BOROUGH COUNCIL OF WELLINGBOROUGH **AGENDA ITEM 8**

Resources Committee **15 March 2017**

Report of the Section 151 Officer

PRUDENTIAL INDICATORS AND TREASURY MANAGEMENT STRATEGY 2017-18

1 Purpose of Report

1.1 The council is debt free and has no borrowing; however, it does have significant cash flows from service expenditure and the income which funds this, as well as revenue and capital reserves, all of which give rise to investment balances. The council follows the Chartered Institute for Public Finance and Accountancy (CIPFA) Treasury Management Code of Practice (the Code). The council has adopted the requirements of the code, as part of its financial regulations, and this report sets out policies and strategies which it needs to approve in order to comply fully with the Code.

1.2 The report also sets out the treasury indicators for members to monitor the council's performance over the coming financial year. This is a mandatory requirement.

2 Executive Summary

This report forms an essential and mandatory part of the council's treasury management process, and provides the Resources Committee with the opportunity to approve/amend the policy and performance indicators as outlined in the report.

3 Appendices

Appendix A: Treasury Management Strategy Statement including Minimum Revenue Provision Policy Statement and Annual Investment Strategy.

4 The Committee is invited to RECOMMEND

4.1 APPROVE the Treasury Management Policy Statement set out in Appendix A of the report.

4.2 APPROVE the Prudential and Treasury indicators as set out in Appendix A

4.3 APPROVE the Annual Investment Strategy included in Appendix A.

5 Background

The Revised CIPFA Treasury Management Code of Practice 2011

5.1 The council adopted the revised Treasury Management in the Public Services Code of Practice (the Code) in March 2010 and adopted updates in 2011, there have been no further updates.

5.2 The Code emphasises a number of key areas of best practice to help limit the potential for loss, including the following:

a) All councils must formally adopt the revised Code and four clauses.

b) The strategy report will affirm that the effective management and control of risk are prime objectives of the council's treasury management activities.

c) The council's appetite for risk must be clearly identified within the strategy report and will affirm that priority is given to security of capital and liquidity when investing funds and explain how that will be carried out.

d) Responsibility for risk management and control lies within the organisation and cannot be delegated to any outside organisation.

e) Credit ratings should only be used as a starting point when considering risk. Use should also be made of market data and information, the quality financial press, information on government support for banks and the credit ratings of that government support.

f) Councils need a sound diversification policy with high credit quality counterparties and should consider setting country, sector and group limits.

g) Borrowing in advance of need is only to be permissible when there is a clear business case for doing so and only for the current capital programme or to finance future debt maturities.

h) The main annual treasury management reports and in-year updates must be approved by full council.

i) There needs to be, at a minimum, a mid year review of treasury management strategy and performance. This is intended to highlight any areas of concern that have arisen since the original strategy was approved.

j) Each council must delegate the role of scrutiny of treasury management strategy and policies to a specific named body; this is the Resources Committee at this council.

k) Treasury management performance and policy setting should be subjected to prior scrutiny.

l) Members should be provided with access to relevant training.

m) Those charged with governance are also personally responsible for ensuring they have the necessary skills and training.

n) Responsibility for these activities must be clearly defined within the organisation.

o) Officers involved in treasury management must be explicitly required to follow treasury management policies and procedures when making investment and borrowing decisions on behalf of the council (this will form part of the updated Treasury Management Practices).

5.3 The attached strategy statement has been prepared in accordance with the revised Code. Accordingly, the council's treasury management strategy will be approved annually by the council and there will also be a mid year report. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting. For Wellingborough the following reporting arrangements are to be put in place in accordance with the requirements of the revised Code:

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Strategy / Annual Investment Strategy / Minimum Revenue Provision (MRP) policy	Resources Committee recommends to council	March
Treasury Management Strategy / Annual Investment Strategy / MRP policy – mid year report	Resources Committee recommends to council	October
Annual Treasury Outturn Report	Resources Committee recommends to council	Annually by 30 September after the end of the year
Treasury Management Practices	Section 151 Officer	Updated on an ongoing basis as appropriate

CIPFA Prudential Code

5.4 Included in the report are the CIPFA Treasury Management Indicators which are part of the Prudential Code on Local Authority borrowing. These indicators are:

- authorised limit for external debt
- operational boundary for external debt
- actual external debt.

