

Treasury Management Strategy Report 2018/19

1 Introduction

1.1 Background

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

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

CIPFA defines treasury management as:

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

The European Union (EU) published the final text of the second Markets in Financial Instruments Directive (MiFID II) in May 2014, aiming to improve the functioning of financial markets in light of the financial crisis and to strengthen investor protection. The new rules come into effect on 3rd January 2018.

Although the UK has voted to leave the EU, MiFID II will still be implemented in the UK for three reasons. Firstly, we remain members of the EU and subject to its laws until we leave; secondly, the UK government is in favour of strengthening investor protection; and thirdly, UK firms will wish to continue providing financial services across the EU after we have left, so will need to comply with equivalent regulations.

Local authorities are currently treated by regulated financial services firms as professional clients (e.g. large businesses, which can be expected to employ professional staff with greater knowledge and therefore need less protection) who can “opt down” to be treated as retail clients (e.g. individuals and small businesses, which are expected to have the least knowledge of financial markets and therefore need the most protection) instead.

Due to the criteria that is set out by MiFID II the Council will be treated as a retail client, which provides additional protection, although limits the Council to regulated investments and, potentially, a lower net investment return.

1.2 Statutory Reporting Requirements

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

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

- the capital plans (including prudential indicators);
- a minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time);

- the treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators; and
- an investment strategy (the parameters on how investments are to be managed).

A mid year treasury management report – This will update members with the progress of the capital position, amending prudential indicators as necessary, and whether any policies require revision.

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

Scrutiny

The above reports are required to be adequately scrutinised before being recommended to the Council. This role is undertaken by both the Audit and Standards Committee and the Finance, Resources and Partnerships Scrutiny Committee.

1.3 Treasury Management Strategy for 2018/19

The strategy for 2018/19 covers two main areas:

Capital Issues

- Prudential indicators;
- The Minimum Revenue Provision (MRP) Policy (Annex C).

Treasury Management Issues

- the current treasury position;
- treasury indicators which limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy and debt rescheduling;
- policy on borrowing in advance of need;
- the investment strategy (Annex A);
- creditworthiness policy (counterparty listing criteria) (Annex B);
- policy on use of external service providers; and
- treasury management glossary of terms (Annex D).

These elements cover the requirements of the Local Government Act 2003, the Chartered Institute of Public Finance and Accountancy (CIPFA) Prudential Code, Department for Communities and Local Government (DCLG) MRP Guidance, the CIPFA Treasury Management Code and DCLG Investment Guidance.

CIPFA consulted on changes to the Prudential Code in 2017, but has yet to publish a revised Code.

The Authority has invested 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.

In accordance with the DCLG 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.

1.4 Treasury Management Consultants

The Council uses Arlingclose Ltd for its external treasury management advice service for the period 1st April 2017 to 31st March 2020.

The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

Changes to the provision of the external treasury management advice service may occur subject to the impact of the MiFID II legislation that is commencing from 3rd January 2018.

2 Prudential and Treasury Indicators

2.1 Background

This report incorporates a number of Prudential Indicators in relation to treasury management in accordance with the CIPFA Prudential Code for Capital Finance in Local Authorities ("the Code"). Regulations to the Local Government Act 2003 lay down that the Council shall have regard to the Prudential Code in determining an affordable borrowing limit.

The indicators are intended to demonstrate that the Council has fulfilled the objective of ensuring that its capital investment decisions are prudent, affordable and sustainable – or in exceptional cases to demonstrate that there is a danger of not ensuring this, so that timely remedial action can be taken. They are further designed to ensure that treasury management decisions are taken in a manner that supports prudence, affordability and sustainability.

2.2 Capital Prudential Indicators

Actual and Estimate of Capital Expenditure

This indicator relating to Actual and Estimates of Capital Expenditure is reported separately to the Council meeting which sets the General Fund Revenue Budget and the Council Tax (21 February 2018).

The Council's Borrowing Need (the Capital Financing Requirement)

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

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

The CFR includes any other long term liabilities (e.g. PFI schemes, finance leases). Whilst these increase the CFR, and therefore the Council's borrowing requirement, these types of scheme include a borrowing facility and so the Council is not required to separately borrow for these schemes.

The Council is asked to approve the CFR projections below:

31/03/17 Actual (£000's)	31/03/18 Estimate (£000's)	31/03/19 Estimate (£000's)	31/03/20 Estimate (£000's)	31/03/21 Estimate (£000's)
828	6,000	5,000	4,000	3,000

The amounts shown above from 2018/19 onwards allow the Council to borrow during those years to finance capital expenditure which cannot be funded from other revenue or capital resources.

However, the likelihood of individual schemes, the timings and the amounts involved cannot be assessed with certainty at this point.

The sale of Council assets for capital receipts will have a significant impact upon the CFR, if sales are made the Council's borrowing requirement will be reduced, if not the Council's borrowing requirement will be greater.

2.3 Affordability Prudential Indicators

Estimates of the Incremental Impact of Capital Investment Decisions on Council Tax

This indicator relating to Estimates of the Incremental Impact of Capital Investment Decisions on Council Tax is reported separately to the Council meeting which sets the General Fund Revenue Budget and the Council Tax (21 February 2018).

Actual and Estimates of the Ratio of Financing Costs to Net Revenue Stream

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

Financing Costs comprise the aggregate of: interest payable, interest receivable and investment income; the amount charged as MRP; depreciation and impairment charges that have not been reversed out of the revenue account.

Net Revenue Stream is defined as the 'amount to be met from government grants and local taxpayers'. This is the Council's 'budgetary requirements' figure shown in the General Fund Revenue Budget, being the net expenditure for the year before deducting government grants (Revenue Support and Business Rates Retention) and adjusting for the Collection Fund surplus/deficit. The relevant figures for this Council are set out in the table below:

	2016/17 Actual (£000's)	2017/18 Estimate (£000's)	2018/19 Estimate (£000's)	2019/20 Estimate (£000's)	2020/21 Estimate (£000's)
Net Revenue Stream	14,132	13,825	13,466	13,067	13,136
Financing Costs	(101)	59	59	59	59
Ratio	(0.71%)	0.43%	0.44%	0.45%	0.45%

2.4 Treasury Indicators

Current Portfolio Position – Debt

Currently the Council has no long term external debt and is categorised as a 'debt free' authority. Short term external loans (i.e. repayable on demand or within 12 months) can be taken to fund any temporary capital or revenue borrowing requirement. The amounts involved would fluctuate according to the cash flow position at any one time. Such short term borrowing does not affect the Council's 'debt free' status.

Any surplus funds arising, for example from favourable cash flow or as a result of asset sales, are potentially available for use as an alternative to short term borrowing. The Actual External Debt of the Council as at the end of the previous financial year is a Prudential Indicator. This indicator comprises actual borrowing (short and long term) as shown in the Council's balance sheet. This indicator will reflect the actual position at one point in time. As at 31 March 2017 the Actual External Debt of the Council was nil.

Delays in receiving capital receipts (in respect of the Ryecroft redevelopment scheme), together with the Council's overall capital financial position, will mean that the Council will have to borrow, at least in the short term, to finance its interest in the Public Sector Hub project. Therefore this would affect the Council's 'debt free' status.

Current Portfolio Position – Investments

It is forecast that at 1 April 2018 the amount of receipts in hand will only enable the Council to make minimal investments.

Limits to Borrowing Activity

The Local Government Act 2003 requires each local authority to determine and keep under review how much money it can afford to borrow. This is to be determined by the calculation of an affordable borrowing limit which Regulations to the Act specify should be calculated with regard to the CIPFA Prudential Code.

Previously borrowing has not been used to fund the capital programme because the Council has had sufficient reserves and useable capital receipts to finance capital expenditure from these sources.

There will be a requirement to fund some capital expenditure by means of borrowing during the interim period before a permanent means of finance becomes available, for example whilst awaiting a capital receipt. As well as borrowing required for capital purposes, it may also be necessary to temporarily borrow in order to cover any temporary shortfall in revenue income which may arise owing to either a mismatch between income and expenditure or problems concerning the non payment of amounts due to be paid by the Council's customers. These factors have been taken into account in calculating the Prudential Indicators referred to below.

Projections of the need for capital investment in projects necessary to ensure operational continuity over the next few years, together with projections of likely capital receipts arising from asset sales and the availability of reserves to finance this expenditure indicate that there will be an adverse gap between expenditure and resources to finance it. This increases the likelihood of borrowing being used over the period of this strategy, particularly as an interim measure to bridge the gap between expenditure being incurred and funds from asset sales being realised. The amounts included for permitted borrowing in the Operational Boundary and Authorised Limit below take account of this. It should be noted that this does not indicate a definite intention at this point in time to borrow up to this amount but is required to permit the option of borrowing to be employed, if necessary.

The Operational Boundary

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

Operational boundary	2018/19 Estimate (£000's)	2019/20 Estimate (£000's)	2020/21 Estimate (£000's)	2021/22 Estimate (£000's)
Borrowing	7,500	7,500	7,500	7,500
Other long term liabilities	0	0	0	0

The Authorised Limit for External Borrowing

A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council. It reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term.

This is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

The Council is asked to approve the following authorised limit:

Authorised limit	2018/19	2019/20	2020/21	2021/22
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	Estimate (£000s)	Estimate (£000's)	Estimate (£000's)	Estimate (£000's)
Debt	15,000	15,000	15,000	15,000
Other Long Term Liabilities	0	0	0	0

Sources of Borrowing

Temporary borrowing can take place via money brokers, from building societies, banks, local authorities, individuals and commercial organisations. If the Council decides to borrow on a long term basis to fund capital expenditure all borrowing options available will be reviewed.

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
- capital market bond investors.

Interest Rates, Loan Periods and Types of Loan

The most favourable options will be selected, depending upon market conditions prevailing at the time of borrowing. The aim will be to minimise the impact upon revenue accounts and to achieve efficient management of the Council's debt portfolio. Advice will be taken, as appropriate from the Council's treasury management advisors. The Council will be eligible for loans at a reduced rate, around 20 basis points less than normally available, (the Treasury Certainty Rate) from the PWLB during 2018/19.

Limits on Interest Rate Exposures (fixed and variable interest rates)

The following limits will apply in relation to the Council's interest rate exposure. They relate to interest on both borrowings and investments. These limits are intended to reduce the risk of the Council suffering unduly from significant adverse fluctuations in interest rates.

Limit on Fixed Interest Rate Exposures (as a percentage of total borrowings / investments)

	Borrowing		Investments	
	Upper	Lower	Upper	Lower
2018/19	100%	0%	100%	0%
2019/20	100%	0%	100%	0%
2020/21	100%	0%	100%	0%
2021/22	100%	0%	100%	0%

Limit on Variable Interest Rate Exposures (as a percentage of total borrowings/ investments)

	Borrowing		Investments	
	Upper	Lower	Upper	Lower
2018/19	100%	0%	100%	0%
2019/20	100%	0%	100%	0%
2020/21	100%	0%	100%	0%
2021/22	100%	0%	100%	0%

In relation to both investing and borrowing fixed rate investments and loans may be anything between 0% and 100% of the total, with the same proportions being permitted for variable rate loans – in effect there is no limit on each type. This enables maximum flexibility to be afforded to your officers to take advantage of prevailing interest trends to obtain the best deal for the Council.

Total Principal Funds Invested for Periods Greater than 364 days

The Council will determine the maximum periods for which funds may prudently be committed. Investments will be for whatever period is considered appropriate by your officers at the time that the investment is made. Regard will be had to relevant matters such as likely future capital values and the Council's forecast need to realise investments in the future in order to finance capital expenditure or for any other purpose.

There will be a limit placed upon the amount which may be invested for periods in excess of 364 days. Investments will be regarded as commencing on the date the commitment to invest is entered into, rather than on the date on which the funds are paid over to the Counterparty.

This Treasury Indicator is intended to limit the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment of sums invested. It consists of the amount that it is considered prudent to have invested for a period greater than 364 days in each of the next three years. The limits as set out in the table below will apply:

	£000's
Beyond 31/03/18	5,000
Beyond 31/03/19	5,000
Beyond 31/03/20	5,000

It should be noted that in practice the sums available for investment are unlikely to be sufficient to allow amounts of this magnitude to be invested for such extended periods. In fact at present investments are being restricted to periods of one month or less due to cash flow fluctuations and on account of continuing uncertainties with regard to the credit worthiness of counterparties with whom investments could be placed.

3 Leasing

3.1 Requirement for the Year

In previous years the Council has acquired some items of plant by means of leases and major items of equipment may also be obtained in the same way.

The total amount of leases to be entered into during the year will depend upon the replacement requirement for vehicles and plant and upon any new requirements arising during the year. It will also depend upon the attraction of leasing as opposed to other forms of finance which may be available, in particular in comparison with contract hire terms for vehicles and plant and the availability and relative cost of internal sources of funding. The appropriate form of finance will be chosen to obtain the best deal for the Council at the time that the requirement arises.

An appropriate lease period will be chosen in relation to the type of asset concerned and to achieve the most satisfactory revenue account impact. Fixed or variable rate leases may be taken out; which is used will depend upon market conditions prevailing at the time the decision is made.

3.2 Leasing Consultants

The current contract with the Council's treasury management advisors includes the provision of leasing advice.

4 Treasury Management Training

4.1 Training Courses

The training need regarding treasury management officers is periodically reviewed. Officers engaging in Treasury Management activities will also attend any suitable courses/seminars provided by the Council's treasury management advisors and any other appropriate organisations where it is considered that this will increase or complement their expertise in relation to the Treasury Management function.

5 Policy on the use of External Service Providers

- 5.1 Officers work with the Council's treasury management advisors to monitor market trends and to advise on strategic considerations affecting borrowing strategy and sums available for investment and any other relevant treasury management matters. Quarterly meetings are held to ensure quality of service is maintained and to develop a constructive relationship. The current contract, awarded to Arlingclose Ltd, was awarded until 31 March 2020.

6 Prospects for Interest Rates

- 6.1. Part of the service provided by the Council's advisors is to assist the Council to formulate a view on interest rates. The following table and information gives the current provider's central view:

	Mar 2018	Sep 2018	Mar 2019	Sep 2019	Mar 2020	Sep 2020	Mar 2021
Bank Rate	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%	0.50%

6.2. Economic Situation (highlights of the report supplied by Arlingclose Ltd)

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%.

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.

7 Treasury Management Scheme of Delegation

7.1 Full Council

- Receiving and reviewing the Treasury Management Strategy / Annual Investment Strategy / Minimum Revenue Provision Strategy on an annual basis (including updates and revisions at other times).
- Receiving the Annual Treasury Outturn Report.

7.2 Finance, Resources and Partnerships Scrutiny Committee

- Scrutiny of the Treasury Management Strategy prior to submission to Full Council.

7.3 Audit and Standards Committee

- Scrutiny of Treasury Management performance including receiving and reviewing the mid-year report.
- Reviewing the Annual Treasury Outturn Report

8 Treasury Management role of the Section 151 Officer

8.1 The S151 (responsible) Officer Role

- Recommending clauses, treasury management policy / practices for approval, reviewing the same regularly, and monitoring compliance;
- Submitting regular treasury management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the treasury management function;
- Ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- Recommending the appointment of external service providers.

Investment Strategy 2018/19**1 Introduction****1.1 Background**

This strategy is compiled according to the DCLG's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code") It sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments (and finally what return can be obtained consistent with these priorities).

In accordance with the above and in order to minimise the risk to investments, the Council has (in Annex B) clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. Using the advisor's ratings service, bank's ratings are monitored in real time with knowledge of any changes notified electronically as the agencies notify any modifications.

The aim of this strategy is to generate a list of highly creditworthy counterparties which will also enable diversification and avoid the concentration of risk. The intention of the strategy is to provide security of investment and minimisation of risk.

1.2 Possible Revisions to the Strategy

The initial strategy may be replaced with a revised strategy at any time during the year in cases where any treasury management issues (including investment issues) need to be brought to the attention of Full Council.

2 Security of Investments**2.1 Specified and Non-Specified Investments**

In accordance with the Investment Guidance, the Council will, in considering the security of proposed investments, follow different procedures according to which of two categories, Specified or Unspecified, the proposed investment falls into.

Specified Investments

These investments are sterling investments of not more than one-year maturity, or those which could be for a longer period but where the Council has the right to be repaid within 12 months if it wishes. These are considered low risk assets where the possibility of loss of principal or investment income is small. These would include sterling investments which would not be defined as capital expenditure with:

- The UK Government (such as the Debt Management Account deposit facility, UK Treasury Bills or a Gilt with less than one year to maturity);
- Supranational bonds of less than one year's duration;
- A local authority, parish council or community council;
- Pooled investment vehicles (such as money market funds) that have been awarded a high credit rating by a credit rating agency;
- A body that is considered of a high credit quality (such as a bank or building society).

Non-Specified Investments

These investments are any other type of investment (i.e. not defined as Specified above). If the Council were to consider placing funds in any other type of investment which would be categorised as Non-Specified, the security of the capital sum would be the paramount concern.

The same requirements as to credit ratings relating to Specified Investments will apply, and in appropriate cases the advice of the Council's treasury management advisors will be sought.

In considering whether it is prudent to place funds for longer than 12 months in 2018/19 and in determining the period of such investment the principles and limits set out under "3 - Liquidity of Investments" below will apply together with the counterparty listing criteria set out in Annex B.

2.2 Use of Treasury Management Advisor's Creditworthiness Service

This Council uses the creditworthiness service provided by the Council's treasury management advisors. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies, Fitch, Moody's and Standard and Poor's.

Credit ratings are obtained and monitored by the Council's treasury management advisers, who will notify the Council of any 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.

2.3 Approved Investment Instruments

The Council has laid down a list of approved investment instruments in the Schedule to Treasury Management Practice 4 (TMP4). These are reproduced below:

Extract from Schedule to TMP 4

"The following types of investments will be permitted, fixed cash deposits, certificates of deposit issued by organisations falling into the categories listed under TMP1 (5), registered British Government Securities (Gilts) and Money Market Funds. Officers of the Council may only invest in Fixed Cash Deposits and Money Market Funds."

Because fund managers are not currently employed this means that investments in 2018/19 will be limited to fixed cash deposits (including deposit accounts and current accounts), money market funds and the Debt Management Account Deposit Facility (DMADF). The DMADF is guaranteed by HM Government and offers investors a flexible and secure facility to supplement their existing range of investment options.

3 Liquidity of Investments

3.1 Maximum Investment Periods

The Council will determine the maximum periods for which funds may prudently be committed. