Annex B

TREASURY MANAGEMENT STRATEGY STATEMENT 2016/17

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1. Background

1.1 The Council is required to produce a Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also incorporates the Annual Investment Strategy (AIS). Together, these cover the financing and investment strategy for the forthcoming financial year. The PIs for 2016/17 to 2018/19 are included at Appendix D.

1.2 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 2016/17 TMSS sets out how the Council intends to address the most significant risks and a schedule is included at Appendix B.

1.3 In order to implement the strategy and monitor treasury management activity, the Council has set up a Treasury Management Panel. Chaired by the Executive Director of Finance, Assets & Information Services 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.

2. Outlook for Interest Rates

2.1 The risk profile of the Council's General Fund (GF) has altered significantly following 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. With 58% of the GF loan pool exposed to short-term interest rate movements it becomes increasingly important to closely monitor the outlook for interest rates.

2.2 The latest forecast from our Treasury Management Advisers has pushed back the timing of the start of increases in Bank Rate to quarter 4 of 2016. This forecast reflects the differences in the strength and pace of recovery between the US and UK which has resulted in the US Federal Reserve making a start on increasing rates in December 2015 while the slower and weaker pace of recovery in the UK, and continuing measures to reduce Government budget deficits in the UK, mean that the UK's Monetary Policy Committee (MPC) will take a slower and more gradual path in increasing rates than in the US.

2.3 The UK GDP growth rates in 2013 and 2014 were the strongest growth rates of any G7 country, including the US, Canada, Germany and Japan. The November 2015 Bank of England Inflation Report included a forecast for growth to remain around 2.5 – 2.7% over the next three years. However, the report also flagged up particular concerns for the potential impact on the UK of worldwide economic statistics distinctly weakening during recent months.

2.4 In terms of borrowing, Capita see the overall trend in the longer term will be for PWLB rates to rise when economic recovery is firmly established, accompanied by rising inflation and increases to the bank rate. Given the Council's (specifically the General Fund's) ongoing borrowing requirement and existing exposure to interest rate movements (see 4.2), the forecasting and monitoring of borrowing rates and the associated management of risk is a key issue for 2016/17. The following strategy outlines how the Council intends to manage this risk.

2.5 A more detailed economic and interest rate forecast provided by Capita is attached at Appendix A.

3. Debt Split – Two Pool Approach

Background

3.1 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).

3.2 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.

3.3 To address these differing requirements borrowing strategies for both the HRA and GF have been produced.

GF Borrowing Requirement

3.4 The Council's underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR). To ensure that this expenditure will ultimately be financed, local authorities are required to make a Minimum Revenue Provision (MRP) for repaying debt from within the revenue budget each year.

3.5 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 and in turn produce an increased requirement to charge MRP in the revenue account. A separate statement on the Council's policy on MRP is shown at Appendix E.

3.6 The GF's estimated CFR is shown below:

	Estimate 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
Capital Financing Requirement (CFR)	654	650	632	615
Less: Other Long Term Liabilities	231	235	227	220
Borrowing CFR	**423**	**415**	**405**	**395**
Less : Existing Profile of Borrowing	262	260	258	255
Cumulative Maximum External Borrowing Requirement	161	155	147	140
Usable Reserves	100	80	70	60
Cumulative Net Borrowing Requirement	**61**	**75**	**77**	**80**

3.7 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 – see section 4.11 to 4.13) to fund major capital schemes such as the Building Schools for the Future Programme and the markets and town centre development.

3.8 As at 31st March 2016 the level of un-funded CFR exceeds the available balances and reserves, illustrated by the positive net cumulative borrowing requirement of £61M. This position will be monitored throughout the financial year and the borrowing options available to the Authority are discussed in greater detail throughout section 4 of the report.

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

4 <u>The Council's borrowing strategy (GF)</u>

Aim

4.1 Given the significant cuts to local government funding, the GF's borrowing strategy seeks to address the key issue of affordability whilst managing the interest rate risk and refinancing risk contained within the debt portfolio.

Interest Rate Risk

4.2 As stated at 3.2, 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 31.3.16):

Borrowing method	Value (£M)	% of portfolio	Interest Rate Risk
PWLB - fixed	150	36	No
Market Fixed	27	6	No
PWLB – variable	35	8	Yes
Temporary Borrowing	55	13	Yes
Internal Borrowing / Borrowing Requirement	156	37	Yes
TOTAL	**423**	**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.

4.3 Assuming an estimated borrowing CFR of £423M (CFR less long-term liabilities) at the end of 2015/16, 58% (£246M) of the GF loan pool is exposed to short-term interest rate movements and in the case of temporary borrowing, refinancing risk.

4.4 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 58% to 49%.

4.5 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 0.70% and the average rate payable on temporary borrowing is 0.64% (Dec 15).

4.6 It is important to view the interest rate risk against the cost of shutting that risk down. For example, the rate on the £55M of temporary borrowing is calculated at 0.64% in Dec 2015. A 5 year and 10 year fixed rate PWLB loan would cost 2.25% or 2.84% (Dec 2015) respectively. If the mid-point is taken on these rates, the cost of eliminating this interest rate risk is roughly 2.5%, equating to a monthly cost of approximately £115K, which equates to £1.3M per annum.

4.7 However, the current composition of the portfolio is exposed to interest rate fluctuations. A 1% increase in variable interest rates (calculated on the liability benchmark) would increase interest payments by approximately £1.7M per annum.

Refinancing Risk

4.8 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 £50M 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.

4.9 Low interest rates mean the Council's £63M of LOBOs loans (GF share of £27M) are unlikely to be called in 2016/17. 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.

Strategy

4.10 The borrowing strategy for 2016/17 will continue to focus on interest costs in order to minimise the impact on the Council's overall revenue budget however it will also seek to address the GF interest rate risk exposure and refinancing risk. The approach will consider a range of options to address these aims including:

1. Continuing the process of internal borrowing;
2. Continuing temporary/ short term borrowing from other local authorities;
3. A phased programme of long-term borrowing aimed at reducing interest rate risk and refinancing risk especially for future borrowing;
4. Taking fixed rate debt to cover maturities, generating guaranteed savings;
5. Restructuring/ rescheduling existing debt.

The potential combination of these 5 approaches should help to keep interest payments at relatively low levels, whilst gradually reducing the GF's exposure to interest rate and refinancing risk.

Internal Borrowing Strategy

4.11 Following on from the previous year, it is anticipated that at 31st March 2016, the GF will be in an internally borrowed position. Essentially, this means that the level of actual debt is below the CFR, and therefore the GF

has used internal resources (reserves and balances) to fund some of its unfinanced capital expenditure.

4.12 The strategy of internal borrowing has two main benefits:

- 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.

- The use of internal resources reduces the funds available for investment thereby reducing credit risk. This is a key consideration given the Council's investment priority of maintaining capital.

4.13 Whilst the strategy is to reduce cash balances, the Council will aim to maintain a suitable level of liquid cash so as not to expose the Council to undue liquidity risk. This will allow decisions on further borrowing to be made using a considered approach, with flexibility around the timing of new borrowing.

Temporary Borrowing Strategy

4.14 The GF will continue to access short-term borrowing opportunities from other local authorities. The restricted lending list of most authorities means that they are willing to lend at rates of around 0.65% for periods up to one year.

4.15 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 budgetary pressures, the use of temporary borrowing is a key consideration when balancing the requirements of risk versus affordability.

4.16 Officers will attempt to mitigate the refinancing risk by spreading the maturity profile of these loans as much as possible within the constraints of what is available.

Phased Programme of Longer-Term Borrowing

4.17 Achieving a suitable balance between minimising interest costs and reducing interest rate risk and refinancing risk whilst maintaining the long-term stability and affordability of the portfolio is a key borrowing theme. As such, consideration will also be given to undertake a phased programme of longer-term borrowing.

4.18 The Council adopts the following criteria to determine exposure to interest rate risk. It is intended to move towards the upper and lower limits of fixed and variable rate risk depending upon the margins between short term

variable rate and long term borrowing using 25 year rates as a benchmark (see examples shown below the table).

	2016/17 Lower Limit	2016/17 Upper Limit	Review Points *	Review Points *
Upper Limit for **Fixed** Interest Rate Exposure	75%	90%	If the difference (i.e. margin) between long-term fixed rates and short-term variable rates are equal to or above 3%, review interest rate exposure towards the lower limit.	If the difference (i.e. margin) between long-term fixed rates and short-term variable rates are equal to or below 2%, review interest rate exposure towards the upper limit.
Upper Limit for **Variable** Interest Rate Exposure	5%	25%	If the difference (i.e. margin) between long-term fixed rates and short-term variable rates are equal to or below 2%, review interest rate exposure towards the lower limit.	If the difference (i.e. margin) between long-term fixed rates and short-term variable rates are equal to or above 3%, review interest rate exposure towards the upper limit.

**For example, if the rate for temporary borrowing was approximately 0.5% for a 3 month loan and the 25yr PWLB rate was 4%, the difference is above 3% and we would therefore look more towards variable rate borrowing. Conversely, if rates changed and short-term borrowing became more expensive we would look at fixing borrowing out. For example, if short-term rates rose above 1% for a 3 month temporary loan and the PWLB 25 year rate dropped to 3%, we would seek to fix out more of the portfolio with fixed term borrowing.*

4.19 The framework puts in place review points to assess the Authority's borrowing position but will take into account other factors such as interest rates trends and outlook, the Council's budget provision, investment returns and advice from its treasury advisers, Capita. The 'trigger points' will act as signals to review rather than absolute points to change or act.

Maturing Loans

4.20 A list of maturing loans over the next 5 years (GF element) is shown below:

Year	2016/17	2017/18	2018/19	2019/20	2020/21
Amount	£2.1M	£8.6M	No maturity	£34.7M	No maturity
Rate	8.6%	7.8%	No maturity	0.7%	No maturity

** this represents maturity loans only. There are number of part repayments on annuity and equal installment of principal loans.*

4.21 Given the rates on the maturing loans, the Council is highly likely to make savings when it comes to replacing these loans. The aim will be to replace these loans with fixed term debt, securing interest savings whilst maintaining the risk composition of the portfolio. The exception to this is the maturity of two variable rate loans in 2019/20 totaling almost £35M which are subject to refinancing risk.

Debt Options

4.22 The Council will consider a number of options including restructuring / rescheduling existing fixed term loans, together with reviewing the Minimum Revenue Provision and PFI Refinancing.

4.23 The low interest rate environment and changes to the regulations regarding the premature repayment of PWLB loans has limited the opportunity for any debt rescheduling. However, the Council's forecast budget deficit requires all options to be considered and this approach has the benefit of generating immediate savings.

4.24 In theory, any premature repayments will include elements of both GF and HRA debt. However, it is possible to partially repay PWLB loans, negating any potential impact on the HRA debt pool.

4.25 This strategy will need to take account of the value of exiting loans early in relation to premium costs and the level of savings that will be generated. As such this is likely to be a selective approach and will need to be part of a mixed approach to past and future borrowing.

Minimum Revenue Provision

4.26 The Council is required by law to annually "determine for the current financial year an amount of minimum revenue provision which it considers to be prudent" which is represented by a charge to the Council's general fund to make a provision for the repayment of the Council's outstanding capital debt liabilities. The Council's Minimum Revenue Provision (MRP) Statement for 2016/17 is shown at Appendix E.

4.27 The Council's current MRP policy (2015/16) uses both annuity and equal instalment methods to repay debt. The Council is seeking to revise its MRP policy to solely adopt the annuity method, only repaying debt over a standard 50 year repayment period, unless a more appropriate timescale is suitable. The revised policy for 2016/17 is attached at Appendix E.

4.28 The changes can be justified on a prudent basis taking into account the following:

- Adopting a single method (i.e. annuity) ensures that the Council adopts a consistent approach to the way it treats its debt going forward;
- Adoption of the annuity method recognises the time value of money i.e. a £1 being worth more today than in 22 years' time, whereas the equal instalment basis unduly penalises the current tax payer in comparison to the future tax payer. This is fundamental to the change in policy as it equitably spreads the true cost of capital across all generations of Council Tax payer;
- Adopting a 50 years average repayment period for non-school assets is a reasonable and prudent average. This is in line with the methodology adopted by other authorities and which is supported by our professional valuers;
- Using a 60 year average life for school assets (as now) is equally prudent. Many of the Authority's schools are part of PFI/BSF programmes with the purpose of maintaining them in day 1 condition at the end of the 25 year programme.

4.29 The proposals above demonstrate that the policy is consistent, affordable over the longer term and ensures a more equitable spread of debt repayment costs across all generations of taxpayer.

4.30 The Council will continue to periodically review its MRP policy to ensure that it consistently follows the above principles in the future but in addition will review its 2015/16 position in line with these revisions. This will be subject to a separate report.

PFI Refinancing

4.31 The Council's is currently reviewing its PFI programmes (especially 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 2009/2010 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 coming 2016/17 financial year.

Borrowing in advance of need

4.32 Given the GF's internal borrowing position, it is unlikely there will be any borrowing in advance of need to fund future capital expenditure. As stated above there may be opportunities to borrow in advance of need to replace maturing loans, but this will only be undertaken where there is a clear business case for doing so.

Source of Borrowing

4.33 As detailed in the 2015/16 Strategy, a consultation has gone out 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.

4.34 The preferred method of borrowing will be through the PWLB but officers will continue to examine alternative options in 2016/17. The Authority has become a shareholder in the Local Government Agency's (LGA) Municipal Bond Agency. The LGA bond is looking to undercut PWLB rates and will also offer an alternative for local authorities to PWLB should the government limit borrowing or artificially raise interest rates. A Cabinet report will be submitted to gain approval to the Framework Agreement and the Agency's Joint and Several Guarantee. This Standard Confirmation will not commit the Authority to any borrowing but will ensure approval is in place should the opportunity arise to borrow a required amount at an acceptable rate.

4.35 As stated at 4.14, the Council will continue to access funding from other local authorities. The 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.

4.36 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
- commercial lenders and banks

4.37 As stated at 4.9, 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

4.38 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.

4.39 The process for the acquisition of vehicles has been reviewed as part of Future Council. The Authority is moving away from approving a total vehicle replacement programme and towards authorising replacements on a case by case basis. The most appropriate and cost effective method of financing will continue to be identified for all assets.

5. HRA Borrowing Requirement and Strategy

5.1 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.

5.2 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.

5.3 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.

Current debt portfolio

5.4 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 £277M (November 2015). There are no loans maturing before the end of the financial year, so the forecast debt level at the end of 2015/16 is £277M, and the breakdown is shown below:

Borrowing method	Value (£M)	% of portfolio	Interest Rate Risk
PWLB – fixed (inc settlement loan £22M)	195	71	No
Market Fixed	36	13	No
PWLB – variable	46	16	Yes
TOTAL	**277**	**100**	

5.5 As at 31st March 2016, 16% of the forecast debt portfolio is sensitive to interest rate fluctuations. The PWLB variable loans (£46M) continue to represent excellent value at rates of 0.68% (£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.

5.6 Low interest rates mean the Council's £63M of LOBOs loans (HRA share of £36M) are unlikely to be called in 2016/17. 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 of prevailing market conditions.

Borrowing and Capital Financing Requirement

5.7 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.

5.8 The forecast CFR for end of the 2015/16 financial year is £285M against a borrowing level of £277M. Therefore, the HRA is £8M 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.

5.9 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)	195	68	No
Market Fixed	36	13	No
PWLB – variable	46	16	Yes
Unfunded CFR	8	3	Yes
TOTAL	**285**	**100**	

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

5.11 The HRA CFR has been reduced from £291M at the implementation of Self-financing, to the forecast £285M at the end of 2015/16. 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.

5.12 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. The Council is currently undertaking a review of its debt repayment policy and the HRA will now form part of this review. There is no actual requirement to repay the debt. At this stage, pending the outcome of the Council review, debt repayments are assumed to be at

a level which is affordable in the HRA Five year forecasts (i.e. £2.3M in 2016/17, £1.8M in 2017/18 and nil thereafter). The debt figures will be updated prior to submission to the Council to reflect the agreed debt repayment policy.

5.13 Overall borrowing is limited by the debt cap set by the CLG of £301M, leaving headroom of approximately £16M. However, in the new financial environment additional borrowing to fund extra capital investment is unlikely to be affordable.

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

5.15 The HRA's estimated CFR is shown below:

	Estimate 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
Capital Financing Requirement (CFR)	285	281	277	275
Less : Existing Profile of Borrowing	277	272	259	257
Cumulative Maximum External Borrowing Requirement	8	9	18	18
Usable Reserves	36	24	15	10
Cumulative Net Borrowing Requirement	(28)	(15)	3	8

5.16 The HRA has a borrowing requirement in 2017/18 and 2018/19, this is partially offset by HRA useable reserves.

Borrowing Strategy

5.17 The key aim of the HRA borrowing strategy is to manage the affordability of debt repayments within the 30 year business plan.

5.18 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. 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. If the new debt policy requires more debt repayment than assumed in the business plan it will mean a lower borrowing requirement.

5.19 This will avoid any ‘cost of carry’ (the difference between long-term borrowing rates and short-term investment rates) and allow flexibility to be maintained should there be any change in the use of reserves.

Borrowing in advance of need

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

5.21 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

5.22 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.

5.23 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

5.24 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.

5.25 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.

5.26 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.

6. Annual Investment Strategy

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

6.2 The Executive Director of Finance, Assets & Information Services, 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.

6.3 The Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In 2015/16 (to 31st Dec 2015), the Council's investment balance has ranged between £23M and £66M, and similar variations are expected for the forthcoming year, depending on cash flow patterns.

Investment Policy

6.4 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.**

6.5 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.

6.6 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.

6.7 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)

6.8 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.

6.9 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. BMBC Officers receive a weekly credit list from Capita Asset Services and any investments are placed in accordance with the maximum duration specified at that time.

6.10 **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**	**1 yr**
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**

1 year is the maximum duration that fixed-term investments will be placed. Specific banks will be subject to reduced 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.* ***The Council will place investments with UK and non-UK institutions that have a minimum long term rating of A- or equivalent.*

6.11 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.

6.12 The Barclays Flexible Interest Bearing Current Account (FIBCA) continues to be used by treasury staff to effectively manage daily cash flows and as well as giving the benefit of regular interest paid quarterly, 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 Council's minimum criteria, it 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 2016, no new fixed term deposits will be placed with Barclays.

6.13 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.

6.14 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.

6.15 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.

6.16 Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. 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.

6.17 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). Organisations that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher are considered 'high credit quality'. 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.

6.18 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:

Table 2: 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.

6.19 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:

Table 3: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£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

6.20 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 Prudential Indicator 8 (Appendix D).

Liquidity (Liquidity Risk)

6.21 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).

6.22 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 Prudential Indicator 10 in Appendix D.

Yield

6.23 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 2016/17 and this will result in reduced investment income.

6.24 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

6.25 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.

6.26 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

6.27 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.

Use of Advisers

6.28 Following a tender process in June 2015, Capita Asset Services were awarded a three year contract for the provision of Treasury Management Services to the Authority, replacing the previous advisers, Arlingclose Ltd.

6.29 The CLG's guidance on Local Government Investments recommends that the AIS should comment on the use of treasury management advisers, and in particular how the Council uses external advisers and how quality of service is measured.

6.30 The services Capita offer are clearly stated in the 'Schedule of Services' contained within the contract documentation. Whilst it is difficult to measure the quality of service in value added terms, it is hoped that Capita will assist the Council in achieving their Treasury Management objectives in what continues to be a challenging environment.

6.31 With regard to the Annual Investment Strategy, the Council's investment priorities remain security, liquidity and yield and it is the Council's relative success in meeting these objectives against which Capita will be primarily assessed.

Staff Training

6.32 The CIPFA Code requires the AIS to outline the Council's approach to training of staff involved in the management of investments. The Council is committed to ensuring staff involved in Treasury Management are fully trained and possess the necessary skills to effectively discharge their role.

