AGENDA ITEM TBC

REPORT

SUBJECT:	**Treasury Management Policy Statement & Strategy Statement, MRP Policy Statement and Investment Strategy 2017/18**
DIRECTORATE:	**Resources**
MEETING:	**Council**
DATE:	**9th March 2017**
DIVISION/WARDS AFFECTED:	**Countywide**

1. PURPOSE:

1.1 To adopt the annual Treasury Management Policy Statement and the Treasury Management Strategy Statement including the Investment and Borrowing Strategies for 2017/18 to 2020/21 and the Minimum Revenue Provision (MRP) Statement for 2017/18 at Annex C.

1.2 This proposed Strategy and Policy will be monitored during the year by Audit Committee.

2. RECOMMENDATIONS:

2.1 It is recommended that the proposed Treasury Management Policy Statement for 2017/18 (Appendix 2) and proposed Treasury Management Strategy and Investment & Borrowing Strategies 2017/18 to 2020/21 (Appendix 1), including the Minimum Revenue Provision (MRP) Statement for 2017/18 at Annex C, be approved together with the Treasury Limits as required by section 3 of the Local Government Act 2003.

3. BACKGROUND

Treasury Management Policy Statement and Treasury Management and Annual Investment & Borrowing Strategy

3.1 Treasury Management is defined 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".

3.2 The Authority pays due regard to CIPFA's Code of Practice for Treasury Management in the Public Services (the "Code") and accompanying Guidance Notes (as revised in 2011) and the Prudential Code for Capital Finance in Local Authorities (as revised in 2011). The Prudential Code for Capital finance in local authorities outlines requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy.

3.3 The Prudential Code further requires the Council to set a number of Prudential and Treasury Management indicators. These indicators are submitted with the capital budget proposals that are to be considered at the same meeting, Council 9th March 2017.

3.4 The Council also has regard to the WG Guidance on Local Government Investments. This guidance requires the production of an Investment Strategy in addition to a Treasury Management Strategy, and allows Councils to combine these two strategies into one document. Appendix 1 contains the Councils detailed proposed investment strategy. With regards to investments the Codes and Guidance emphasise an appropriate approach to risk management, particularly in relation to the security and liquidity of invested funds. Authorities are required to demonstrate value for money when borrowing in advance of need and ensure the security of such funds.

3.5 The Code requires that Council approve annually a Treasury Management Policy Statement and a Treasury Management Strategy Statement and Investment Strategy. The Council also has regard to the revised Welsh Government (WG) guidance on Local Government Investments issued in April 2010.

3.6 Furthermore, as a minimum, the Code requires that the Authority formally report on their treasury activities and arrangements at the mid-year point and after the year-end. Audit Committee is identified as being the committee responsible for reviewing update reports on the treasury function, given its overarching role in assessing the risk management arrangements for the Authority. It received its last such report at its meeting of 17th November 2016, given a cancellation of its meeting on 13th October.

3.7 The Council delegates responsibility for 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 2) and treasury management practices and CIPFA's Standard of Professional Practice on Treasury Management.

3.8 The Council is also clear that overall responsibility for treasury management remains with the Council.

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.

3.10 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. Annex C of the attached Treasury Management Strategy and Investment Strategy (Appendix 1) incorporates the Council's Statement in this regard and captures the full extent of changes approved by members as part of their 2016-17 and 2017-18 pre-budget considerations.

Considerations influencing strategy

3.11 Bail-in legislation, which ensures that large unsecured investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and European Union and Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes now in force mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with Local Authorities making unsecured bank deposits has therefore increased since early 2015.

3.12 These changes have resulted in the loss of Government support for failing banks and have therefore affected the ratings given to these banks by the ratings agencies. Alongside the effects of bail in however, many banks have strengthened their own core capital position and are therefore less likely to fail. Thirdly, the Ratings agencies, Fitch, Moody's and Standard and Poors have adapted their rating methodologies to give an uplift to institutions which have other factors such as parent companies which could assist them with the absorbency of losses either externally or from within.

3.13 As a result of these changes the number of counterparties with a rating of A- or higher which the Authority can invest with is similar to 2016/17. It is recognized however that it is not prudent to invest large sums of money with any one counterparty to reduce the effect of any one bail in affecting the Council disproportionately. Due to the stance that we will maximize internal borrowing and given our investment balances will therefore remain low, this is not expected to be an issue, but in order to be prudent and to encourage diversification across a larger number of counterparties, a prudent limit of the higher of 10% total investments or of £2m per counterparty has been set for unsecured investments with banks and building societies whose rating is A- or above. This category represents the majority of our investments. Other limits have been set (see Appendix 1) for other types of investments.

3.14 The Authority's current account provider is Barclays bank. At the time of writing, Barclays continues to have a minimum rating of (A-). An additional limit of £1m has been set to allow for the total of overnight credit balances held in the Authority's current accounts even if the bank's rating should fall to (BBB) or it should be put on credit watch negative. This is to allow for the total of all credit balances, as the Authority does not have the right to a legal offset of its current account balances that it enjoyed with its previous provider. The total of all positive and negative account balances are reduced to a practical minimum level at the end of each day.

4. PROPOSED STRATEGY CHANGES:

4.1 Whilst the Council's appetite to risk and the rating indicator level we adopt as a standard as a result isn't proposed to change, individual counterparties rating indicators and circumstances do change fairly frequently to reflect their organizational resilience to markets and their reported performance, so it is commonplace for our actual counterparty usage to change during any one year as parties meet our expectations and others fade away.

4.2 Similarly interest rates and growth predictions will continually change over time and rebalance. This has not resulted in a proposed change to either our borrowing or investment strategy which continues to revolve around active management involving short term recurrent investment and borrowing decisions and utilising internal borrowing to mitigate our net borrowing costs and avoid material cost of carry appreciating longer term borrowing costs are invariably above equivalent investment rates.

4.3 The risk of bank bail-in is still a very real consideration for any Council lending function. The result of which is an increase in inter Council lending, we're also starting to see a move away from local authorities lending by way of <u>unsecured</u> bank and building society deposits in favour of covered bonds, gilts, repurchase agreements (repos), supranational securities agencies (SSAs) and asset backed securities (ABS) which represent a much safer more appropriate alternative in this climate. Our historic Council Strategy already provides sufficient flexibility in the use of some of these instruments, but irrespective, our investment trend is on the decline given our strategy and the Liability benchmark graph including in Appendix 1 demonstrates an increasing borrowing need.

4.4 Consequently there is very little active change proposed with 2017-18 strategy, other than re-imposing a percentage limit alongside an absolute £2m investment limit for unsecured investments and the revision to the Supported borrowing minimum revenue provision considered and approved by Members during 2016-17 which is captured in Appendix 1 annex C. The Strategy will be monitored during the year by the Audit committee, however given the minimal changes to the Strategy for 2017/18 it has not been considered by Audit committee prior to being considered by full Council.

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 2017-2018 revenue budget proposals to be presented to Council on 9th March 2017, 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 2017/18 or later 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 Strategy Statement & Investment Strategy 2017/18 (including MRP policy statement)
Appendix 2 – Treasury Management Policy Statement 2017/18
Appendix 3 – Prudential Indicators

10. AUTHORS:

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Appendix 1

Treasury Management Strategy Statement 2017/18

(supplied by Council's Treasury Advisors – Arlingclose)

Introduction

In Mar 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, or in the Authority's capital programme or in the level of its investment balance.

External Context

Economic background: The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future 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. 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 continue to fall.

Interest rate forecast: The Authority's treasury adviser, Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18**.** The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. Arlingclose's central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

A more detailed economic and interest rate forecast provided by Arlingclose at the end of this Appendix.

For the purpose of setting the budget for 2017/18, 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 1.40%.

