

3.45 Approved sources of long and short-term borrowing are:

- PWLB,
- UK local authorities,
- Any institution approved for investment,
- UK public and private sector pension funds,
- Capital market bond investors,
- Special purpose companies created to enable joint local authority bond issues, and
- Commercial lenders and banks.

3.46 As stated at 3.26, the Council holds £63M of LOBOs, the GF share of £27M representing just less than 10% of GF debt. To protect against the uncertainty and refinancing risk associated with such products, no further LOBO borrowing will be undertaken.

Leasing

3.47 Leasing remains a value for money option for financing suitable assets with a defined residual value, such as vehicles. Despite the financial crisis causing some banks to withdraw from the market, the remaining funders are willing to take risks on the future residual value of assets, making leasing a cheaper option for financing than funding acquisitions in-house. There is also a benefit to transferring the risk associated with the residual value away from the Council. The most appropriate and cost effective method of financing will continue to be identified for all assets.

4 ANNUAL INVESTMENT STRATEGY

Investment Policy

4.1 The Council is required to set an Annual Investment Strategy (AIS) as prescribed in guidance from the CLG on Local Government Investments.

4.2 The Director of Finance, under delegated powers, will undertake the most appropriate form of investments in keeping with the investment objectives, income and risk management requirements and Prudential Indicators. Decisions taken on the core investment portfolio will be reported to the Treasury Management Panel.

4.3 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In 2016/17 (to 31st Dec 2016), the Council's investment balance has ranged between £24M and £60M, and similar variations are expected for the forthcoming year, depending on cash flow patterns.

4.4 Low investment risk is a key treasury objective, and to comply with the CIPFA Code and the CLG guidance, the Council's general policy objective is to invest its surplus funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's investment priorities are:

- **Security of the invested capital;**
- **Liquidity of the invested capital;**
- **Optimum yield which is commensurate with security and liquidity.**

4.5 In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

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

4.7 Other information sources used will include the financial press, share price and such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

Security (Credit and Counterparty Risk)

4.8 As outlined above, BMBC applies the creditworthiness service provided by the Authority's Treasury Management Advisers, Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

- credit watches and credit outlooks from credit rating agencies;
- Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

4.9 This modelling approach combines credit ratings, credit Watches and credit Outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the end product is a series of colour coded bands indicating the relative creditworthiness of counterparties.

4.10 **Approved Counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 1 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 1: Approved Investment Counterparties and Limits

	Maximum Amount	Maximum Duration
UK Government Debt	Unlimited	5 yrs
Banks (subject to Capita rating: minimum A-)*	£10m	2 yrs
Barclays Bank – the Authority's Banker	£10m	liquid
Building Societies	£5m	6 mths
Local Authorities	£5m	1 yr
Money Market Funds (AAA-mmf rated)	£10m	liquid
Enhanced Money Market Funds (AAA-mmf rated)	£10m	liquid

**Specific banks will be subject to maximum durations depending on Capita's Credit List. This list is received on a weekly basis and investments are placed in accordance with the recommended maximum duration for individual counterparties at that time. At present, the Council will place investments with UK and non-UK institutions that have a minimum long term rating of A- or equivalent. In the current volatile economic environment there is the possibility that the ratings of financial institutions could be downgraded across the board. The Authority will review its view on minimum credit ratings should this become the case.*

4.11 Investment treasury indicator and limit - total principal funds invested for greater than 364 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for early sale of an investment, and are based on the availability of funds after each year-end.

4.12 The Council is asked to approve the treasury indicator and limit: -

Maximum Principal Sums Invested > 364 days			
£m	**2017/18**	**2018/19**	**2019/20**
Principal Sums Invested > 364 Days	£m 20	£m 20	£m 20

4.13 The Barclays Flexible Interest Bearing Current Account (FIBCA) continues to be used by treasury staff to effectively manage daily cash flows and the FIBCA also provides an additional annual interest payment. Barclays currently meets the Council's minimum credit criteria. Even if the bank's credit rating falls below the minimum criteria, the Authority will continue to use the bank for short term liquidity requirements and business continuity arrangements. An individual limit of £10M applies to the Authority's bank account provider, Barclays, (specifically the FIBCA account) in order to meet the Authority's cash flow requirements. From 1st April 2017, no new fixed term deposits will be placed with Barclays.