All indicators have to be presented together as one suite. In addition, where there is a significant difference between the net and the gross borrowing position, the risks and benefits associated with this strategy should be clearly stated in the annual strategy.

Balanced Budget Requirement

5.5 It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in the revenue impacts of capital expenditure must be limited to a level which is affordable. Such increases will be the result of: -

1. increases in interest charges or, in circumstances where the authority is debt free, reductions in overall interest receivable, that are caused by increased borrowing or reduced investment balance required to finance additional capital expenditure, and
2. increases in annual running costs from new capital projects.

6 Treasury Management Strategy for 2017-18

The Local Government Act 2003 (the Act) and supporting regulations requires the council to 'have regard to' the CIPFA Code and the CIPFA Treasury Management Code of Practice to set prudential and treasury Indicators for the next three years to ensure that the council capital investment plans are affordable, prudent and sustainable. The Act requires the council to set out its treasury strategy for borrowing and to prepare an annual investment strategy setting out the council's policies for managing its investments for giving priority to the security and liquidity of those investments.

The recommended strategy for 2017-18 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with leading market forecasts provided by the council's treasury adviser, Capita Asset Services (appointed by tender). The Strategy Covers:

- Treasury limits in force which will limit the treasury risk and activities of the council
- Prudential and treasury Indicators
- The current treasury position
- The borrowing requirement
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers

6.1 Treasury Limits for 2017-18 to 2019-20

6.1.1 It is a statutory duty under Section 3 of the Act and supporting regulations, for the council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Affordable Borrowing Limit". In England and Wales the authorised limit represents the legislative limit specified in the Act.

6.1.2 The council must have regard to the Prudential Code when setting the authorised limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax level is 'acceptable'.

6.1.3 Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The authorised limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years, details of the authorised limit can be found in appendix A of this report. This shows that the budget plans for the Borough Council of Wellingborough are to remain debt free and thus borrowing to remain at nil. Provision has been made however for the council's agreed £50,000 overdraft limit and up to £5m emergency temporary borrowing.

6.2 Prudential and Treasury Indicators for 2017-18 to 2019-20

6.2.1 Prudential and treasury indicators are needed for the purposes of setting an integrated treasury management strategy. The Borough Council of Wellingborough remains debt free under the 2017-18 to 2020-21 Medium Term Financial Plan.

6.2.2 The council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. This original 2001 Code was adopted by the full council, and its subsequent updates have been adopted.

6.3 Current Treasury position

6.3.1 The council's investment policy was reviewed, as part of the 2017/18 budget setting. Section 6.8 of this report sets out details of the basis for approving the institutions which the council invests its funds with.

6.3.2 The in-house funds available for investment are largely cash flow and the capital receipts generated from the sale of assets. The council's treasury investment portfolio position at 16 February 2017 comprised:

Table 1	Principal	Ave rate
	£m	%
Gross Debt	0	0
Total Investments	24.6	0.87

6.3.3 Funds available for investment have been estimated as part of the council's medium term budget projections. These estimates assume that capital receipts are realised and include the use of funds to finance the capital programme and use of revenue balances to meet revenue expenditure as required by the financial strategy, as follows:

2016/17	2017/18	2018/19	2019/20
£'000	£'000	£'000	£'000
20.000	19.454	27.106	26.407

6.4 Borrowing Requirement

The medium term financial plan assumes no borrowing requirement and is in line with previous decisions to maintain a debt free position. However, if there was a change in this policy decision an amendment to this strategy would be presented to Resources Committee for recommendation to council before any borrowing could be undertaken.

