

**REPORT**

**SUBJECT:** Treasury Management Policy Statement; Strategy Statement including MRP Statement and Investment Strategy and also Prudential Indicators 2018/19

**DIRECTORATE:** Resources

**MEETING:** Audit Committee

**DATE:** 11<sup>th</sup> January 2018

**1. PURPOSE:**

- 1.1 To set a policy and strategies for the 2018/19 financial year which cover treasury and prudential borrowing activities which Council employees must then adhere to. This is to ensure that an appropriate level of care is taken of the Authority's funds and that a prudent budget is set to cover these activities.

**2. RECOMMENDATIONS:**

- 2.1 It is recommended that the proposed Treasury Management Policy Statement for 2018/19 (Appendix 1); and proposed Treasury Management Strategy 2018/19 (Appendix 2) including the Investment & Borrowing Strategies & the Minimum Revenue Provision (MRP) Policy Statement in Annex C, be approved together with the Treasury Limits as required by section 3 of the Local Government Act 2003.
- 2.2 It is recommended that the items in 2.1 are ratified by Full Council.
- 2.3 The Audit Committee continues to review the Council's Treasury activities on behalf of the Council by receiving the mid-year report and year-end report.
- 2.4 Note that the Prudential Indicators (full draft list in Appendix 3) are referenced in the Treasury Strategy. If significant changes are made to the Draft Capital MTFP between now and when it is finalised, these Prudential Indicators could change. Any changes will be approved as part of the approval of the Final Capital Budget for 2018/19. Changes are not expected to be significant.

### **3. BACKGROUND:**

#### **Treasury Management Policy Statement and Treasury Management Strategy**

- 3.1 As stated in the Treasury Management Policy Statement, the Council adopts the key recommendations of CIPFA's Code of Practice for Treasury Management in the Public Services (the "Code") (as revised in 2011) which are designed to provide effective control of the risks of Treasury Management activities, prioritising security and liquidity of investments above yield.
- 3.2 The Council also adheres to the Prudential Code for Capital Finance in Local Authorities (as revised in 2011) which outlines requirements for the manner in which capital spending plans are to be considered and approved. Authorities are required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds.
- 3.3 The Prudential Code further requires the Council to set a number of Prudential and Treasury Management indicators which are covered in this report.
- 3.4 The WG Guidance on Local Government Investments issued in April 2010 requires the production of an Investment Strategy in addition to a Treasury Management Strategy and allows both to be included in one document. Appendix 2 contains the Council's detailed proposed investment strategy.
- 3.5 The Code requires that "Council" approve annually a Treasury Management Policy Statement and a Treasury Management Strategy Statement and an Investment Strategy and that it receives as a minimum a semi-annual report and an annual report after its close. The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit Committee although Full Council will still ratify the approval of the Treasury Strategy at the start of the year and the receipt of the Treasury outturn report at the end of the year.
- 3.6 Full Council delegates the execution and administration of treasury management decisions to the Head of Finance (S151 officer) who will act in accordance with the Treasury Management policy statement (appendix 1) and treasury management practices and CIPFA's Standard of Professional Practice on Treasury Management.
- 3.7 The Council is also clear that overall responsibility for treasury management remains with the Council.
- 3.8 Revisions to the Prudential Code, Treasury Management Code and the WG Investment Guidance are anticipated early in 2018. If these impact on the 2018/19 Treasury Strategy or any of the Appendices the amendments will be brought to Audit Committee for approval in a timely fashion.

#### **Annual Minimum Revenue Provision Policy Statement**

- 3.9 The annual Minimum Revenue Provision is the mechanism used for spreading the capital expenditure financed by borrowing over the years to which benefit is provided. Regulations state that the authority must calculate for the current financial year an amount of minimum revenue provision which it considers to be

prudent. In addition there is the requirement for an Annual Minimum Revenue Provision Policy Statement to be drafted and submitted to full Council. This is attached at Annex C.

### **Considerations influencing the strategy**

- 3.10 The limits proposed in the 2018/19 Treasury Strategy have not changed significantly from the 2017/18 Strategy which means that most of our investments will be limited to £2 million per counterparty – see the Table ‘Approved Investment counterparties & Limits’ in Appendix 2. The counterparty rating limits and investment maturities in this table are ultimate limits which may be further restricted if advice from our Treasury advisers indicate that the risks associated with a specific counterparty or investment product warrant it.
- 3.11 The section on External context within the Strategy in Appendix 2 explains the backdrop which has been considered when setting the limits for borrowing & investing. These include:
- The effect the Brexit process has had on Sterling, GDP and UK growth
  - CPI (Consumer Price index) has risen to 3%
  - Bail-in legislation has now been fully implemented in the EU, Switzerland and the USA so Local Authorities could be called on to bail-in failing banks.
  - The largest UK banks will “ring-fence” or separate their retail banking functions from their Investment banking activities during 2018.
  - The Authority has requested that the financial institutions which it deals with on regulated products allow it to act up to Professional status under the MifID II regulations which come into force on the 3<sup>rd</sup> January 2018 & require the Authority to hold £10 million of Investments (See Investment Strategy section)

### **5. REASONS:**

- 5.1 The Authority is required to produce a Treasury Management Policy and a Treasury Management and Annual Investment Strategy in order to comply with the Chartered Institute of Public Finance and Accountancy’s Code of Practice for Treasury Management in Public Services (the “CIPFA TM Code”).
- 5.2 The Authority is required to produce an MRP Policy Statement in order to comply with the Local Authorities (Capital Finance and Accounting) (Wales) Regulations, last amended in 2009.

### **6. RESOURCE IMPLICATIONS:**

- 6.1 There are no resource implications directly arising from this report. The medium-term treasury budgets contained within the 2018-2019 revenue budget proposals to be presented to Council in March 2018, were constructed in accordance with the strategy documents appended to this report.
- 6.2 There are however some key future financial risks on medium-term treasury budgets concerning:

- The number of significant capital receipts in the existing medium-term forecasts, and on which the authority's internal borrowing strategy and budgets are based. There will be an adverse financial impact in the event that such receipts do not materialise or are significantly delayed.
- The strategy states the Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. It presents the option of taking advantage of currently low short-term interest rates possibly at the expense of increasing future borrowing costs. This balance will be monitored regularly in order to decide whether to borrow additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.
- It should be noted that as a result of the expenditure plans of the Authority and the forecasts for interest rates in the future, that borrowing costs are expected to rise in the medium/long term.