6.33 General training requirements are reported through the Council's Personal Development Review (PDR) process.

6.34 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.

6.35 All training activities are recorded in accordance with Treasury Management Practice 10 – Training and Qualifications.

Berneslai Homes

6.36 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.

7. Reporting on Treasury Management and Leasing activity

7.1 As outlined at paragraph 1.3, the Executive Director of Finance, Assets & Information Services will report to the Treasury Management Panel on a regular basis. It will report to Cabinet on treasury management and leasing activity / performance on a quarterly basis and produce an outturn report to Council on its treasury activity no later than 30th September after the financial year end.

7.2 The Treasury Management Panel will report to both Cabinet and Council on an exceptional basis as required. The Treasury Management Panel will also liaise with the nominated Audit Committee representatives on key issues and reports will be submitted to full Audit Committee on a minimum six monthly basis. The TM Strategy and Policy Statements and Prudential Indicators are subject to Scrutiny.

8. Summary

8.1 The effective identification and management of risk remains at the forefront of the Council's objectives. This is especially so given the move to housing self-financing, and the need to manage the differing requirements of the respective debt pools. The Council is determined to take a proactive approach to treasury management in what are challenging times for local government.

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Appendices

A. Capita Economic & Interest Rate Forecast December 2015

B. Risk Schedule

C. Policy on use of Financial Derivatives

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APPENDIX A

Capita Asset Services Economic & Interest Rate Forecast December 2015

Economic Background

UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again.

The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February.

The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely get back up to the 2% target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12 month calculation of CPI, there will be a sharp tick up from the current zero rate to around 1% in the second half of 2016.

There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015 to Q4 2016 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

Capita Asset Services Forward View

Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions) will be liable to further amendment depending on how economic data evolves over time. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast from Capita Asset Services includes a first increase in Bank Rate in quarter 4 of 2016 (shown in the table below).

The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

However, the overall balance of risks to the Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected. Market expectations in November, (based on short sterling), for the first Bank Rate increase are currently around the end of 2016.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

Capita Asset Services Interest Rate View													
	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19
Bank Rate View	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
3 Month LIBID	0.50%	0.50%	0.60%	0.80%	0.90%	1.00%	1.10%	1.30%	1.40%	1.50%	1.60%	1.80%	1.90%
6 Month LIBID	0.70%	0.70%	0.80%	0.90%	1.00%	1.20%	1.30%	1.50%	1.60%	1.70%	1.80%	2.00%	2.20%
12 Month LIBID	1.00%	1.00%	1.10%	1.20%	1.30%	1.50%	1.60%	1.80%	1.90%	2.00%	2.10%	2.30%	2.40%
5yr PWLB Rate	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
10yr PWLB Rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
25yr PWLB Rate	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
50yr PWLB Rate	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Bank Rate													
Capita Asset Services	0.50%	0.50%	0.50%	0.75%	0.75%	1.00%	1.00%	1.25%	1.25%	1.50%	1.50%	1.75%	1.75%
Capital Economics	0.50%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	-	-	-	-	-
5yr PWLB Rate													
Capita Asset Services	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%
Capital Economics	2.60%	2.70%	2.80%	3.00%	3.10%	3.20%	3.30%	3.50%	-	-	-	-	-
10yr PWLB Rate													
Capita Asset Services	2.60%	2.70%	2.80%	2.90%	3.00%	3.10%	3.20%	3.30%	3.40%	3.50%	3.60%	3.60%	3.70%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
25yr PWLB Rate													
Capita Asset Services	3.40%	3.40%	3.50%	3.60%	3.70%	3.70%	3.80%	3.90%	4.00%	4.00%	4.10%	4.10%	4.10%
Capital Economics	3.35%	3.45%	3.45%	3.55%	3.65%	3.75%	3.85%	3.95%	-	-	-	-	-
50yr PWLB Rate													
Capita Asset Services	3.20%	3.20%	3.30%	3.40%	3.50%	3.60%	3.70%	3.80%	3.90%	3.90%	4.00%	4.00%	4.00%
Capital Economics	3.40%	3.50%	3.50%	3.60%	3.70%	3.80%	3.90%	4.00%	-	-	-	-	-

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. **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. **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. **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 2016/17 and is addressed in detail throughout the TMSS.
   Probability : Medium
   Impact : Very High

4. **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. **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. **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. **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 carry out an annual regulatory review of the treasury management function including probity testing. The recommendations of these reports are actioned in accordance with the agreed timetable.
   Probability : Low
   Impact : Medium

8. **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

1. Capital Expenditure

	Current Estimate 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
General Fund (GF)	72	30	24	9
Housing Revenue Account (HRA)	48	37	28	25
TOTAL	**120**	**67**	**52**	**34**

2. Ratio of Financing Costs to Net Revenue Stream

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	%	%	%	%
GF	14	15	16	17
HRA	43	44	44	46

3. Capital Financing Requirement

	Current Estimate 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
GF	654	650	632	615
HRA	285	281	277	275
TOTAL	**939**	**931**	**909**	**890**

4. Estimates of the Incremental Impact of Capital Decisions on Council Tax / Rents

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£	£	£	£
Increase in Band D Council Tax	8.30	8.23	8.17	8.10
Increase in Average Weekly Housing Rents	1.19	0.86	2.26	3.51

5. Authorised Limit for External Debt

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
Borrowing	734	726	712	700
Other Long-term Liabilities	231	235	227	220
TOTAL LIMIT	**965**	**961**	**939**	**920**

6. Operational Boundary for External Debt

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
Borrowing	719	696	682	670
Other Long-term Liabilities	231	235	227	220
TOTAL LIMIT	**950**	**931**	**909**	**890**

7. Adoption of CIPFA code of Practice in TM

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

8a. Interest Rate Exposure - GF

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	%	%	%	%
Upper Limit for Fixed Interest Rate Exposure	90	90	90	90
Upper Limit for Variable Rate Exposure	25	25	25	25

8b. Interest Rate Exposure – HRA

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	%	%	%	%
Upper Limit for Fixed Interest Rate Exposure	100	100	100	100
Upper Limit for Variable Rate Exposure	25	25	25	25

9a. Maturity Structure of Borrowing - GF

	Approved 2015/16		2016/17	
	Lower Limit	Upper Limit	Lower Limit	Upper Limit
Less than 12 months	0%	50%	0%	50%
12 months & within 24 months	0%	25%	0%	25%
24 months & within 5 years	0%	25%	0%	25%
5 years & within 10 years	0%	25%	0%	25%
10 years & within 20 years	0%	75%	0%	75%
20 years and within 30 years	0%	75%	0%	75%
30 years and within 40 years	0%	75%	0%	75%
40 years and within 50 years	0%	75%	0%	75%
50 years and above	0%	75%	0%	75%

9b. Maturity Structure of Borrowing - HRA

	Approved 2015/16		2016/17	
	Lower Limit	Upper Limit	Lower Limit	Upper Limit
Less than 12 months	0%	25%	0%	25%
12 months & within 24 months	0%	25%	0%	25%
24 months & within 5 years	0%	25%	0%	25%
5 years & within 10 years	0%	25%	0%	25%
10 years & within 20 years	0%	75%	0%	75%
20 years and within 30 years	0%	75%	0%	75%
30 years and within 40 years	0%	75%	0%	75%
40 years and within 50 years	0%	75%	0%	75%
50 years and above	0%	75%	0%	75%

10. Maximum Principal Sums Invested

	Approved 2015/16	Year 1 2016/17 Estimate	Year 2 2017/18 Estimate	Year 3 2018/19 Estimate
	£M	£M	£M	£M
Principal Sums Invested > 364	20	20	20	20
Principal Sums Invested > 2yrs	20	20	20	20
Principal Sums Invested > 3yrs	20	20	20	20

11. Gross Debt and CFR

Gross Debt & CFR	2016/17 Estimate
	£M
Outstanding Borrowing	532
Other Long-term Liabilities	235
Gross Debt	**767**
Max CFR	931
Headroom	**164**

APPENDIX E

2016/17 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 2016/17: 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 2016/17 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.