6.5 Prospect for Interest Rates.

6.5.1 The council appointed by tender, Capita Asset Services, as treasury advisor to the council, and part of this service is to assist the council to formulate a view on interest rates. From a review of a number of current City forecasts for short term (Bank Rate) and longer fixed term interest rates. The current unpredictable nature of the market beyond the next two years for investment, being a debt free authority, shows that Sector's central view for that period is as follows:

Capita Bank Rate forecast for financial year ends (March)

2017/18	0.25%
2018/19	0.25%
2019/20	0.75%

6.5.2 For the purposes of 2017-18 Budget the level of investment income assumed has been based on an average return of 0.5% for new investments. This is in line with this advice and reflects current investment returns.

6.6 Borrowing Strategy

The council is currently debt free and it is the intention that this will remain so in the medium term financial plan.

6.7 Policy on Borrowing in advance

As the council plans to remain debt free, then it has no proposals to borrow and would not borrow in advance.

6.8 Annual Investment Strategy

Investment Policy

6.8.1 The council has regard to the DCLG's Guidance on Local Government Investments ("the Guidance") issued in March 2004, revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The council's investment priorities are: -

(a) the security of capital and
(b) the liquidity of its investments.

6.8.2 The council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this council is low, in order to give priority to ensure greater security of its investments

6.8.3 Investment instruments identified for use in the financial year are listed in Appendix A. This list provides a guide as to which institutions are suitable to use but it will be amended as criteria of institutions change during the course of the year. The key drivers as to which institutions are suitable are as per paragraph 6.9.4, but officers also ensure the overall creditworthiness policy is applied.

6.8.4 Investments will accordingly be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

6.9 Creditworthiness policy

6.9.1 As part of considering the 2017/18 Treasury Strategy, officers in conjunction with advice from the council's treasury advisors, have reviewed the list of financial institutions with whom the council places investments and associated investment periods to ensure the approach is both robust and prudent. Additional banks have been added to the list to provide a wider range of investment opportunities in the banking sector.

6.9.2 This council uses the creditworthiness service provided by Capita Asset Services, its current treasury management advisors. This service uses a sophisticated modeling approach with credit ratings from all three rating agencies - Fitch, Moodys and Standard and Poors, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays:

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

6.9.3 The council's investment decisions are based on comparisons between the changes priced into market rates against the council's and advisor's own forecasts. The section 151 officer, under delegated powers, will undertake the most appropriate form of investments depending on the prevailing interest rates at the time, taking into account the relevant risks.

6.9.4 All investments will also be made in accordance with the Government's investment guidelines. The classes of institution proposed for inclusion in the council's counterparty investment list are as follows: -

- UK domiciled banks, with a minimum long term Fitch rating of A-,
- Buildings societies with assets > 1bn

- Non UK banks, domiciled in a country which has a minimum sovereign long term Fitch rating of AA- (or equivalent)

- Other local authorities and Government gilts

- Money market funds (cash is invested with a fund holder)

- Certificates of Deposit (negotiable form of fixed deposit)

6.9.5 Credit ratings are used by investors as indications of the likelihood of getting their money back in accordance with the terms on which they were invested. For short term investments (maximum 1 year) FITCH IBCA rate each organisation by one of the following:

F1+	exceptionally strong credit quality
F1	high credit quality
F2	good credit quality
F3	fair credit quality
B	some risk of default
C	high risk of default
D	will, or has already defaulted

Long-term ratings are also provided with "AAA" being the strongest and "D" the weakest.

Country Limits

6.9.6 The council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). This list will be added to or deducted from by officers should ratings change in accordance with this policy.

Levels of investment

6.9.7 To manage the Council's risk, it currently applies an overall limit of no more than 25% of the total investments per institution and institution group. Subject to this the following individual limits are applied:

Banks

6.9.8 Part nationalised banks have the highest limits of £5m. The remaining UK domiciled banks have limits between £2m to £3m which is influenced by a variety of factors including the Fitch long term and short term rating and credit default swaps data. The list of banks has been increased to provide a wider opportunity of potential investments.

6.9.9 At the Resources Committee in June 2014, Members approved the increase to the total credit level for Lloyds (part nationalised bank) to £6m. This is to cover the required payments under the new Business Rates Retention Scheme, to both DCLG and to the pool lead authority. This higher balance should only occur around 18th of each month to cover this eventuality. This will only be utilised when needed but will prevent the strategy from being breached and is reviewed annually.

