

# **CHERWELL DISTRICT COUNCIL**

## **Treasury Management Strategy Statement**

### **Minimum Revenue Provision Policy Statement and Annual Investment Strategy**

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2017/18

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# 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 policies, 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 any policies require revision. In addition, the Accounts Audit and Risk Committee will receive quarterly update reports.

**An annual treasury report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

### Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by the Accounts Audit and Risk Committee.

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### **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) policy.

#### **Treasury management issues**

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy;
- policy on borrowing in advance of need;
- 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. This especially applies to members responsible for scrutiny.

The training needs of treasury management officers are periodically reviewed.

### **1.5 Treasury management consultants**

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

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.

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

## 2 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 the 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. Members are asked to approve the capital expenditure forecasts:

Capital Expenditure £'000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Total</b>	<b>17,424</b>	<b>72,149</b>	<b>3,770</b>	<b>1,880</b>	<b>1,650</b>

The table below summarises the above 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.

Financing of Capital Expenditure £'000	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Expenditure</b>	<b>17,424</b>	<b>72,149</b>	<b>3,770</b>	<b>1,880</b>	<b>1,650</b>
<b>Financed by:</b>					
Capital Receipts	-16,962	-580	-3,395	-1,505	-1,275
Capital Grants	-462	-375	-375	-375	-375
Capital Reserves	0	0	0	0	0
Revenue	0	0	0	0	0
<b>Net financing need for the year</b>	<b>0</b>	<b>71,194</b>	<b>0</b>	<b>0</b>	<b>0</b>

### 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 £0 of such schemes within the CFR

The Council is asked to approve the CFR projections below:

<b>Borrowing Need £'000</b>	<b>2015/16 Actual</b>	<b>2016/17 Estimate</b>	<b>2017/18 Estimate</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>
<b>Capital Financing Requirement</b>					
<b>Total CFR</b>	<b>-5,880</b>	<b>65,314</b>	<b>48,743</b>	<b>47,990</b>	<b>47,435</b>
<b>Movement in CFR</b>		<b>71,194</b>	<b>-16,571</b>	<b>-753</b>	<b>-555</b>

<b>Movement in CFR represented by</b>					
Net financing need for the year	0	71,194	0	0	0
Less MRP/VFRP and other financing movements	0	0	-16,571	-753	-555
<b>Movements in CFR</b>		<b>71,194</b>	<b>-16,571</b>	<b>-753</b>	<b>-555</b>

### 2.3 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.).

## 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 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 appropriate 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 is currently debt free however the capital programme as detailed in section 2 demonstrates that capital resources are diminishing. Future projects may require the need to borrow and for the council to enter into long term debt arrangements.

The Chief Finance Officer will monitor this situation and if and when there is a requirement to borrow outside of the operational and authorised limits as detailed below an updated version of this strategy will be prepared for member approval.

The Council's treasury portfolio position at 31 March 2016, with 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).

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

The Chief Finance Officer 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 the budget report.

### 3.2 Treasury Indicators: limits to borrowing activity

**The operational boundary.** This is the limit 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 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	£70m	£70m	£70m	£70m
Other long term liabilities	0	0	0	0
<b>Total</b>	<b>£70m</b>	<b>£70m</b>	<b>£70m</b>	<b>£70m</b>

**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 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Debt	£75m	£75m	£75m	£75m
Other long term liabilities	0	0	0	0
<b>Total</b>	<b>£75m</b>	<b>£75m</b>	<b>£75m</b>	<b>£75m</b>

### 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.

	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
<b>Bank rate</b>	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%
<b>5yr PWLB rate</b>	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%
<b>10yr PWLB rate</b>	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%
<b>25yr PWLB rate</b>	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%
<b>50yr PWLB rate</b>	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%

The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp



fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts, (and MPC decisions), will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point, there would be a start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields.

The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets.

The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established.

The expected substantial rise in the Fed. rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging

market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
- Major national polls:
  - Italian constitutional referendum 4.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
  - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
  - Dutch general election 15.3.17;
  - French presidential election April/May 2017;
  - French National Assembly election June 2017;
  - German Federal election August – October 2017.
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
- UK economic growth and increases in inflation are weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
  - A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
  - The pace and timing 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.
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- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4<sup>th</sup> August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;
- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### **3.4 Borrowing strategy**

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

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

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

Any decisions will be reported to the appropriate decision making body at the next available opportunity.