## **7. EQUALITY IMPACT ASSESSMENT:**

There is no equality impact arising directly from this report.

## **8. SUSTAINABLE DEVELOPMENT IMPLICATIONS:**

None

## **9. BACKGROUND PAPERS:**

Appendix 1 – Treasury Management Policy Statement 2018/19

Appendix 2 – Treasury Management Strategy Statement 2018/19 including the Investment & Borrowing Strategies & the MRP policy statement

Appendix 3 – Prudential Indicators 2018/19 (Also distributed with Revenue and Capital budget proposals, Council March 2018)

## **10. AUTHORS:**

Lesley Russell – Senior Accountant – Treasury & Fixed Assets

Jonathan Davies – Central Accountancy Finance Manager

## **11. CONTACT DETAILS:**

Tel: (01633) 644399

Email: [lesleyrussell@monmouthshire.gov.uk](mailto:lesleyrussell@monmouthshire.gov.uk)

Tel: (01633) 644114

Email: [jonathandavies2@monmouthshire.gov.uk](mailto:jonathandavies2@monmouthshire.gov.uk)

### TREASURY MANAGEMENT POLICY STATEMENT 2018/19

#### 1 INTRODUCTION AND BACKGROUND

- 1.1 The Council adopts the key recommendations of CIPFA's Treasury Management in the Public Services: Code of Practice (the Code), as described in Section 5 of the Code.
- 1.2 Accordingly, the Council will create and maintain, as the cornerstones for effective treasury management:-
- A treasury management policy statement, stating the policies, objectives and approach to risk management of its treasury management activities
  - Suitable treasury management practices (TMPs), setting out the manner in which the Council will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.
- 1.3 The Council (i.e. full Council) will receive reports on its treasury management policies, practices and activities including, as a minimum, an annual strategy and plan in advance of the year, and a semi-annual report and an annual report after its close.
- 1.4 The Council delegates responsibility for the implementation and monitoring of its treasury management policies and practices to the Audit Committee and for the execution and administration of treasury management decisions to the Head of Finance (S151 officer), who will act in accordance with the organisation's policy statement and TMPs and CIPFA's Standard of Professional Practice on Treasury Management.
- 1.5 The Council nominates Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies and they will receive the mid-year report on Treasury Management activities.

#### 2. POLICIES AND OBJECTIVES OF TREASURY MANAGEMENT ACTIVITIES

- 2.1 The Council defines its treasury management activities as:
- “The management of the Council'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.”
- 2.2 This Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

- 2.3 This Council acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable performance measurement techniques, within the context of effective risk management.”

***As CIPFA states the policy statement should also include the Council’s high level policies for borrowing and investments:***

- 2.4 The Council’s borrowing will be affordable, sustainable and prudent and consideration will be given to the management of interest rate risk and refinancing risk. The source from which the borrowing is taken and the type of borrowing should allow the Council transparency and control over its debt.
- 2.5 The Council’s primary objective in relation to investments remains the security of capital. The liquidity or accessibility of the Authority’s investments followed by the yield earned on investments remain important but are secondary considerations.

### **3. Approach to Risk Management**

- 3.1 This section identifies the risks that the Council faces as a result of it undertaking treasury management activities.

Liquidity risk  
Credit (or counterparty) risk  
Interest rate risk  
Inflation rate risk  
Exchange rate risk  
Market risk  
Refinancing risk  
Procedural risk  
Legal and regulatory risk

The Council manages these down to an acceptable level within the regulatory framework through the consideration and application of its Treasury Strategy and appropriate monitoring against agreed prudential indicators and limits.

# Treasury Management Strategy Statement 2018/19

(Based on a template provided by the Councils Treasury Advisors - Arlingclose)

### Introduction

In March 2005 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

**Revised strategy:** In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance.

This Strategy covers the requirements of the 2010 Welsh Government Investment Guidance and the 2011 CIPFA TM Code of Practice, including the Treasury Management Indicators. The Prudential Indicators in Appendix 3 meet the requirements of the CIPFA Prudential code. CIPFA consulted on changes to both these Codes in 2017 but has yet to publish revised versions. The DCLG (Department for Communities and Local Government) will be revising its Investment Guidance and its MRP guidance for local authorities in England for 2018/19 but there have been no discussions with the Wales yet. This Strategy therefore does not reflect any of these proposed changes. The Authority will review the final versions when they are issued and if necessary recommend revisions to this strategy at that time to avoid pre-empting the final changes and their timing.

### External Context

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

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



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

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

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

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

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

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

A more detailed economic and interest rate forecast provided by Arlingclose is attached at **Annex A**.

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.15%, and that new long-term loans will be borrowed at an average rate of **2.37%**.

### **Local Context**

On 30th November 2017, the Authority held £113.2m of borrowing and £6.4m of investments. This is set out in further detail at **Annex B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

#### **Table 1: Balance sheet summary and forecast**



|   | 31.3.17<br>Actual<br>£m | 31.3.18<br>Estimate<br>£m | 31.3.19<br>Forecast<br>£m | 31.3.20<br>Forecast<br>£m | 31.3.21<br>Forecast<br>£m |
|---|-------------------------|---------------------------|---------------------------|---------------------------|---------------------------|
| General Fund CFR *                        | 134.6                   | 143.2                     | 155.4                     | 159.3                     | 157.8                     |
| Less: Other debt liabilities **           | (1.0)                   | (1.0)                     | (0.8)                     | (0.6)                     | (0.4)                     |
| <b>Borrowing CFR</b>                      | <b>133.6</b>            | <b>142.2</b>              | <b>154.6</b>              | <b>158.7</b>              | <b>157.4</b>              |
| Less: External borrowing committed to *** | (89.3)                  | (98.2)                    | (75.2)                    | (73.5)                    | (54.3)                    |
| <b>Borrowing requirement</b>              | <b>44.2</b>             | <b>44.0</b>               | <b>79.4</b>               | <b>85.2</b>               | <b>103.0</b>              |
| Less: Usable reserves                     | (35.2)                  | (19.0)                    | (14.3)                    | (19.6)                    | (22.3)                    |
| Less: Working capital                     | (9.0)                   | (9.0)                     | (9.0)                     | (9.0)                     | (9.0)                     |
| <b>New external borrowing requirement</b> | <b>0.0</b>              | <b>16.0</b>               | <b>56.1</b>               | <b>56.6</b>               | <b>71.7</b>               |