Building Societies

6.9.10 Recent history suggests traditional Building Societies represent a relatively secure component of the financial markets. The institutions that have fallen into crisis are the banks and some of the Building Societies which have demutualised and followed a more risky business model.

6.9.11 In addition the larger Building Societies have a history of buying out any of the smaller societies if they encounter difficulties. The Nationwide Building Society, which does carry a very strong credit rating, is many times the size of the next largest society, and larger than all the other societies combined, and in the past has provided stability within the sector. It cannot however be assumed that the Nationwide will automatically support failing societies in the future. The council's Treasury Management advisors, Capita asset services are currently advising that councils use only the Nationwide Building Society. In practice this would be very restrictive and the advice is not intended to be prescriptive. The strategy over the past year has been to reduce the number of investments with the building societies.

6.9.12 Currently the list of building societies available to invest with has increased as there are currently more societies which hold asset over £1bn. Current policy is to ensure the level of investments with the building societies, is limited, to no more than £25m of the council's investments.

6.9.13 The value of investments with building society counterparties is leading to some reduction in the average interest return achieved by officers, which will affect the rates potentially achieved in 2017-18 and future periods.

Local Authorities

6.9.14 A limit of £5m has been applied to other local authorities and / or Government backings such as Gilts. This is in line with the maximum risk exposure to the highest rated financial institutions.

6.9.15 All credit ratings will be monitored continually**.** The council is alerted to changes to ratings of all three agencies through its use of the Sector creditworthiness service. If a downgrade results in the counterparty/investment scheme no longer meeting the council's minimum criteria, its further use as a new investment will be withdrawn immediately, and any existing investments will be immediately reviewed.

6.10 Policy on the use of external service providers

6.10.1 The council uses Capita Asset Services as its external treasury management advisers. Sole reliance will not be placed on the use of this external service. In addition this council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

6.10.2 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.

6.10.3 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.

6.11 Scheme of delegation

In addition to the Strategy there is a need for the treasury management function to be operated accordingly and with due regard to the Code of Practice. As such the delegations covering the management of this area are set out clearly in the council's Financial Procedure Rules.

7 Legal Powers

Local Government Act 2003

8 Financial and Value For Money Implications

There are no financial implications as a direct result of this report other than those noted in the body of the report and already accounted for in the 2017-18 budget.

9 Risk Analysis

Nature of risk	**Consequences if realized**	**Likelihood of occurrence**	**Control measures**
Unexpected fall in interest rates	Reduced income	Medium / High	Mix of short and longer term, fixed and variable rate investments.
Less funds available for investment	Reduced income	Medium / High	Regular budget monitoring allowing for remedial action to be taken.
Loss of capital	Reduced funds available for both capital and revenue purposes	Low	Financial ratings of counterparties and limits on amounts invested.

10 Implications for Resources

No direct implications.

11 Implications for Stronger and Safer Communities

No direct implications

12 Implications for Equalities

No direct implications

13 Author and Contact Officer

Helen Essom, Treasury & Technical Accountant

14 Consultees

Samantha Knowles, Principal Finance Manager
Senior Management Team

15 Background Papers

The CIPFA Prudential Code for Capital Finance in Local Authorities
CIPFA Code of Practice for Treasury Management in the Public Services

Treasury Management Strategy Statement

Minimum Revenue Provision Policy Statement and Annual Investment Strategy

Borough Council of Wellingborough
2017-18

1 INTRODUCTION

1.1 Background

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

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

CIPFA defines treasury management as:

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

1.2 Reporting requirements

The council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals.

Prudential and treasury indicators and treasury strategy (this report) - The first, and most important report covers:

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);
- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or 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.

1.3 Treasury Management Strategy for 2017-18

The strategy for 2017-18 covers two main areas:

Capital issues

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

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.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. The last member training was on the 8th December 2011 and future training will be organised within the next financial year.

2 THE CAPITAL PRUDENTIAL 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 prudential indicators, which are designed to assist members' overview and confirm capital expenditure plans.

2.1 Capital expenditure

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.

Other long term liabilities

The financing need excludes any other long term liabilities, such as PFI and leasing arrangements which would already include borrowing instruments. However, at present the council has no such liabilities.

The table below summarises the capital expenditure plans and how these plans are being financed by capital or revenue resources. Any shortfall of resources results in a funding borrowing need

Capital expenditure £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Non-HRA					
Total	8.174	5.345	3.974	0.068	0.034
Financed by:					
Capital receipts	0	0	0	0	0
Capital grants	0.358	0.816	1.529	0	0
Capital reserves	7.816	4.529	2.445	0.068	0.034
Revenue	0	0	0	0	0
Net financing need for the year	**0**	**0**	**0**	**0**	**0**

2.2 The council's borrowing need (the Capital Financing Requirement)

The second prudential indicator is the council's Capital Financing Requirement (CFR). The CFR is simply the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the council's underlying borrowing need. Any capital expenditure above, which has not immediately been paid for, will increase the CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each assets life.

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 no such schemes within the CFR.

£m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Capital Financing Requirement					
Total CFR	**0**	**0**	**0**	**0**	**0**
Movement in CFR	**0**	**0**	**0**	**0**	**0**
Movement in CFR represented by					
Net financing need for the year (above)					
Less MRP/VRP and other financing movements					
Transfer to Usable Reserves					
Movement in CFR	**0**	**0**	**0**	**0**	**0**

2.3 Minimum revenue provision (MRP) policy statement

The council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP), although it is also allowed to undertake additional voluntary payments if required (voluntary revenue provision - VRP).

CLG regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council currently has no external borrowing nor any finance leases, nor are there any current plans to enter into any during 2017-18. The Council is recommended to approve the following MRP Statement*:*

In the event that external financing or any finance lease is entered into during 2017-18, then the Council will make provision in its revenue accounts each year to meet the costs of the Principal element of such borrowing and/or finance lease(s)

2.4 Core funds and expected investment balances

The application of resources (capital receipts, reserves etc.) to either finance capital expenditure or other budget decisions to support the revenue budget will have an ongoing impact on investments unless resources are supplemented each year from new sources (asset sales etc.). Detailed below are estimates of the year end balances for each resource and anticipated day to day cash flow balances.

Year End Resources £m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Fund balances / reserves	7.762	7.098	6.027	5.449	4.568
Capital Reserves	12.604	17.456	13.4275	21.657	21.839
Provisions	0.065	0.065	0	0	0
Total core funds	**20.431**	**24.619**	**19.4545**	**27.106**	**26.407**
Working capital*	**-2.532**	**-2.000**	**-2.000**	**-2.000**	**-2.000**
Under/over borrowing	0	0	0	0	0
Expected investments	**17.899**	**22.619**	**17.4545**	**25.106**	**24.407**

*Working capital balances shown are estimated year end; these may be higher mid year

2.5 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:

2.6 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. The indicator is negative because the Council is debt free and therefore net interest is income to the Council.

The indicator in increasing slightly over time, not because of an assumed increase in the net interest due to the Council but because the Council budget requirement is anticipated to reduce due to reductions in external funding.

%	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Non-HRA	-1.21%	-1.93%	-3.24%	-3.34%

The estimates of financing costs include current commitments and the proposals in this budget report.

2.7 Incremental impact of capital investment decisions on council tax.

This indicator identifies the revenue costs associated with proposed changes to the 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 the same period.

Incremental impact of £1m of additional capital investment on the band D council tax

£	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Council tax - band D	0.26	0.42	0.48	0.51

3 BORROWING

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 the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities. The strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

3.1 Current portfolio position

The council's treasury portfolio position at 31 March 2016, with forward projections are summarised below. The table shows the actual external debt (the treasury management operations), against the underlying capital borrowing need (the Capital Financing Requirement - CFR), highlighting any over or under borrowing. In the absence of any external borrowing or finance leases, the actual debt position is zero and, with the resolution of the negative CFR, this too is reduced to zero.