### **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.

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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 Municipal Bond Agency**

It is likely that the Municipal Bond Agency, currently in the process of being set up, will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). This Authority will consider making use of this new source of borrowing as and when appropriate, along with other organisations.

## 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 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.

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 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.

Investment instruments identified for use in the financial year are listed in appendix 5.2 under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

### 4.2 Creditworthiness policy

This Council applies the creditworthiness service provided by 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;
- CDS spreads to give early warning of likely changes in credit ratings;
- sovereign ratings to select counterparties from only the most creditworthy countries.

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 which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested duration for investments. The Council will therefore use counterparties within the following durational bands:

- Yellow            5 years \*
- Dark pink       5 years for Enhanced money market funds (EMMFs) with a credit score of 1.25
- Light pink      5 years for Enhanced money market funds (EMMFs) with a credit score of 1.5
- Purple           2 years
- Blue            1 year (only applies to nationalised or semi nationalised UK Banks)

- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

Y	Pi1	Pi2	P	B	O	R	G	N/C
1	1.25	1.5	2	3	4	5	6	7
Up to 5yrs	Up to 5yrs	Up to 5yrs	Up to 2yrs	Up to 1yr	Up to 1yr	Up to 6mths	Up to 100days	No Colour
	Colour (and long term rating where applicable)		Money and/or % Limit		Time Limit			
Banks *	yellow		£15m		5 yrs			
Banks	purple		£15m		2 yrs			
Banks	orange		£15m		1 yr			
Banks – part nationalised	blue		£15m		1 yr			
Banks	red		£15m		6 mths			
Banks	green		£15m		100 days			
Banks	No colour		Not to be used		-			
Council's banker (not meeting above ratings)	-		£5m		1 day			
Other institutions limit	-		£15m		5 yrs			
DMADF	AAA		unlimited		6 months			
Local authorities	n/a		£5m per auth		5 years			
	Fund rating		Money and/or % Limit		Time Limit			
Money market funds	AAA		£10m per fund		liquid			
Enhanced money market funds with a credit score of 1.25	Dark pink / AAA		£10m per fund		liquid			
Enhanced money market funds with a credit score of 1.5	Light pink / AAA		£10m per fund		liquid			

\* Please note: the yellow colour category is for UK Government debt, or its equivalent, money market funds and collateralised deposits where the collateral is UK Government debt –see appendix 5.2.

The Capita Asset Services' creditworthiness service uses a wider array of information than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

All credit ratings will be monitored weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita Asset Services' 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.
- in addition to the use of credit ratings the Council will be advised of information in movements in credit default swap spreads against the iTraxx benchmark and other market data on a daily basis via its Passport website, provided exclusively to it by Capita Asset Services. Extreme market movements may result in downgrade of an institution or removal from the Council's lending list.

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 any external support for banks to help support its decision making process.

### 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). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 5.3. 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 stay flat at 0.25% until quarter 2 2019 and not to rise above 0.75% by quarter 1 2020. Bank Rate forecasts for financial year ends (March) are:

- 2016/17 0.25%
- 2017/18 0.25%
- 2018/19 0.25%
- 2019/20 0.50%

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

	<b>Now</b>
2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%

The overall balance of risks to these forecasts is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise, there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.



**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: -

<b>Maximum principal sums invested &gt; 364 days</b>			
<b>£m</b>	<b>2017/18</b>	<b>2018/19</b>	<b>2019/20</b>
Principal sums invested > 364 days	£15m	£15m	£15m

For its cash flow generated balances, the Council will seek to utilise instant access and notice accounts, money market funds and short-dated deposits (overnight to 100 days) in order to benefit from the compounding of interest.

#### **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.

#### **4.6 Icelandic bank investments**

The Council no longer holds any investments with Icelandic banks. The remaining principal plus interest, adjusted for exchange rates, was received in June 2016.