4.14 Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

4.15 Counterparties will be individually selected for investment and as such there is no definitive list of counterparty names within this Annual Investment Strategy. The list of current eligible counterparties is monitored on a weekly basis and circulated to treasury staff. Any negative credit developments that affect the counterparty list are communicated immediately. An institution that meets criteria may be suspended, but institutions not meeting criteria will not be added.

Liquidity (Liquidity Risk)

4.16 In line with the CLG investment advice on the liquidity of investments, the Council will aim to keep a proportion of the investment portfolio totally liquid (i.e. use of FIBCA and Money Market Funds).

4.17 In a period of prolonged low interest rates, accepted practice would be to lengthen the investment period to lock in to higher rates. However, the uncertainty and volatility in the financial markets has heightened credit risk. As a consequence the Council will keep the investment maturity relatively short, and this is reflected in the maturity periods specified in the Prudential Indicator shown in Appendix D.

Yield

4.18 As a result of continuing stress within the market, opportunities for investment are limited and returns are expected to remain subdued. The Council will seek to maximise returns from its investments but this will be secondary to security and liquidity priorities. Short-term money market rates are likely to remain at low levels throughout 2017/18 and this will result in reduced investment income.

4.19 Although the Council currently has a good spread of investment instruments, officers will continue to evaluate alternative investment options that meet the principles of security, liquidity and yield. Consideration will be given to alternative investment instruments and whether they are suitable for the investment portfolio. Proposals for new investment instruments will be taken to Treasury Management Panel for discussion and advice will be sought from Capita prior to making any investment decisions.

Diversification

4.20 In addition to the core investment principles of security, liquidity and yield the Council will also seek to diversify investments to avoid concentration in specific banks, types of instrument, sovereign state etc.

4.21 In order to diversify a portfolio largely invested in cash, investments will be placed with approved counterparties over a range of maturity periods. Maximum investment levels are set to ensure prudent diversification is achieved and these, together with minimum ratings and cash limits, are shown in Table 1.

Performance Measurement

4.22 The Council receives benchmarking information from Capita which compares performance against that of their other clients. This information has the added advantages of including risk weightings and also allows comparison with other Authorities who are receiving the same investment advice. The Authority also participates in the CIPFA Treasury Management benchmarking survey.

Berneslai Homes

4.23 The funds of Berneslai Homes continue to be ring fenced in a segregated Barclays account, with clear separation from Council funds. Officers of the Council are responsible for the management of Berneslai Homes cash balances and the account is run in accordance with Treasury Management best practice and the effective management of risk.

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APPENDIX A

Capita Asset Services Economic & Interest Rate Forecast December 2016

Economic Background

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the latest view for 2016 - 2020.

Capita Asset Services Interest Rate View													
	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%

The **referendum vote for Brexit** in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The **Monetary Policy Committee, (MPC), meeting of 4th August** was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in the Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The **MPC meeting of 3 November** left the Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank.

The latest MPC decision included a forward view that **Bank Rate** could go either up or down depending on how economic data evolves in the coming months. Capita forecast that the Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019. It is worth pointing out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on forecasts.

The **August quarterly Inflation Report** was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a 'business as usual' mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015. In addition, the GfK consumer confidence index has recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

The Chancellor has said he will do 'whatever is needed' i.e. to **promote growth**; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is **inflation** where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of 3.2% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, (16% down against the US dollar and 11% down against the Euro); this will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external influences (outside of the UK), although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that **consumer disposable income** will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend and reached 1.2% in November. However, producer output prices rose at 2.1% and core inflation was up at 1.4%, confirming the likely future upwards path.

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

Employment has been growing steadily during 2016, despite initial expectations that the referendum would cause a fall in employment. However, the latest employment data in November, (for October), showed a distinct slowdown in the rate of employment growth and an increase in the rate of growth of the unemployment claimant count. House prices have been rising during 2016 at a modest pace but the pace of increase has been slowing since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

The Federal Reserve in the **USA** embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene and then the Brexit vote, have caused a delay in the timing of the second increase which is now strongly expected in December 2016. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis.