£m	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
External Debt					
Debt at 1 April					
Expected change in Debt					
Other long-term liabilities (OLTL)	0	0	0	0	0
Expected change in OLTL	0	0	0	0	0
Actual debt at 31 March	**0**	**0**	**0**	**0**	**0**
The Capital Financing Requirement	**0**	**0**	**0**	**0**	**0**
Under / (over) borrowing	0	0	0	0	0
Total investments at 31 March					
Investments	**20.000**	**20.000**	**19.4545**	**27.106**	**26.407**
Investment change		0.00	-0.55	7.65	-0.70

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 total debt, net of any investments, 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 (shown as net borrowing above). This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

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

3.2 Treasury Indicators: limits to borrowing activity

The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt.

Operational boundary £m	2016/17	2017/18	2018/19	2019/20
Debt	0.000	0.000	0.000	0.000
Other long term liabilities	0.050	0.050	0.050	0.050
Total	0.050	0.050	0.050	0.050

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.

1. 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.
2. The council is asked to approve the following authorised limit:

Authorised limit £m	2016/17	2017/18	2018/19	2019/20
Debt	5.000	5.000	5.000	5.000
Other long term liabilities	0.050	0.050	0.050	0.050
Total	5.050	5.050	5.050	5.050

3.3 Prospects for interest rates

The council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the council to formulate a view on interest rates. The following table gives our central view.

Annual Average %	Bank Rate %	PWLB Borrowing Rates % (including certainty rate adjustment)		
		5 year	25 year	50 year
Mar 2017	0.25	1.60	2.90	2.70
Jun 2017	0.25	1.60	2.90	2.70
Sep 2017	0.25	1.60	2.90	2.70
Dec 2017	0.25	1.60	3.00	2.80
Mar 2018	0.25	1.70	3.00	2.80
Jun 2018	0.25	1.70	3.00	2.80
Sep 2018	0.25	1.70	3.10	2.90
Dec 2018	0.25	1.80	3.10	2.90
Mar 2019	0.25	1.80	3.20	3.00
Jun 2019	0.50	1.90	3.20	3.00
Sep 2019	0.50	1.90	3.30	3.10
Dec 2019	0.75	2.00	3.30	3.10
Mar 2020	0.75	2.00	3.40	3.20

3.4 Borrowing strategy

The Council currently has no external debt, nor is there any forecast requirement to enter into any with the time periods covered by this report. There are substantial capital reserves and the expectation is that these will be adequate to cover any changes that may be incorporated into spending plans.

The current strategy is therefore that the Council will not enter into any new borrowings, other than for short term arrangements should these be deemed necessary for cash flow purposes.

Treasury management limits on activity

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.

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

£m	2016/17	2017/18	2018/19
Interest Rate Exposure	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates: Debt/Investments	100%	100%	100%
Limits on variable interest rates: Debt/Investments	50%	50%	50%

3.5 Policy on borrowing in advance of need

The council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be within forward approved Capital Financing Requirement estimates, and will be considered carefully to ensure that value for money can be demonstrated and that the council can ensure the security of such funds.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

3.6 Debt rescheduling

As short term borrowing rates will be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the treasury strategy;
- enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identify if there is any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to the council, at the earliest meeting following its action.

4 ANNUAL INVESTMENT STRATEGY

4.1 Investment policy

The council's investment policy has regard to the CLG's Guidance on Local Government Investments ("the Guidance") and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities will be security first, liquidity second, then return.

In accordance with the above guidance from the CLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of these reflect in the eyes of each agengy. Using the Sector ratings service potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

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

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

The aim of the strategy is to generate a list of highly creditworthy counterparties which will also enable divesification and thus avoidance of concentration risk.

The intention of the strategy is to provide security of investment and minimisation of risk.

Investment instruments identified for use in the financial year are listed in appendices under the 'specified' and 'non-specified' investments categories. This list provides a guide as to which institutions are suitable to use during the year. Counterparty limits will be as set through the council's treasury management practices – schedules.

4.2 Creditworthiness policy

The primary principle governing the council's investment criteria is the security of its investments, although the yield or return on the investment is also a key consideration. After this main principle, the council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in, criteria for choosing investment counterparties with adequate security, and monitoring their security. This is set out in the specified and non-specified investment sections below; and

- It has sufficient liquidity in its investments. For this purpose it will set out procedures for determining the maximum periods for which funds may prudently be committed. These procedures also apply to the council's prudential indicators covering the maximum principal sums invested.