\* the CFR at 31.3.18 and 31.3.19 has been set £5m and £10m higher than currently required, to allow for Capital expenditure which is being considered for approval. This does not constitute approval but allows for it in the Treasury Strategy should it gain Member approval.

\*\* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

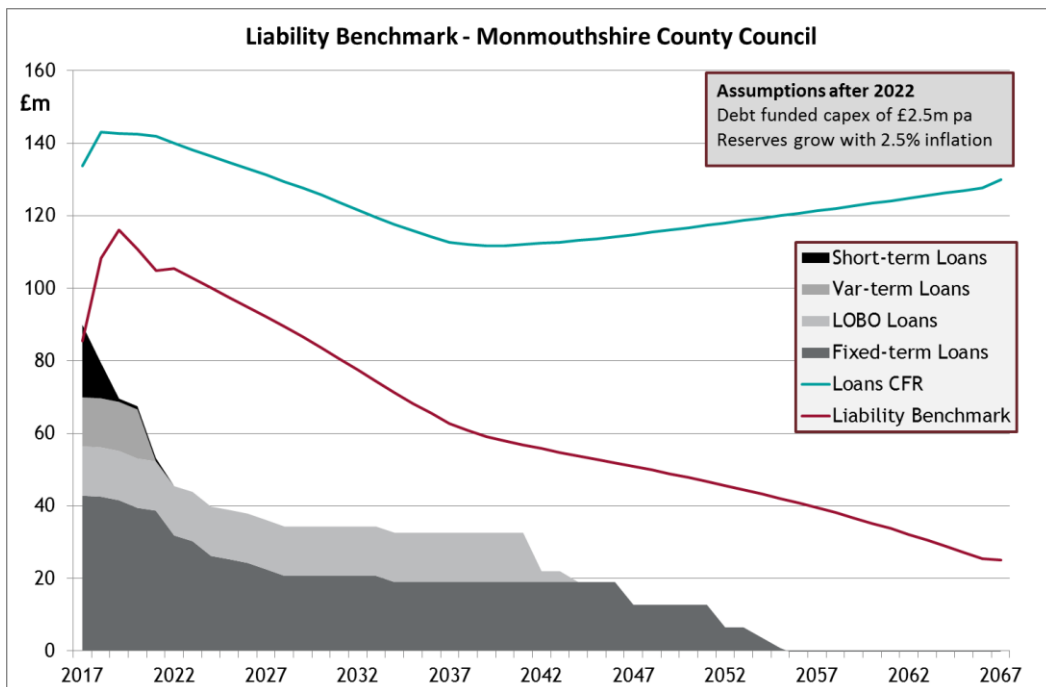
\*\*\* shows only loans to which the Authority is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. The Authority has an increasing CFR due to the capital programme, but low levels of investments and will therefore be required to borrow up to £72m over the forecast period, should all the projected capital expenditure be incurred. Short term and variable rate PWLB borrowing at 30<sup>th</sup> November 2017 was £42m & £13.5m which will both need to be replaced in the forecast window. These make up the majority of the £72m.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2018/19 as existing debt of £75m will still be in place at 31<sup>st</sup> March 2019 and new debt of £56m is anticipated as required. The combination of £131m is less than the CFR of £155m. The difference is due to internal borrowing

To assist with its long-term treasury management strategy, the Authority and its advisers have created a liability benchmark, which forecasts the Authority's need to borrow over a 50 year period. Following on from the medium-term forecasts in table 1 above, the benchmark assumes:

- capital expenditure funded by borrowing of £2.4m in 2021/22 increasing by 2.5% per year
- minimum revenue provision on capital expenditure, funded by unsupported borrowing, based on asset life and using an annuity profile
- minimum revenue provision on new capital expenditure funded by supported borrowing based on a 50 year asset life and a straight line profile
- income, expenditure and reserves all increase by 2.5% inflation a year after 2021/22



The Liability Benchmark line (red) represents the minimum Debt that Monmouthshire needs to hold over time in order to have sufficient cash to operate. The shaded area is the total debt which we hold today, reducing as the various types of debt mature. The gap between the two is the amount of debt which the Authority is expected to need to take out over time which is aligned with Table 1 in the first few years.

**Borrowing Strategy**

The Authority held £113 million of loans at 30<sup>th</sup> November 2017, an increase of £24 million from 31<sup>st</sup> March 2017, as part of its strategy for funding previous years’ capital programmes. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to £131 million by the end of 2018/19. The Authority may borrow additional sums, providing this does not exceed the authorised limit for borrowing of £194 million.

**Objectives:** The Authority’s chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required. The flexibility to renegotiate loans should the Authority’s long-term plans change is a secondary objective.

**Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority’s borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits in the short term of internal / short-term will be monitored regularly against the potential for incurring additional costs in the future by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this ‘cost of carry’ and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

In addition, the Authority may borrow further short-term loans to cover unplanned cash flow shortages.

It is anticipated during 2018/19, that the Authority will continue to rely heavily on short term loans to reduce interest costs, rather than filling the long term gap on the Liability Benchmark graph with more expensive long term loans which would be more costly. Approximately £6m of longer term debt is expected to be taken out to reduce interest rate risk in the medium term. Approval to lend for longer than one year is required from the S151 officer, Deputy or a more senior line manager of theirs in their absence.