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

The Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

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

Brexit Timetable and Process

The following Brexit timetable and process may be helpful in terms of the economic background to the 2017/18 TMSS:

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

APPENDIX B

Council's Approach to Risk Management

The following schedule contains information from the Treasury Management Practice documents and the Council's risk management software, and provides a summary as to how the Council manages the various treasury management risks.

1. Credit and Counterparty Risk

Risk : Credit and counterparty risk is the risk of failure by a third party to meet its contractual obligations to the Council under an investment.
Mitigation : Credit & Counterparty risk is addressed through the use of the Annual Investment Strategy (AIS) as detailed in Section 6. The implications of 'Bail-in' will impact on the ratio of probability of loss. The AIS aims to reduce the impact through diversification whilst acknowledging that the probability of default will potentially increase.
Probability : Medium
Impact : High

2. Liquidity Risk

Risk : Liquidity risk is the risk that cash will not be available when it is needed.
Mitigation : The Council has access to short-term funding through the money markets and borrowing is also readily available from the PWLB.
The Council will also aim to keep a proportion of investments totally liquid i.e. with immediate access.
Probability : Low
Impact : Medium

3. Interest Rate Risk

Risk : Interest Rate risk is the risk that fluctuations in the levels of interest rates create an unexpected or unbudgeted burden on the Council's finances.
Mitigation : Both the HRA and particularly the GF debt pools are subject to a degree of interest rate risk. The balancing of risk against cost is a key theme for 2017/18 and is addressed in detail throughout the TMSS.
Probability : Medium
Impact : Very High

4. Exchange Rate Risk

Risk : Exchange rate risk is the risk that fluctuations in foreign exchange rates create an unexpected or unbudgeted burden on the Council's finances.
Mitigation : None – the Council undertakes minimal foreign currency transactions, so the risk is negligible.
Probability : Very Low
Impact : Very Low

5. Refinancing Risk

Risk : Refinancing risk is the risk that maturing borrowings cannot be refinanced on terms that reflect the provisions made by the Council.
Mitigation : The GF has a significant amount of temporary borrowing which will need to be refinanced and this is addressed in the borrowing strategy. The PIs place limits on the maturity structure of borrowing to limit the refinancing risk.
Probability : Medium
Impact : High

6. Legal and Regulatory Risk

Risk : Legal and regulatory risk is where the Council fails to act in accordance with its legal powers or regulatory requirements, and suffers losses accordingly.
Mitigation : The Council receives professional advice from Treasury Management advisers and officers receive regular training updates.
Probability : Low
Impact : Low

7. Fraud, Error and Corruption Risk / Contingency Management Risk

Risk : Fraud error and corruption and contingency management risk is the risk that the Council fails to identify the circumstances in which it may be exposed to the risk of loss through fraud, error, corruption or other eventualities in its treasury management dealings.
Mitigation : Internal Audit consider on an annual basis carrying out a regulatory review of the treasury management function including probity testing. This decision is made on a risk-based strategy and discussed and agreed with management. The recommendations of these reports are actioned in accordance with the agreed timetable.
Probability : Low
Impact : Medium

8. Market Risk

Risk : Market risk is the risk that through adverse market fluctuations in the value of the principal sums the Council invests, its stated investment objectives of security of capital is compromised.
Mitigation : The use of alternative investments vehicles such as property funds may increase the level of market risk. Investment in such instruments will only be undertaken after rigorous assessment and on the advice of Capita Asset Services.
Probability : Medium
Impact : Medium

APPENDIX C

Policy on use of Financial Derivatives

1. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of financial derivatives. The CIPFA Code requires authorities to clearly detail their policy on the use of derivatives in the TMSS.

2. The Council will only use derivatives where they can be clearly demonstrated to reduce the overall level of financial risk

3. Derivatives may be arranged with any organisation that meets the Council's approved investment criteria.

4. The Council will only use derivatives after seeking a legal opinion and ensuring that officers have the appropriate training to effectively manage their use.