The Head of Finance will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to council for approval as necessary. These criteria are separate to that which determines which types of investment instrument are either specified or non-specified as it provides an overall pool of counterparties considered high quality which the Council may use, rather than defining what types of investment instruments are to be used.

All investments will be made in accordance with the Government's investment guidelines. The classes of institutions proposed for inclusion in the council's counterparty investment lists are as follows:-

- UK domiciled banks, with a minimum long term Fitch rating of A-
- Non UK banks, domiciled in a country which has a minimum sovereign long term Fitch rating of AA-
- Building societies with assets > 1bn
- Money market funds – (cash is invested with a fund holder)
- Other Local authorities and Government Gilts
- Certificates of Deposit (negotiable form of fixed deposit)

4.3 Country limits

The council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch or equivalent. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy.

4.4 Investment strategy

In-house funds. Investments will be made with reference to the core balance and cash flow requirements and the outlook for short-term interest rates (i.e. rates for investments up to 12 months).

Investment returns expectations. Bank Rate is forecast to remain unchanged at 0.25% before starting to rise from quarter 1 of 2019. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.75%

There are upside risks to these forecasts (i.e. start of increases in Bank Rate occurs sooner) if economic growth remains strong and unemployment falls faster than expected. However, should the pace of growth fall back, there could be downside risk, particularly if Bank of England inflation forecasts for the rate of fall of unemployment were to prove to be too optimistic.

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

2016/17	0.60%
2017/18	1.00%
2018/19	1.15%
2019/20	1.25%

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.

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

Maximum principal sums invested > 364 days			
£m	**2016/17**	**2017/18**	**2018/19**
Principal sums invested > 364 days	£5m	£5m	£5m

4.5 End of year investment report

At the end of the financial year, the council will report on its investment activity as part of its Annual Treasury Report.

5 APPENDICES

1. Interest rate forecasts
2. Treasury management practice 1 – credit and counterparty risk management
3. Treasury management scheme of delegation
4. The treasury management role of the section 151 officer

5.1 APPENDIX: Interest Rate Forecasts 2016 - 2019

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
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%	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%	2.60%	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%	3.30%	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%	3.10%	3.20%

5.2 APPENDIX: Treasury Management Practice (TMP1) – Credit and Counterparty Risk Management

A variety of investment instruments will be used, subject to the credit quality of the institution, and depending on the type of investment made it will fall into one of the below categories. In addition to the Fitch rating, credit default swaps are consider in assessing the suitablility of institutions.

Time and monetary limits applying to investments. The time and monetary limits for institutions on the Council's counterparty list are as follows (these will cover both specified and non-specified investments):

	Min Fitch Long term Rating (or equivalent)	Money Limit	Time Limit *
Banks 1	***A-***	**£3m**	**2yrs**
Banks 2 – part nationalised Nationwide Building Society	**N/A**	**£5m**	**2yrs**
Building Societies 1 Assets >£1bn	**N/A**	**£3m**	**18 Months**
Building Societies 1 Assets >£500m <£1bn	**N/A**	**£1m**	**1 year**
DMADF	**AA**	**unlimited**	**6 months**
Local authorities	**N/A**	**£3m**	**1yr**
Money market funds	**AAA**	**£3m**	**liquid**

- **Plus an additional 3 months where a part of the total exposure is represented by a commitment under a forward deal with a single institution**

APPENDIX: Approved countries for investments

AAA
- Australia
- Canada
- Denmark
- Finland
- Germany
- Luxembourg
- Netherlands
- Norway
- Singapore
- Sweden
- Switzerland

AA+
- France
- Hong Kong
- U.K
- U.S.A.

AA
- Abu Dhabi
- Qatar
- UAE

AA-
- Belgium
- Japan
- Saudi Arabia

5.3 APPENDIX: Treasury management scheme of delegation

(i) Full board/council

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

(ii) 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.

(iii) Body/person(s) with responsibility for scrutiny

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

5.4 APPENDIX: 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.