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

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

**Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

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

In previous years, the Authority raised the majority of its long-term borrowing from the PWLB but has this year taken £5.9m of 3-5 year loans from other local Authorities. It continues to investigate other sources of finance, such as bank loans, that may be available at more favourable rates.

**LOBOs:** The Authority holds £13.6m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. All of these LOBOS have options during 2018/19, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

**Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

**Debt rescheduling:** The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Other lenders may also be prepared to negotiate premature redemption terms. The Authority may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

## Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. Since 1<sup>st</sup> April 2017, the Authority's investment balance has ranged between £2 and £22 million.

As a result of the implementation of the Markets in Financial Instruments Directive (MiFID II), on the 3<sup>rd</sup> January 2018, the Authority has put in a request to the financial institutions, with which it deals, to elect up from Retail to Professional Status. This is in order to maintain access to regulated financial services firms including banks, brokers, advisers, fund managers and custodians with whom we have dealings regarding regulated investment products. This does mean that we have to be able to demonstrate that we have an investment balance of at least £10 million. To that end, the Authority will maintain an average of at least £10 million over each financial year and maintain a balance of £10 million on at least 85% of working days during the year, only allowing balances to fall below £10 million due to cyclical influences which are disproportionately onerous to work around. This also has the benefit of reducing the risk of having insufficient liquidity to continue normal operations. This will be reviewed quarterly to ensure that the Authority is staying within the spirit of the regulation which does not specify how this limit should be met.

**Objectives:** Both the CIPFA Code and the WG Guidance require the Authority to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Authority's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Authority will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

**Negative interest rates:** If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

**Strategy:** Given the increasing risk and very low returns from short-term unsecured bank investments, the Authority will continually reassess the need to diversify into more secure and/or higher yielding asset classes during 2018/19. This is especially the case for the estimated £5m that is available for longer-term investment. The remainder of the Authority's surplus cash remains invested in short-term unsecured bank & building society deposits, certificates of deposit, money market funds, T-bills and the DMO.

**Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown. Any formal recommendations received from the Authority's treasury advisors which places additional restrictions on certain counterparties in terms of eligibility or duration of Investments will supercede the limits set below. Investments classified as Non Specified must obtain further approval from the S151 Officer or Deputy or more senior line manager and also the Authority's treasury advisors before being made.

Table 2: Approved investment counterparties and limits

| <b>Counterparty / Instrument</b> | <b>Instrument Limit of Portfolio</b> | <b>Counterparty Limit of Portfolio</b> | <b>Country Limit</b> | <b>Other Limits</b> | <b>Time Limit (Over 1 Year = Non Specified)</b> |
|----------------------------------|--------------------------------------|--|----------------------|---------------------|---|
|----------------------------------|--------------------------------------|--|----------------------|---------------------|---|

|   |   |  |                                |  |  |
|---|---|--|--------------------------------|--|--|
| <b>UK Central Government including Debt Mgt deposit facility, Gilts and T Bills.</b>  | <b>100%</b>   | <b>100%</b>  | <b>N/A</b>                     | <b>N/A</b>   | <b>50 Years</b>  |
| <b>Any investment with UK Local Authorities (irrespective of credit rating)</b>   | <b>75%</b>  | <b>The higher of £2m or 10% of total investments (at the time of deposit)</b>  | <b>N/A</b>                     | <b>NA</b>  | <b>2 Years</b>   |
| <p><b>‘Unsecured’ investments with Banks, Building Societies, Other Organisations and Securities whose lowest published rating from Fitch, Moody’s and S&amp;P’s is (A-)</b></p> <p><b>As above but (A)</b></p> <p><b>As above but (A+)</b></p> | <p><b>75% of total investments at the time of deposit</b></p> <p><b>For Non-UK 50% of total investment at the time of deposit</b></p> | <p><b>Upper limit of £2m.</b></p> <p><b>An additional £1m can be held in the Authority’s bank current account to cover the total of credit balances.</b></p> | <b>£4m per foreign country</b> | <p><b>Limit for negotiable instruments held in Brokers nominee accounts: the lower of 50% or £10m per Broker</b></p> | <p><b>6 months</b></p> <p><b>13 months</b></p> <p><b>2 years</b></p> |

|  |  |   |  |                   |   |
|--|--|---|--|-------------------|---|
| <p><b>Secured Investments with Banks, Building Societies, Other Organisations and Securities, (including Re-po's) whose lowest published rating from Fitch, Moody's and S&amp;P's is (A-)</b></p> <p><b>As above but (A) or (A+)</b></p> | <p><b>75% of total investments at the time of deposit (both secured and unsecured)</b></p> <p><b>For Non-UK 50% of total investments at the time of deposit (both secured and unsecured)</b></p> | <p><b>£4m per counterparty (both secured and unsecured)</b></p>   | <p><b>£4m per foreign country for all investment types</b></p> | <p><b>N/A</b></p> | <p><b>13 months</b></p> <p><b>2 years</b></p> |
| <p><b>Deposits with unrated UK Building Societies which have been assessed by our Treasury advisers as comparable with the Building Societies that have an A- credit rating or higher</b></p>  | <p><b>25% of total investments</b></p>   | <p><b>£1m per Counterparty</b></p>  | <p><b>UK only</b></p>  | <p><b>N/A</b></p> | <p><b>6 months</b></p>                        |
| <p><b>Money Market Funds with a Constant Net Asset Value (CNAV) or Variable NAV or Low Volatility NAV if assessed by our Treasury advisers as being of high credit worthiness</b></p>  | <p><b>50% of total investments at the time of deposit increased to 75% if total investments is £10m or less</b></p>  | <p><b>The lower of £2m and 10% of total investments rounded up to the next £0.5m; not exceeding 0.50% of MMF size or 2% for Government MMFs</b></p> | <p><b>N/A</b></p>  | <p><b>N/A</b></p> | <p><b>N/A</b></p>                             |
| <p><b>Pooled funds without credit ratings which are not classed as capital expenditure - if assessed by our Treasury advisers as</b></p>   | <p><b>£4m total investment at the time of deposit</b></p>  | <p><b>£2m per issuer</b></p>  | <p><b>N/A</b></p>  | <p><b>N/A</b></p> | <p><b>N/A</b></p>                             |

|  |   |                       |            |            |                |
|--|---|-----------------------|------------|------------|----------------|
| <b>being of high credit worthiness</b>   |   |                       |            |            |                |
| <b>Investments with UK Registered Providers (e.g. Housing Associations) where the lowest published credit rating is A- or higher</b> | <b>£4m of total investments at the time of deposit.</b> | <b>£2m per issuer</b> | <b>N/A</b> | <b>N/A</b> | <b>5 years</b> |

This table must be read in conjunction with the notes below

**Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

**Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

**Government:** Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. This includes police and fire authorities, district councils, transport authorities and combined authorities. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made following an external credit assessment or as part of a diversified pool in order to spread the risk widely.

**Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

**Pooled funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an



alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £50,000 per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

**Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

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

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

**Specified investments:** The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,

- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

**Non-specified investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, pooled funds that are defined as capital expenditure and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

|  | <b>Cash limit</b> |
|--|-------------------|
| Total long-term investments  | £6m               |
| Total shares in pooled funds excluding Money Market Funds  | £4m               |
| Total investments without credit ratings or rated below [A-] (except the UK Government and UK local authorities) | £3m               |
| Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [A-]        | £0m               |
| Total non-specified investments  | £11m              |

**Investment limits:** The Authority’s revenue reserves available to cover investment losses are forecast to be £14 million on 31st March 2018. In order that no more than 30% of available reserves will be put at risk in the case of a single default, the maximum that will be lent to any one organisation (other than the UK Government) is £4.0 million for secured investments or £2.0 million for unsecured investments to banks & building societies. These levels are considered prudent. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts and foreign countries as in Table 2 above. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

**Liquidity management:** The Authority uses an excel based cash flow forecasting tool to determine the maximum period for which funds may prudently be committed. Amounts are held on an ongoing basis in instant access accounts to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority’s medium term financial plan and cash flow forecast.

### Non-Treasury Investments

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example to shared service entities, to landlords, or as equity investments or loans to the Authority’s subsidiaries.

Such loans and investments are not subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy. As mentioned in the Introduction section above, when the Revised Treasury Management and Prudential codes are issued (anticipated December 2017), they will be reviewed and if necessary a revision to this strategy will be proposed.

The Authority's existing non-treasury investments are listed in Annex B.

### Treasury Management Indicators

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Security:** The Authority has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating/score of its investment portfolio. The credit score is calculated by applying a score to each investment (AAA=1, AA+=2, etc.) and taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

|                                       | Target   |
|---------------------------------------|----------|
| Portfolio average credit rating/score | A- / 5.0 |

**Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of net principal borrowed will be:

|  | 2018/19 | 2019/20 | 2020/21 |
|--|---------|---------|---------|
| Upper limit on net fixed interest rate exposure    | £110m   | £110m   | £110m   |
| Upper limit on net variable interest rate exposure | £78m    | £78m    | £78m    |

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate. The Upper limit on net variable interest rate exposure is at level which maintains the % of net variable interest rate exposure at 50% of total net debt.

**Maturity structure of borrowing:** This indicator is set to control the Authority's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing (excluding variable rate and short term borrowing) will be:

|                                | Levels anticipated as at 1 Apr 2018<br>£m / % | Lower Limit for 2018/19<br>% | Upper Limit for 2018/19<br>% |
|--------------------------------|---|------------------------------|------------------------------|
| Under 12 months - LOBO's       | £13.7m / 28%                                  | 0                            | 50                           |
| Under 12 months - other        |   | 0                            |                              |
| 12 months and within 24 months | £1.5m / 3%                                    | 0                            | 25                           |
| 24 months and within 5 years   | £8.6m / 17%                                   | 0                            | 45                           |
| 5 years and within 10 years    | £7.8m / 15%                                   | 0                            | 30                           |
| 10 years and above             | £19.3m / 37%                                  | 0                            | 100                          |
| TOTAL                          | £51.8m / 100%                                 |                              |                              |

Maturity is measured as the outstanding duration of loans on the 1<sup>st</sup> day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment

**Principal sums invested for periods longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

|   | 2018/19 | 2019/20 | 2020/21 |
|---|---------|---------|---------|
| Limit on principal invested beyond year end * | £6m     | £6m     | £6m     |

*\* meaning for longer than 1 year*

### **Other Items**

There are a number of additional items that the Authority is obliged by CIPFA or WG to include in its Treasury Management Strategy.

**Policy on the use of financial derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

**Investment training:** The needs of the Authority's treasury management staff for training in investment management are assessed on an ongoing basis as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff attend training courses, seminars and conferences provided by Arlingclose and CIPFA.

**Investment advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is assessed at the contract tender stage by comparing to other market leaders and their historical track record. It is then monitored by on-going interaction with treasury personnel. The Authority maintains the quality of the service from its advisors by holding quarterly meetings and tendering periodically.

**Investment of money borrowed in advance of need:** The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £191 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

### **Financial Implications**

The budget for investment income in 2018/19 is £8,000, based on an average investment portfolio of £5 million at an interest rate of 0.15%. The budget for debt interest paid in 2018/19 is £3.3 million, based on an average debt portfolio of £119.8 million at an average interest rate of 2.8% resulting from a mixture of short and long term debt. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

### Other Options Considered

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Head of Finance, having consulted the Audit Committee, believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

| <b>Alternative</b>   | <b>Impact on income and expenditure</b>  | <b>Impact on risk management</b>  |
|--|--|---|
| Invest in a narrower range of counterparties of higher credit worthiness and/or for shorter times    | Interest income will be lower  | Lower chance of losses from credit related defaults, but any such losses may be greater   |
| Invest in a wider range of counterparties, some with lower credit worthiness and/or for longer times | Interest income will be higher   | Increased risk of losses from credit related defaults, but any such losses may be smaller   |
| Borrow additional sums at long-term fixed interest rates   | Debt interest costs will rise; this is unlikely to be fully offset by higher investment income | Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain            |
| Borrow higher percentage of short-term or variable loans instead of long-term fixed rates            | Debt interest costs will initially be lower  | Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain |
| Reduce level of borrowing  | Saving on debt interest is likely to exceed lost investment income                             | Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain            |