APPENDIX D

THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2017/18 – 2019/20

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

Capital Expenditure

Capital Expenditure £000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
General Fund (GF)	52,401	68,217	51,182	32,274	6,931
Housing Revenue Account (HRA)	25,091	29,905	30,004	32,975	21,888
Total	**77,492**	**98,122**	**81,186**	**65,249**	**28,819**

Affordability Prudential Indicators

The previous sections cover the overall capital and control of borrowing prudential indicators, but within this framework prudential indicators are required to assess the affordability of the capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances. The Council is asked to approve the following indicators:

a. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs net of investment income) against the net revenue stream.

%	2016/17 Approved	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
GF	**15.0**	**9.5**	**8.8**	**9.2**
HRA	**43.6**	**43.8**	**45.7**	**47.7**

b. Incremental impact of capital investment decisions on the band D council tax

This indicator identifies the revenue costs associated with proposed changes to the three year capital programme recommended in this budget report compared to the Council's existing approved commitments and current plans. The assumptions are based on the budget, but will invariably include some estimates, such as the level of Government support, which are not published over a three year period.

£	2016/17 Approved	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council Tax - band D	**8.30**	**4.49**	**4.30**	**4.26**

c. Incremental impact of capital investment decisions on housing rent levels

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

£	2016/17 Approved	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Weekly housing rent levels	**0.86**	**0.61**	**1.91**	**3.36**

Adoption of the CIPFA TM Code

This indicator is acknowledgment that the Local Authority has adopted CIPFA's *Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes.*

The Council adopted the CIPFA Code of Practice on Treasury Management on 13th February 2002.

Gross Debt and the Capital Financing Requirement

Gross Debt & CFR	**2017/18 Estimate**
	£M
Outstanding Borrowing	549
Other Long-Term Liabilities	239
Gross Debt	**788**
Max CFR	954
Headroom	**166**

APPENDIX E

ADDITIONAL INVESTMENT STRATEGY INFORMATION AND LIMITS

1. The Council may invest money using any of the following instruments:

    - interest-bearing bank accounts,
    - fixed term deposits,
    - callable deposits where the Council may demand repayment at any time (with or without notice),
    - certificates of deposit,
    - bonds, notes, bills, commercial paper and other marketable instruments, and
    - shares in money market funds and other pooled funds.

    Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures specified in section 3.22 of the report.

2. Investments made by the Authority will be classified as either specified or non-specified investments. The CLG Guidance defines specified investments as those:

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

    It should be emphasised that institutions with a rating within the single A band are considered to be 'high credit quality' (Fitch). At present, the Council will place investments with UK and non-UK institutions that have a minimum long term rating of A- or equivalent. In the current volatile economic environment there is the possibility that the ratings of financial institutions could be downgraded across the board. The Authority will review its view on minimum credit ratings should this become the case.
    In terms of Sovereign ratings, the UK is currently rated AA, but is on negative watch due to Brexit concerns. To reflect this uncertainty, the Council will use UK banks irrespective of the UK sovereign rating and any other sovereign with a minimum rating of AA-. Any new specified investments will be made within the limits shown within table 1 in the AIS. For money market funds and other pooled funds 'high credit quality' is defined as those having a credit rating of 'AAA-mmf' or higher.

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

Non-Specified Investment Limits

	Cash limit
Total long-term investments	£20m
Total investments without credit ratings or rated below [A-]	£30m
Total investments with institutions domiciled in foreign countries rated below [AA-]	£10m
Total non-specified investments	£60m

All non-specified investments must be approved in accordance with the authorisation procedures as detailed in Treasury Management Practice Document 5: Organisation, Clarity and segregation of Responsibilities and Dealing Arrangements. This involves prior authorisation and approval of the Acting Head of Financial Services.