Local Context

On 31st December 2016, the Authority currently held £77.9m of borrowing and £9.3m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.16 Actual £m	**31.3.17 Estimate £m**	**31.3.18 Forecast £m**	**31.3.19 Forecast £m**	**31.3.20 Forecast £m**
General Fund CFR	114	126	134	133	131
Less: Other debt liabilities *	-1	-1	-1	-1	-1
Borrowing CFR	**113**	**125**	**133**	**132**	**130**
Less: External borrowing **	-92	-77	-65	-66	-66
Internal/ (over) borrowing	**21**	**48**	**68**	**66**	**64**
Less: Usable reserves	-23	-26	-14	-13	-18
Working capital	2	0	0	0	0
New borrowing / (Investments) required	0	22	54	53	46

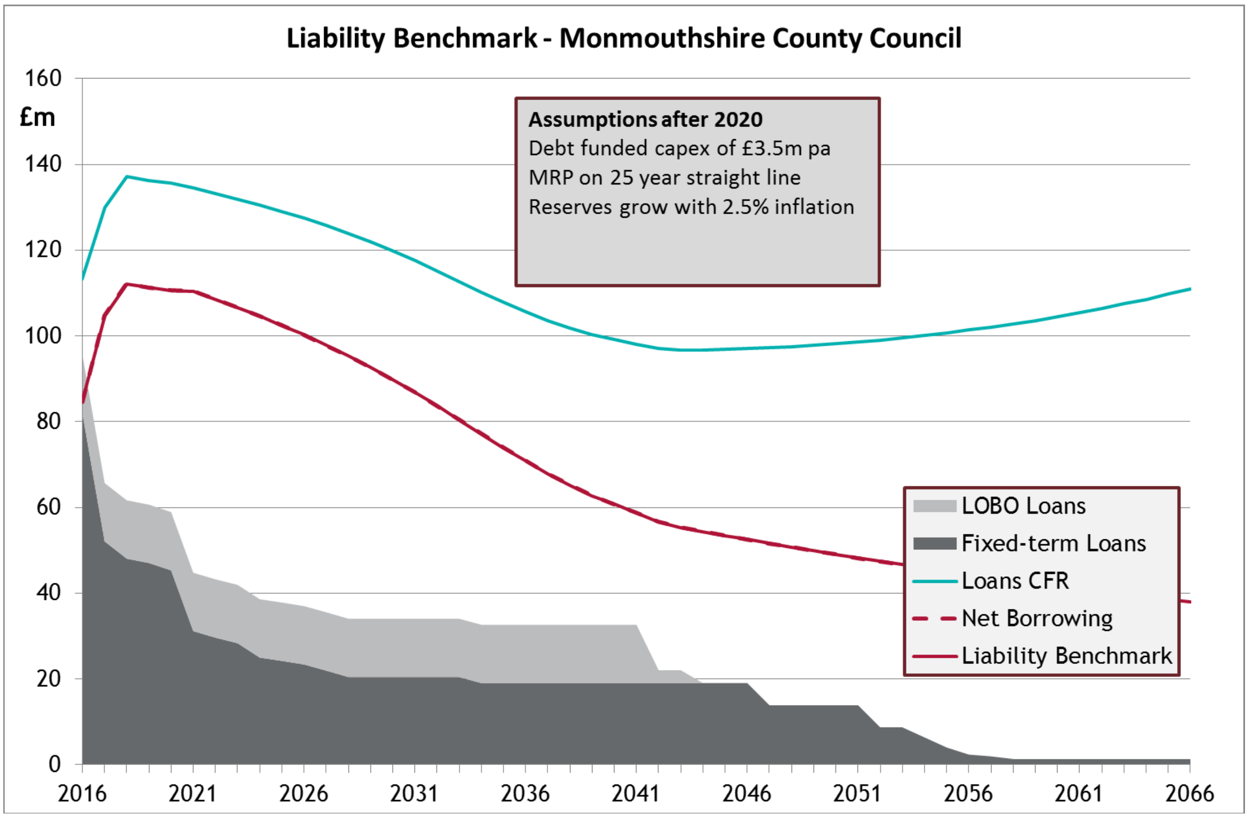
* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt
** shows only loans to which the Authority is committed and excludes optional refinancing

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the 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 minimal investments and will therefore be required to borrow up to £54m over the forecast period. This includes financing of new borrowing, renewal of current short term borrowing and borrowing required to replace capital receipts previously used for internal borrowing.