## Annex A - Arlingclose Economic & Interest Rate Forecast November 2017

### Underlying assumptions:

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

### Forecast:

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.
- The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

|                           | Dec-17 | Mar-18 | Jun-18 | Sep-18 | Dec-18 | Mar-19 | Jun-19 | Sep-19 | Dec-19 | Mar-20 | Jun-20 | Sep-20 | Dec-20 | Average |
|---------------------------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|--------|---------|
| <b>Official Bank Rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.00   | 0.00   | 0.00   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.19    |
| Arlingclose Central Case  | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50    |
| Downside risk             | 0.00   | 0.00   | 0.00   | 0.00   | 0.00   | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.15   |
| <b>3-month LIBID rate</b> |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.10   | 0.10   | 0.10   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.25   | 0.22    |
| Arlingclose Central Case  | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50   | 0.50    |
| Downside risk             | -0.10  | -0.10  | -0.15  | -0.15  | -0.15  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.25  | -0.20   |
| <b>1-yr LIBID rate</b>    |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.15   | 0.15   | 0.20   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.30   | 0.27    |
| Arlingclose Central Case  | 0.70   | 0.70   | 0.70   | 0.70   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.80   | 0.77    |
| Downside risk             | -0.15  | -0.20  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.30  | -0.15  | -0.15  | -0.26   |
| <b>5-yr gilt yield</b>    |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.20   | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.32    |
| Arlingclose Central Case  | 0.75   | 0.75   | 0.80   | 0.80   | 0.80   | 0.85   | 0.90   | 0.90   | 0.95   | 0.95   | 1.00   | 1.05   | 1.10   | 0.89    |
| Downside risk             | -0.20  | -0.20  | -0.25  | -0.25  | -0.25  | -0.35  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.33   |
| <b>10-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.20   | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.32    |
| Arlingclose Central Case  | 1.25   | 1.25   | 1.25   | 1.25   | 1.25   | 1.30   | 1.30   | 1.35   | 1.40   | 1.45   | 1.50   | 1.55   | 1.55   | 1.36    |
| Downside risk             | -0.20  | -0.25  | -0.25  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.40  | -0.33   |
| <b>20-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.20   | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.32    |
| Arlingclose Central Case  | 1.85   | 1.85   | 1.85   | 1.85   | 1.85   | 1.90   | 1.90   | 1.95   | 1.95   | 2.00   | 2.05   | 2.05   | 2.05   | 1.93    |
| Downside risk             | -0.20  | -0.30  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.45  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.38   |
| <b>50-yr gilt yield</b>   |        |        |        |        |        |        |        |        |        |        |        |        |        |         |
| Upside risk               | 0.20   | 0.25   | 0.25   | 0.25   | 0.30   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.35   | 0.40   | 0.32    |
| Arlingclose Central Case  | 1.70   | 1.70   | 1.70   | 1.70   | 1.70   | 1.75   | 1.80   | 1.85   | 1.90   | 1.95   | 1.95   | 1.95   | 1.95   | 1.82    |
| Downside risk             | -0.30  | -0.30  | -0.25  | -0.25  | -0.30  | -0.35  | -0.40  | -0.45  | -0.50  | -0.50  | -0.50  | -0.50  | -0.50  | -0.39   |



## Annex B - Existing Investment & Debt Portfolio Position

|  | 30 Nov 17<br>Actual Portfolio<br>£m | 30 Nov 17<br>Average Rate<br>% |
|--|-------------------------------------|--------------------------------|
| <b>External borrowing:</b>               |                                     |                                |
| Public Works Loan Board - Fixed          | 38.3                                | 5.3                            |
| Public Works Loan Board - Variable       | 13.5                                | 0.6                            |
| Local authorities                        | 42.9                                | 0.3                            |
| LOBO loans from banks                    | 13.6                                | 4.8                            |
| Other loans                              | 4.9                                 | 0.0                            |
| <b>Total external borrowing</b>          | <b>113.2</b>                        |                                |
| <b>Other long-term liabilities:</b>      |                                     |                                |
| Private Finance Initiative               | 0.8                                 |                                |
| Other                                    | 0.4                                 |                                |
| <b>Total other long-term liabilities</b> | <b>1.2</b>                          |                                |
| <b>Total gross external debt</b>         | <b>114.4</b>                        |                                |
| <b>Treasury investments:</b>             |                                     |                                |
| Banks & building societies (unsecured)   | 0.0                                 |                                |
| Government (incl. local authorities)     | 3.7                                 |                                |
| Money Market Funds                       |                                     |                                |
| <b>Total treasury investments</b>        | <b>6.4</b>                          | 0.2                            |
| <b>Net debt</b>                          | <b>108.0</b>                        |                                |

|                                       | 31 Mar 17<br>£m | Annualised Return<br>% |
|---------------------------------------|-----------------|------------------------|
| <b>Non-treasury investments:</b>      |                 |                        |
| Investment property                   | 41.9            | 1%                     |
| Investment assets classed as L&B      | 4.4             | 6% *                   |
| Shares in subsidiaries                | 0.0             | -                      |
| Loans to subsidiaries                 | 0.0             | -                      |
| Loans to local companies              | 0.0             | -                      |
| <b>Total non-treasury investments</b> | <b>46.3</b>     |                        |

\* This % return excludes MRP or repayments of borrowed capital

## **Annex C – MRP Policy Statement 2017/18**

The Welsh Government's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Welsh Ministers and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

Authorities are permitted discretion in terms of the charge levied, albeit within certain parameters. A "prudent" period of time for debt repayment is defined as being one which reflects the period over which the associated capital expenditure provides benefits.

The four MRP options available are:

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

*Note: This does not preclude other prudent methods.*

### **MRP in 2018/19:**

Options 1 and 2 can only be used for supported Non-HRA capital expenditure funded from borrowing (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government). Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses).