4. To minimise counterparty risk, the maximum that will be lent to any one organisation (other than the UK Government) will be £10 million. A group of banks under the same ownership or a group of funds under the same management will be treated as a single organisation for limit purposes. Limits will also be placed on investments in brokers' nominee accounts (e.g. King & Shaxson), foreign countries and industry sectors as below:

Investment Limits

	Cash limit
Any single organisation, except the UK Central Gov.	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£15m per group
Any group of pooled funds under the same management	£15m per manager
Negotiable instruments held in a broker's nominee account (King & Shaxson)	£30m per broker
Foreign countries	£15m per country
Registered Providers	£10m in total
Unsecured investments with Building Societies	£10m in total
Money Market Funds	£30m in total
Loans to small businesses	To be determined

5. When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

6. The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

7. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

   - no new investments will be made,
   - consideration will be given to recalling or selling any existing investments with the affected counterparty where there will be no cost to the authority.

   Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

APPENDIX F

2017/18 MRP STATEMENT

The Council is required to make a prudent provision for debt redemption known as the Minimum Revenue Provision (MRP). Guidance on MRP has been issued by the Secretary of State and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

The four MRP options available are:

Option 1: Regulatory Method
Option 2: CFR Method
Option 3: Asset Life Method
Option 4: Depreciation Method

NB This does not preclude other prudent methods.

MRP in 2017/18: Options 1 and 2 may be used only for General Fund supported expenditure. Methods of making prudent provision for General Fund self-financed expenditure include Options 3 and 4 (which may also be used for supported expenditure if the Council chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

The MRP Statement is required to be submitted to Council before the start of the 2017/18 financial year for approval. Any revision of which must be submitted to Council for approval.

The Council is recommended to approve the following statement:

- **For capital expenditure incurred before 1st April 2008, and for supported capital expenditure incurred on or after that date, MRP will be determined in accordance with Option 3.**

- **For non-supported (prudentially borrowed) capital expenditure incurred after 1st April 2008, MRP will be determined in accordance with Option 3.**

- **MRP in respect of Private Finance Initiatives (PFI) brought on balance sheet under the International Reporting Standard Code of Practice will be determined in accordance with Option 3.**

- **Within Option 3, MRP is permitted to be calculated in one of two ways – equal instalments or on an annuity basis. The Council has chosen to calculate MRP on an annuity basis.**

- **MRP will normally commence in the financial year following the one in which expenditure is incurred. However, MRP Guidance permits authorities to defer MRP until the financial year following the one in which the asset becomes**

operational. The Council has chosen to employ this “MRP holiday” on the significant qualifying projects such as the Building Schools for the Future programme.

MRP in respect of leases brought on balance sheet under the International Financial Reporting Standard Code of Practice will match the annual principal repayment for the associated deferred liability. This approach will produce an MRP charge comparable to that under Option 3 in that it will run over the life of the lease term.

APPENDIX G

TREASURY MANAGEMENT SCHEME OF DELEGATION

Full Council

- Receiving and reviewing reports on treasury management policies, practices and activities;
- Approval of annual strategy.

Boards/committees/council/responsible body

- Approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices;
- Budget consideration and approval;
- Approval of the division of responsibilities;
- Receiving and reviewing regular monitoring reports and acting on recommendations;
- Approving the selection of external service providers and agreeing terms of appointment.

Body/person(s) with responsibility for scrutiny

- Reviewing the treasury management policy and procedures and making recommendations to the responsible body.

APPENDIX H

THE TREASURY MANAGEMENT ROLE OF THE SECTION 151 OFFICER

The S151 (responsible) officer

- Recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- Recommending the appointment of external service providers.

APPENDIX I

Housing Revenue Account
Borrowing Strategy
2017/18

1 Background

1.1 Following the reform of the HRA subsidy system, on 1st April 2012 the Council notionally split each of its existing long-term loans into General Fund (GF) and Housing Revenue Account (HRA) pools.

1.2 This split included all long-term fixed and variable rate debt, from both the Public Works Loan Board (PWLB) and market sources. The HRA was apportioned debt of £269M in addition to the £22M payment made to Government to 'buy out' of the subsidy system, giving a total debt level of £291M.

1.3 Debt costs account for approximately 20% of expenditure on the business plan and therefore represent an area of key risk. Given the significance of debt management to the business plan, it is acknowledged that there is a need for a separate borrowing strategy for the HRA and this is addressed within the TMSS.