## 5.1 THE CAPITAL PRUDENTIAL AND TREASURY INDICATORS 2017/18 – 2019/20 AND MRP STATEMENT

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

### 5.1.1 Capital expenditure

	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Capital expenditure £'000</b>	<b>17,424</b>	<b>72,149</b>	<b>3,770</b>	<b>1,880</b>	<b>1,650</b>

### 5.1.2 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 is recommended to approve the following MRP Statement.

From 1 April 2008 for all unsupported borrowing (including PFI and finance leases) the MRP policy will be:

- **Asset life method** – MRP will be based on the estimated life of the assets, in accordance with the regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction) (option 3);
- **Depreciation method** – MRP will follow standard depreciation accounting procedures (option 4);

These options provide for a reduction in the borrowing need over approximately the asset's life.

Repayments included in annual PFI or finance leases are applied as MRP.

The Council has established a company to which it is providing loans on a commercial basis. The cash advances will be used by the company to fund capital expenditure and should therefore be treated as capital expenditure and a loan to a third party by the Council.

The Capital Financing Requirement (CFR) will increase by the amount of loans advanced and, under the terms of contractual loan agreements, are due to be returned in full by 2026, with interest paid as shown in the contract.

Once funds are returned to the Council, the returned funds are classed as a capital receipt, off-set against the CFR, which will reduce accordingly. As this is a temporary (10 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application. The outstanding loan/CFR position will be reviewed on an annual basis and if the likelihood of default increases, a prudent MRP policy will commence.

To ensure that any required changes to this approach can be addressed promptly and prudently the Council has adopted a policy providing delegated authority to the

Chief Finance Officer to defer the charging of MRP in accordance with the Prudential Code and current accounting regulations in the following circumstances:

- There is a separately identifiable project with quantified borrowing costs.
- The period from the projects inception to it becoming operational is significantly in excess of 12 months.
- A business case has been produced incorporating the deferred MRP and capitalised interest which demonstrates that the project is prudent and affordable over its whole life.
- The borrowing and MRP amounts are material, in excess of £250,000 annually.
- The deferred MRP and accumulated interest will be charged to the appropriate revenue account on a prudent basis, once the project is operational.

### 5.1.3 Affordability prudential indicators

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

#### a. Ratio of financing costs to net revenue stream

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

%	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Ratio</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>	<b>0%</b>

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

#### b. Incremental impact of capital investment decisions on council tax

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

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

£	2015/16 Actual	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
<b>Council tax - band D</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>	<b>0.00</b>

### 5.1.4 Treasury indicators for debt

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:

£'000	2017/18	2018/19	2019/20
<b>Interest rate exposures</b>			
	<b>Upper</b>	<b>Upper</b>	<b>Upper</b>
<b>Limits on fixed interest rates based on net debt</b>	100%	100%	100%
<b>Limits on variable interest rates based on net debt</b>	100%	100%	100%
<b>Maturity structure of fixed interest rate borrowing 2017/18 (if required)</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	
<b>Maturity structure of variable interest rate borrowing 2017/18</b>			
	<b>Lower</b>	<b>Upper</b>	
Under 12 months	0%	100%	
12 months to 2 years	0%	100%	
2 years to 5 years	0%	100%	
5 years to 10 years	0%	100%	
10 years and above	0%	100%	

## 5.2 TREASURY MANAGEMENT PRACTICE (TMP1) – CREDIT AND COUNTERPARTY RISK MANAGEMENT OPTION 1

### **SPECIFIED INVESTMENTS:** *(please select from table below)*

(All such investments will be sterling denominated, with **maturities up to maximum of 1 year**, meeting the minimum 'high' rating criteria where applicable)

	* Minimum 'High' Credit Criteria	Use
Debt Management Agency Deposit Facility	--	In-house
Term deposits – local authorities	--	In-house
Term deposits – banks and building societies	Green	In-house

### **Term deposits with nationalised banks and banks and building societies**

	* Minimum Credit Criteria	Use	*** Max % of total investments	Max. maturity period
UK part nationalised banks	Blue	In-house	£15m	5 yrs

Collateralised deposit	UK sovereign rating	In-house
UK Government Gilts	UK sovereign rating	In-house buy and hold
Bonds issued by multilateral development banks	AA-	In-house buy and hold
Bond issuance issued by a financial institution which is explicitly guaranteed by the UK Government e.g. National Rail	UK sovereign rating	In-house buy and hold
Sovereign bond issues (other than the UK govt)	AA-	In-house buy and hold
Corporate Bonds – secured	A	In-house
Corporate Bonds – unsecured	AA-	In-house
Certificates of deposit issued by banks and building societies	A-	In-house
Treasury Bills	UK sovereign rating	In house
Instant Access Deposit Accounts	AA	In-house