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 2017/18.

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 beyond the period described in table 1 above for 50 years.



The level of borrowing required is given by the gap between red, liability benchmark line and the grey areas which denote the level of existing borrowing i.e. there will be a significant level of borrowing required into the foreseeable future.

Borrowing Strategy

The Authority held £78 million of loans at 31st December 2016, a decrease of £14 million from 31st March 2016. This is mainly due to cash coming into the Authority due to a large capital receipt and also grants in advance of need which have not yet been fully utilised, which in turn has allowed the level of internal borrowing to increase temporarily. The balance sheet forecast in table 1 shows that the Authority expects to borrow up to a total of £119m in 2017/18. This includes £5m of 4.5/5 year PWLB loans taken out in February 2017.

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 of internal / short-term borrowing will be monitored regularly against the potential for incurring additional costs 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 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2017/18, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

Sources: 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)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except our local Pension Fund the GGPF)
- capital market bond investors
- Special purpose companies created to enable local authority bond issues

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

The Authority has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans that may be available at more favourable rates. In 2015/16 & 2016/17 the Council was able to access the Project rate from the PWLB, 0.2% lower than the Certainty rate.

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 as 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 2017/18, 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. In the past 12 months, the Authority's investment balance has ranged between nil and £41 million. These higher levels are not expected in 2017/18. As borrowing levels are forecast to increase during 2017/18, keeping Investment balances low will reduce the level and costs of borrowing required. In order to keep balances low but sufficient for daily operations, will require working closely with staff running schemes with large cash flows so these can be factored in.

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. As balances are anticipated to be low, these is not expected to be a major factor.

Negative Interest Rates: If the UK enters into a recession in 2017/18, 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 falling 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 2017/18. Due to the anticipated low levels of surplus cash, the majority of the Authorities surplus cash remains invested in short-term unsecured bank and 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 supersede the limits set below. Investments classified as Non Specified must obtain further approval before implementation see page 9.

Table 2: Approved Investment Counterparties and Limits

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

Secured Investments with Banks, Building Societies, Other Organisations and Securities, (including Re-po's) whose lowest published rating from Fitch, Moody's and S&P's is (A-)	**75% of total investments at the time of deposit (both secured and unsecured) For Non-UK 50% of total investments at the time of deposit (both secured and unsecured)**	**£4m per counterparty (both secured and unsecured)**	**£4m per foreign country for all investment types**	**N/A**	**13 months**
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	**25% of total investments**	**£1m per Counterparty**	**UK only**	**N/A**	**100 Days**
Money Market Funds with a Constant Net Asset Value (CNAV) or Variable Net Asset Value if assessed by our Treasury advisers as	**50% of total investments at the time of deposit increased to 75% if total investments is £10m or less**	**The lower of £2m and 10% of total investments rounded up to the next £0.5m; not exceeding 0.50% of MMF size or**	**N/A**	**N/A**	**N/A**

being of high credit worthiness		**2% for Government MMFs**			
Pooled funds without credit ratings which are not classed as capital expenditure - if assessed by our Treasury advisers as being of high credit worthiness	**£4m total investment at the time of deposit**	**£2m per issuer**	**N/A**	**N/A**	**N/A**
Investments with UK Registered Providers (e.g. Housing Associations) where the lowest published credit rating is A- or higher	**£4m of total investments at the time of deposit.**	**£2m per issuer**	**N/A**	**N/A**	**5 years**

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.

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. 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 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.

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 in 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 comprise long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement; those that are defined as capital expenditure by legislation, such as shares in pooled funds; 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.

<u>Table 3: Non-Specified Investment Limits</u>

	Cash limit
Total long-term investments	£5m
Total shares in pooled funds excluding MMF's	£4m
Total investments without credit ratings or rated below [A-]	£3m
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [A-]	£0m
Total non-specified investments	£10m

Investment Limits: The Authority's revenue reserves available to cover investment losses are forecast to be £14 million on 31st March 2017. In order that no more than 30% of the average 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 £4.0m for secured investments or £2.0 million for unsecured investments to banks & building societies. The amount that is put at risk in the case of a single default should therefore be no more than 30% (secured) or 15% (unsecured) of average reserves, levels which 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, foreign countries and industry sectors 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.

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 score of its investment portfolio. This 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] *or* [score]	*e.g.* [A-] *or* [5.0]

Liquidity: The Authority has adopted a voluntary measure of its exposure to liquidity risk. Where cash is forecast to drop below £2m in the following 5 working days, additional short term borrowing should be taken out. Where cash falls below £1m this should be reported to the S151 officer or deputy.

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 as follows:

	Existing Level 31.12.16	**2016/17 Approved £m**	**2017/18 £m**	**2018/19 £m**	**2019/20 £m**
Upper limit on fixed interest rate exposure	46.9	100.0	100.0	100.0	100.0
Upper Limit on Net Variable Interest Rate Exposure	21.2	50.0	58.0	50.0	50.0

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.

In the table above, LOBO loans have been classed as fixed rate instruments. The Authority is currently paying a fixed rate of interest. They may be called at each 6 monthly interval, but this outcome is not expected in the current interest rate climate and they could be replaced with a PWLB loan at a lower rate of interest if this did occur.

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 will be:

	Level at 31/12/16 % - £m	Lower Limit for 2017/18 %	Upper Limit for 2017/18 %
Under 12 months – LOBO's	27% - £13.6m	0	50
Under 12 months – Other	6% - £3.0m	0	
12 months and within 24 months	0% - £0.0m	0	25
24 months and within 5 years	10% - £4.9m	0	45
5 years and within 10 years	15% - £7.7m	0	30
10 years and above	42% - £20.7m	0	100
TOTAL	100% - £49.9m		

Time periods start on the first 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:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£5m	£5m	£5m

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 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 with 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 £147 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 2017/18 is £8,600, based on an average investment portfolio of £5.7 million at an interest rate of 0.15%. The budget for debt interest paid in 2017/18 is £3.0 million, based on an average debt portfolio of £102 million at an average interest rate of 2.9% being made up of a mixture of long and short 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/S151 officer, 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.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of lower risk counterparties 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 including some which may have higher risk 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 at long-term fixed interest rates instead of short term	Debt interest costs will rise in the short term but may level out in the medium term; this is unlikely to be offset by higher investment income in the short term	Long-term interest costs may be more certain
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise in the short term and medium term; this is unlikely to be 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 more / even shorter-term or variable loans instead of long-term fixed interest rates	Debt interest costs will initially be lower but this is more time consuming for the treasury team	Debt interest costs will reduce in the short term but the benefit will reduce in the medium / long term; long term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income; But there is a minimum level of cash that can sensibly be managed due to the uncertainty of cash flow requirements. Emergency loans at high costs may need to be taken out.	Reduced investment balance leading to a lower impact in the event of a default OR the Authority could run out of cash required to carry out its day to day activities. Long-term interest costs may be less certain

Annex A- Arlingclose Economic & Interest Rate Forecast November 2016

Assumptions underpinning the proffered strategy:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.

- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.

- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.

- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.

- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely.

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.

- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	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	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	**0.12**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.40**
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.18**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.29**
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.34**
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.60**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**	**0.65**
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.24**
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**	**0.45**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**0.96**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**

20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.60**	**1.40**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.41**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**

Annex B - Existing Investment & Debt Portfolio Position

	31st Dec 2016 **Actual Portfolio £m**
External Borrowing:	
Public Works Loan Board Fixed rate	**33.3**
Public Works Loan Board Variable rate	**13.5**
Local authorities (S/T)	**17.0**
Welsh Government Loans	**0.5**
LOBO loans from banks	**13.6**
Total External Borrowing	**77.9**
Other Long Term Liabilities:	
PFI	0.8
Other deferred liabilities	0.4
Total Gross External Debt	79.1
Investments:	
Banks & building societies (unsecured)	5.9
Government (incl. local authorities)	0.0
Money Market Funds	3.4
Total Investments	9.3
Net Debt	69.8

Annex C – MRP 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.

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.

<u>MRP in 2017/18:</u>

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 2017/18 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 current policy is to apply Option 2 in respect of supported capital expenditure funded from borrowing. A report received by Council on 17th November 2016 approved a change from a 4% reducing balance approach to a 2% straight line basis.

MRP on Unsupported Borrowing funded Expenditure

The Authority's policy is to apply Option 3 (asset lives basis) in respect of unsupported capital expenditure funded from borrowing. A report received by Council on 17th December 2015 approved a change to the annuity 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 2017-18 budget proposals reflect these 3 positions.

Appendix 2

TREASURY MANAGEMENT POLICY STATEMENT 2017/18

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 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.

Appendix 3

Prudential Indicators for Capital Programme Proposals 2017/2021

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 2017/2021 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 2017/18 to 2020/21 is as follows: The 2017/18 figures are inclusive of slippage from 2016/17 as identified and reported as part of the month 6 capital monitoring process.

- General Unsupported borrowing of £1,000,000 2017/18 to 2020/21.
- 21st Century Schools – budgeted unsupported borrowing of £12,453,000 and £8,155,000 (adjusted for slippage) in 2016/17 and 2017/18.
- The solar farm – budgeted unsupported borrowing of £4,805,000 in 2016/17.
- £2,400,000 of supported borrowing in 2016/17 and £2,402,000 in 2017/18 to 2020/21 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 2015/16 and the estimates of capital expenditure and financing for the current year and future years that are recommended for approval are:

	2015/16 Actual £000	**2016/17 Estimate £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Capital Expenditure	18,845	50,911	41,029	13,900	6,141	5,391

The estimate of capital expenditure for the 2016/17 and 2017/18 financial years includes allowance for slippage of expenditure from the 2016/17 capital programme that was forecast at month 6 capital monitoring.

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:

	2015/16 Actual %	**2016/17 Estimate %**	**2017/18 Estimate %**	**2018/19 Estimate %**	**2019/20 Estimate %**	**2020/21 Estimate %**
Ratio of financing costs to net revenue stream	6.08	4.40	4.70	6.32	6.23	6.20

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 2016 are:

	2015/16 Actual £000	**2016/17 Estimate £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Capital Financing Requirement	114,077	126,429	134,256	132,576	130,947	128,942

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 10th March 2016 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.

	2015/16 Actual £000	**2016/17 Estimate £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Net External borrowing	83,411	84,811	111,811	103,811	96,811	95,811
Gross External borrowing	94,811	84,811	111,811	103,811	96,811	95,811
Capital Financing Requirement	114,077	126,429	134,256	132,576	130,947	128,942

The Head of Finance, as the Authority's S151 officer, reports that the Authority had no difficulty meeting this requirement in 2015/16, 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.

	2015/16 Actual £000	**2016/17 Limit set £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**
Borrowing	123,811	119,012	147,423	144,816	143,311	142,311
Other long term liabilities	2,737	2,707	2,677	2,647	2,617	2,587
Total	**126,548**	**121,719**	**150,100**	**147,463**	**145,928**	**144,898**

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 the proposals in this budget report 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.

	2015/16 Actual £000	2016/17 Limit Set £000	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020 Estimate £000
Borrowing	102,811	98,812	127,233	124,616	123,111	122,111
Other long term liabilities	1,237	1,207	1,177	1,147	1,117	1,087
	104,048	**100,019**	**128,400**	**125,763**	**124,228**	**123,198**

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 2016 was £96.0 million, comprising £94.8 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 this budget report, the Council is asked to note that the Authorised Limit determined for 2017/18 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:

	2015/16 Actual £ p	2016/17 Estimate £ p	2017/18 Estimate £ p	2018/19 Estimate £ p	2019/20 Estimate £ p	2020/21 Estimate £ p
Effect on Band D Council Tax	2.03	36.85	17.17	2.52	2.58	1.88

The notable incremental impact in 2016/17 is due to the high level of borrowing required to fund the 21C schools programme.

Joy Robson
Responsible Financial Officer