HRA Borrowing Requirement and Strategy

2 Current debt portfolio

2.1 Since 2012, there have been a number of part repayments of PWLB annuity and equal instalment of principal (EIP) loans lowering the debt level to £275M as at November 2016. A loan repayment of £2.9M is due in January 2017, so the forecast debt level at the end of 2016/17 is £272M, and the breakdown is shown below:

2.2

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB – fixed (inc settlement loan £22M)	190	70	No
Market Fixed	36	13	No
PWLB – variable	46	17	Yes
TOTAL	**272**	**100**	

2.3 As at 31st March 2017, 17% of the forecast debt portfolio is sensitive to interest rate fluctuations. The PWLB variable loans (£46M) continue to represent excellent value at rates of 0.43% (£28M) and 0.70% (£18M). There is an interest rate risk associated with the loans, but the semi-annual rate fixing provides some protection against increases.

2.4 Low interest rates mean the Council's £63M of LOBOs loans (HRA share of £36M) are unlikely to be called in 2017/18. The interest rate of 4.75% is above current PWLB levels and therefore the refinancing risk in respect of these loans is low when taking into account prevailing market conditions.

3 Borrowing and Capital Financing Requirement

3.1 The Capital Financing Requirement (CFR) reflects the HRA's underlying need to finance capital expenditure by borrowing. Any capital expenditure that is not resourced immediately (from useable capital receipts, capital grants and contributions or charges to revenue) will result in an increase in the CFR.

3.2 The forecast CFR for end of the 2016/17 financial year is £277M against a borrowing level of £272M. Therefore, the HRA is £5M under-borrowed. A debt level below the CFR means the HRA has been internally borrowing – using internal reserves and balances in-lieu of external borrowing.

3.3 Assuming this under-borrowed amount is subject to interest rate fluctuations, then 19% of the debt portfolio is subject to interest rate movements, as shown below:

Borrowing method	Value (£M)	% of Portfolio	Interest Rate Risk
PWLB – fixed (inc settlement loan £22M)	190	68	No
Market Fixed	36	13	No
PWLB – variable	46	17	Yes
Unfunded CFR	5	2	Yes
TOTAL	**277**	**100**	

3.4 This figure of 19% is still well within the Prudential Indicator of 25% which determines the upper threshold for variable rate exposure.

3.5 The HRA CFR has been reduced from £291M at the implementation of Self-financing, to the forecast £277M at the end of 2016/17. The reduction is due to applied capital receipts from housing properties sold under the Right to Buy Scheme. Where sales under the Right to Buy exceed those assumed in the Self Financing Settlement the Council is allowed to retain an amount to cover the housing debt which would have been supported from the rental income on the additional properties sold. It is considered prudent to apply this funding to reduce the CFR. In addition, a 50 year annuity debt repayment policy was agreed with the Council in early 2016 and has been reflected within the debt figures.

3.6 In a surprise announcement in his budget on 8th July 2015 the Chancellor of the Exchequer stated that social housing rents would decrease by 1% per annum for the next 4 years with the aim of reducing the Housing Benefit bill. This replaces the existing Government commitment made in 2013 to allow rents to increase by the Consumer Price Index of inflation (CPI) plus 1%. This means that HRA debt can no longer be repaid within the 30 Year Business Plan.

3.7 Overall borrowing is limited by the debt cap set by the CLG of £301M, leaving headroom of approximately £24M. However, in the new financial environment additional borrowing to fund extra capital investment is unlikely to be affordable.

3.8 There is no requirement to charge Minimum Revenue Provision (MRP) as with the GF CFR.

3.9 The HRA's estimated CFR is shown below:

	Estimate 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	£M	£M	£M	£M
Capital Financing Requirement (CFR)	277	271	264	257
Less : Existing Profile of Borrowing	272	259	257	207
Cumulative Maximum External Borrowing Requirement	5	12	7	50
Usable Reserves	37	27	17	10
Cumulative Net Borrowing Requirement	(32)	(15)	(10)	40

3.10 The HRA has a borrowing requirement in 2019/20; this is partially offset by HRA useable reserves.

<u>Borrowing Strategy</u>

3.11 The key aim of the HRA borrowing strategy is to manage the affordability of debt repayments within the 30 year business plan. The options are set out below:

Internal and Short-Term Borrowing

3.12 As stated, there is a limited borrowing requirement in the immediate future and any changes to the HRA working balance, for example slippage in the capital programme, will mean the HRA can fund this requirement internally.

3.13 As shown in the above table, the HRA is in an internally borrowed position. Essentially, this means that the actual level of debt is below the CFR and the HRA has used internal resources (reserves and balances) to fund some of its unfinanced capital expenditure. The main benefit of the strategy of internal borrowing is that the cost of carry associated with long-term fixed rate borrowing compared to investment returns is such that the use of internal resources remains an attractive means of minimising external debt payments.

3.14 Given the limited borrowing requirement, the initial strategy will be to monitor the HRA treasury position, and to borrow short-term should any need arise. When the borrowing requirement arises in 2019/20, the HRA could consider introducing more variable rate debt to the portfolio. Although there is interest rate risk associated with variable rate debt, this is offset by reduced interest rate costs. At a time of increasing budgetary pressures, maximising the debt portfolio is a key consideration when balancing the requirements of risk versus affordability.

Borrowing in Advance of Need

3.15 Given the HRA's limited borrowing requirement, it is unlikely there will be any borrowing in advance of need.

3.16 There may be opportunities to borrow in advance of need to fund future loan maturities, but this will only be undertaken where there is a key business case for doing so.

Premature Redemption of Debt

3.17 Given the Council's budget deficit, consideration will be given to restructuring existing fixed term loans. There is a potential impact on the HRA as the debt split was only notional so any premature repayments will include elements of both GF and HRA debt.

3.18 The Director of Corporate Services for Berneslai Homes will be consulted on any rescheduling decisions to ensure the impact on the HRA, and the 30 year business plan, are fully understood.

Charging of Debt Interest Costs

3.19 Long-term borrowing, post 1st April 2012 is allocated directly to either the GF or HRA pool. Interest payable and other charges (e.g. premiums on early redemption) will be allocated to the respective revenue account.

3.20 Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative.

3.21 This balance will be measured each month and interest will be transferred on a quarterly basis between the General Fund and HRA at the monthly average rate earned by the Council on its portfolios of treasury investments and short-term borrowing.

4. HRA Prudential Indicators

4.1 The Local Government Act 2003 requires the Council to adopt the CIPFA Prudential Code and produce a suite of Prudential Indicators. In accordance with the principle of a developing a distinct borrowing strategy for the HRA, a suite of Prudential Indicators for 2017/18 to 2019/20 have also been produced.

1. Capital Expenditure

	Approved 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	£M	£M	£M	£M
HRA	37	27	28	28

2. Ratio of Financing Costs to Net Revenue Stream

	Approved 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	%	%	%	%
HRA	43.6	43.8	45.7	47.7

3. Capital Financing Requirement

	Approved 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	£M	£M	£M	£M
HRA	277	271	264	257

4. Estimates of the Incremental Impact of Capital Decisions on Housing Rents

	Approved 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	£	£	£	£
Increase in Average Weekly Housing Rents	0.86	0.61	1.91	3.36

5. Interest Rate Exposure

	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	%	%	%
Upper Limit for Fixed Interest Rate Exposure	100	100	100
Upper Limit for Variable Rate Exposure	25	25	25

6. Maturity Structure of Borrowing

	2017/18		
	Lower Limit %	Upper Limit %	Estimated Current Profile (31.3.17) %
Less than 12 months	0	25	22
12 months & within 24 months	0	25	1
24 months & within 5 years	0	25	3
5 years & within 10 years	0	25	11
10 years & within 20 years	0	75	7
20 years and within 30 years	0	75	6
30 years and within 40 years	0	75	25
40 years and within 50 years	0	75	25
50 years and above	0	75	0

7. HRA Limit on Indebtedness

	Approved 2016/17	Year 1 2017/18 Estimate	Year 2 2018/19 Estimate	Year 3 2019/20 Estimate
	£M	£M	£M	£M
HRA CFR	277	271	264	257
CLG HRA Debt Cap	301	301	301	301
Headroom	24	30	37	44