<b>Collective Investment Schemes structured as Open Ended Investment Companies (OEICs): -</b>		
1. Government Liquidity Funds	AAA	In-house
2. Money Market Funds	AAA	In-house
3. Enhanced Cash Funds	AA	In-house
4. Pooled Funds, such as those investing in sovereign bonds, corporate bonds, property funds, equity funds	AA-	In-house

**Accounting treatment of investments.** The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by this Council. To ensure that the Council is protected from any adverse revenue impact, which may arise from these differences, we will review the accounting implications of new transactions before they are undertaken.

**NON-SPECIFIED INVESTMENTS:** A maximum of 40% will be held in aggregate in non-specified investment

### Maturities of ANY period

<b>Where applicable limits are per Bank Group and not individual Banks within a Group</b>	<b>* Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of fund</b>	<b>Max. maturity period</b>
Commercial paper issuance covered by a specific UK Government (explicit) guarantee	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	270 days
Commercial paper other	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	270 days
Other debt issuance by UK banks covered by UK Government (explicit) guarantee	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	2 years
	<b>* Minimum Credit Criteria</b>	<b>Use</b>	<b>Max % of fund</b>	<b>Max. maturity period</b>
Bonds – Secured (i.e. with collateral or other cover)	Short-term F1, Long-term A, Viability BB+	In- house and Fund Manager	15%	2 years
Bonds – Unsecured	Short-term F1, Long-term AA-, Viability BB+	In- house and Fund Manager	15%	2 years

Term Deposits with Banks and Building Societies which meet the Specified Investments criteria	Purple	In- house and Fund Manager	15%	2 years
Term Deposits with Banks and Building Societies which fall in the Non- Specified Investments criteria	Green	In- house and Fund Manager	15%	100 days
Term Deposits with Local Authorities	-	In- house and Fund Manager	10%	2 years
Gilts	UK Sovereign rating	In- house and Fund Manager	25%	10 years
Bonds issued by multilateral development banks	Short-term F1, Long-term AA, Viability BB+	In- house and Fund Manager	15%	5 years
Money Market Funds (MMF) operating on Constant Net Asset Value (CNAV) basis if not credit rated – up to value of 10% of total investment portfolio per MMF	Short-term F1, Long-term AA+, Viability BB	In- house and Fund Manager	20%	-
Enhanced Money Market Funds - up to value of 10% of total investment portfolio per MMF	Short-term F1, Long-term AA+, Viability BB	In- house and Fund Manager	40%	-
Pooled Funds such those investing in sovereign bonds, corporate bonds, property funds, equity funds	Short-term F1, Long-term AA-, Viability BB+	In- house and Fund Manager	15%	2 years
Investment in Share Capital of a wholly owned and /or subsidiary company of the Council	Not applicable	In- house	Not applicable	Not applicable
Investments with other organisations**	Not applicable	In house	Not applicable	Not applicable

\*\* Investments with other organisations have been included as a non-specified investment category for 2017/18. This would include investment opportunities with small and medium sized enterprises (SMEs) and other businesses and entities across the UK. Because of the higher perceived credit risk of SMEs, such investments may provide considerably higher rates of return. An external credit assessment will be undertaken and advice from Capita will be sought (where available) before any investment decision is made.

Delegated authority is granted to the Chief Finance Officer, in consultation with the Lead Member for Financial Management and the Chairman of Accounts, Audit and Risk

Committee, to amend the lending criteria and counterparty limits detailed above as required to ensure that investments can continue to be made in a rapidly changing financial environment and the security of investments are maximised if this is deemed by him to be the most appropriate course of action.

### **5.3 APPROVED COUNTRIES FOR INVESTMENTS**

#### **AAA**

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

#### **AA+**

- Finland
- Hong Kong
- U.S.A.

#### **AA**

- Abu Dhabi (UAE)
- France
- Qatar
- U.K.

#### **AA-**

- Belgium



## **5.4 TREASURY MANAGEMENT SCHEME OF DELEGATION**

### **(i) Full council**

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

### **(ii) Executive**

- 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) Accounts Audit and Risk Committee**

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

## **5.5 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.