The MRP Statement will be submitted to Council before the start of the 2018/19 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

### **MRP on Supported Borrowing funded Expenditure**

The Authority's policy is to apply Option 3 in respect of supported capital expenditure funded from borrowing. A report received by Council on 17<sup>th</sup> November 2016 approved this change to 2% straight line, asset life basis.

### **MRP on Unsupported Borrowing funded Expenditure**

The Authority's policy is to apply Option 3 in respect of unsupported capital expenditure funded from borrowing. The MRP is calculated on an annuity basis within the asset life method, whereby the MRP element increases over time to reflect a consistent charge over the assets life taking into account the real value of money.

### **MRP in respect of leases and PFI**

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the CIPFA Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

The 2018/19 budget proposals reflect these 3 positions.

## DRAFT PRUDENTIAL INDICATORS for Programme Proposals 2018/22

Local Authorities determine their own programmes for capital investment in fixed assets. The Prudential Code is the code of practice supporting local authorities in taking decisions and underpins the system of capital finance. The key objectives of the Prudential Code are to ensure, within the Prudential Framework, that capital investment plans of the Authority are affordable, prudent and sustainable.

To demonstrate that local authorities have fulfilled these objectives, the Prudential Code sets out the indicators that must be used, and the factors that must be taken into account. These indicators are reported below based on actual, current and planned capital budget proposals as in the proposed 2018/2019 capital medium term financial plan.

Importantly, it should be noted that the proposed supported and unsupported borrowing results from the current and future capital budget proposals:

Borrowing budgeted in the capital budget proposals 2018/19 to 2021/22 is as follows: The 2018/19 figures are inclusive of £6,000,000 of slippage from 2017/18 as estimated in the draft 2018/19 MTFP on which these indicators are based.

- General Unsupported borrowing of £1,000,000 2018/19 to 2021/22.
- 21<sup>st</sup> Century Schools – budgeted unsupported borrowing of £7,547,000 and £4,070,000 (adjusted for slippage) in 2017/18 and 2018/19.
- Other budgeted unsupported borrowing of £1,658,000 in 2017/18 including £506,000 for the Solar Farm and £550,000 for carparks. And in 2018/19, £2,283,000 for the Abergavenny Community Hub and £1,400,000 for the refurbishment of J block at County Hall, Usk
- £2,402,000 of supported borrowing in 2017/18 and £2,410,000 in 2018/19 to 2021/22 which assists in financing the core capital programme and is funded through Revenue Support grant from the Welsh Government.

## Capital Expenditure

The actual capital expenditure and financing (excluding vehicle leasing) that was incurred in 2016/17 and the estimates of capital expenditure and financing for the current year and future years that are recommended for approval are:

|                     | 2016/17<br>Actual<br>£000 | 2017/18<br>Estimate<br>£000 | 2018/19<br>Estimate<br>£000 | 2019/20<br>Estimate<br>£000 | 2020/21<br>Estimate<br>£000 | 2021/22<br>Estimate<br>£000 |
|---------------------|---------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|-----------------------------|
| Capital Expenditure | 41,684                    | 48,645                      | 28,805                      | 6,623                       | 5,863                       | 6,120                       |

The estimate of capital expenditure for the 2017/18 and 2018/19 financial years includes allowance for estimated slippage of expenditure from the 2017/18 capital programme.

As stated in the Capital programme budget proposals the medium term programme has been drafted, and a programme constructed for the next four years. There will be opportunity for the programme to be reviewed annually.

### Ratio of financing costs to net revenue stream

Estimates of the ratio of financing costs to net revenue stream for the current and future years, and the actual figures for 2014/15 are:

|  | <b>2016/17<br/>Actual<br/>%</b> | <b>2017/18<br/>Estimate<br/>%</b> | <b>2018/19<br/>Estimate<br/>%</b> | <b>2019/20<br/>Estimate<br/>%</b> | <b>2020/21<br/>Estimate<br/>%</b> | <b>2021/22<br/>Estimate<br/>%</b> |
|--|---------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| Ratio of financing costs to net revenue stream | 4.33                            | 4.79                              | 5.18                              | 5.13                              | 5.19                              | 5.10                              |

The estimates of financing costs include current commitments and the proposals in this budget report and are based on the actual and anticipated borrowing, net of investments.

### Capital Financing Requirement

Estimates of the end of year Capital Financing Requirement for the Authority for the current and future years and the actual Capital Financing Requirement at 31 March 2017 are:

|                               | <b>2016/17<br/>Actual<br/>£000</b> | <b>2017/18<br/>Estimate<br/>£000</b> | <b>2018/19<br/>Estimate<br/>£000</b> | <b>2019/20<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2021/22<br/>Estimate<br/>£000</b> |
|-------------------------------|------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Capital Financing Requirement | 134,588                            | 143,219                              | 155,484                              | 159,345                              | 157,820                              | 156,553                              |

The Capital Financing Requirement measures the authority's underlying need to borrow for capital purposes. In accordance with best professional practice, Monmouthshire County Council does not associate borrowing with particular items or types of expenditure, other than under its current policy for determining its Minimum Revenue Provision. The authority has an integrated treasury management strategy (last approved on 9<sup>th</sup> March 2017 by Council) and has adopted the CIPFA Code of Practice for Treasury Management in the Public Services.

The Council manages its treasury position in terms of its borrowings and investments in accordance with its approved treasury management strategy and practices. In day-to-day cash management, no distinction can be drawn between revenue and capital cash. External borrowing arises as a consequence of all the financial transactions of the authority and not simply those arising from capital spending. In contrast, the Capital Financing Requirement reflects the authority's underlying need to borrow for a capital purpose.

CIPFA's Prudential Code for Capital Finance in Local Authorities includes a key indicator of prudence where Gross External Borrowing does not, except in the short term exceed the total of Capital Financing Requirement. This is the case for the preceding year plus the estimates of any Capital Financing Requirement for the current and next two financial years.

Net external borrowing is the borrowing budgeted to finance the capital programme (Gross External borrowing) offset by the levels of cash and investments.

|                               | <b>2016/17<br/>Actual<br/>£000</b> | <b>2017/18<br/>Estimate<br/>£000</b> | <b>2018/19<br/>Estimate<br/>£000</b> | <b>2019/20<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2021/22<br/>Estimate<br/>£000</b> |
|-------------------------------|------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Net External borrowing        | 84,904                             | 119,597                              | 135,110                              | 133,207                              | 127,449                              | 127,081                              |
| Gross External borrowing      | 89,329                             | 125,305                              | 140,289                              | 139,046                              | 132,897                              | 133,090                              |
| Capital Financing Requirement | 134,588                            | 143,219                              | 155,484                              | 159,345                              | 157,820                              | 156,553                              |

The Head of Finance, as the Authority's S151 officer, reports that the Authority had no difficulty meeting this requirement in 2016/17, nor are any difficulties envisaged for the current or future years. This view takes into account current commitments, existing plans, and the proposals in this budget report.

### **Authorised Limit for External Borrowing**

In respect of external debt, it is recommended that the Council approves the following Authorised Limit for its total external debt gross of investments for the next four financial years.

|                             | <b>2016/17<br/>Actual<br/>£000</b> | <b>2017/18<br/>Estimate<br/>£000</b> | <b>2018/19<br/>Estimate<br/>£000</b> | <b>2019/20<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> |
|-----------------------------|------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Borrowing                   | 123,529                            | 170,917                              | 191,489                              | 190,246                              | 184,097                              | 184,290                              |
| Other long term liabilities | 2,707                              | 2,543                                | 2,843                                | 2,643                                | 2,443                                | 2,368                                |
| <b>Total</b>                | <b>126,236</b>                     | <b>173,460</b>                       | <b>194,332</b>                       | <b>192,889</b>                       | <b>186,540</b>                       | <b>186,658</b>                       |

These limits separately identify borrowing from other long-term liabilities. The Council is asked to approve these limits and to delegate authority to the Head of Finance, within the total limit for any year, to effect movement between the separately agreed limits of borrowing and other long-term liabilities, in accordance with option appraisal and best value for money for the authority. Any such changes made will be reported to the Audit Committee or Council at the next opportunity following the change.

These limits are consistent with the authority's current commitments, existing plans and draft budget proposals for capital expenditure and financing, and with its approved treasury management policy statement and practices. They are based on the estimate of the most likely, prudent but not worse case scenario, with sufficient headroom over and above this to allow for operational management, for example unusual cash movements.

### **Operational Boundary for External Debt**

The Council is also asked to approve the following Operational Boundary for external debt for the same period.

|                 | <b>2016/17<br/>Actual<br/>£000</b> | <b>2017/18<br/>Estimate<br/>£000</b> | <b>2018/19<br/>Estimate<br/>£000</b> | <b>2019/20<br/>Estimate<br/>£000</b> | <b>2020/21<br/>Estimate<br/>£000</b> | <b>2021/22<br/>Estimate<br/>£000</b> |
|-----------------|------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|--------------------------------------|
| Borrowing       | 103,329                            | 140,717                              | 161,289                              | 160,046                              | 153,897                              | 154,090                              |
| Other long term | 1,207                              | 1,043                                | 1,343                                | 1,143                                | 943                                  | 868                                  |

|             |                |                |                |                |                |                |
|-------------|----------------|----------------|----------------|----------------|----------------|----------------|
| liabilities |                |                |                |                |                |                |
|             | <b>104,536</b> | <b>141,760</b> | <b>162,632</b> | <b>161,189</b> | <b>154,840</b> | <b>154,958</b> |

The proposed Operational Boundary for external debt is based on the same estimates as the Authorised Limit but reflects the estimate of the most likely, prudent but not worst case scenario, without the additional headroom included within the Authorised Limit to allow, for example, for unusual cash movements and equates to the maximum of external debt projected by this estimate.

The Operational Boundary represents a key management tool for in-year monitoring by the Head of Finance. Within the Operational Boundary, figures for borrowing and other long-term liabilities are separately identified. The Council is asked to delegate authority to the Head of Finance, within the total Operational Boundary for any individual year, to effect movement between the separately agreed figures for borrowing and other long term liabilities, in a similar fashion to the Authorised Limit. Any such changes will be reported to the Audit Committee or Council at the next opportunity following the change.

The Council's actual external debt at 31 March 2017 was £90.5 million, comprising £89.3 million borrowing and £1.2 million other long-term liabilities. It should be noted that the actual external debt is not directly comparable to the Authorised Limit and Operational Boundary, since the actual external debt reflects the position at one point in time.

In taking its decisions on the 2018/19 budget report, the Council is asked to note that the Authorised Limit determined for 2018/19 would be the statutory limit determined under section 3(1) of the local Government Act 2003.

### **Incremental impact of new capital investment decisions on Council Tax**

A key measure of affordability is the incremental impact on the Council Tax, and the Council should consider different options for its capital investment programme in relation to their differential impact on the Council Tax.

The incremental impact works on the basis that supported borrowing is funded through Revenue Support Grant. The calculation is therefore determined by establishing the revenue impact of:

- Unsupported borrowing – in terms of interest payments and the statutory Minimum Revenue Provision (MRP)
- Any revenue savings or costs that have been identified and that will result from capital schemes being delivered

The current capital budget proposals, using current information available, would have the following impact:

|                              | <b>2016/17<br/>Actual<br/>£ p</b> | <b>2017/18<br/>Estimate<br/>£ p</b> | <b>2018/19<br/>Estimate<br/>£ p</b> | <b>2019/20<br/>Estimate<br/>£ p</b> | <b>2020/21<br/>Estimate<br/>£ p</b> | <b>2021/22<br/>Estimate<br/>£ p</b> |
|------------------------------|-----------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Effect on Band D Council Tax | 40.50                             | 17.19                               | 15.27                               | 3.10                                | 2.46                                | 2.89                                |

The incremental impact is reducing with time as the amount of Capital expenditure on the 21 Century schools is coming to an end.

**Joy Robson**  
**Responsible Financial Officer**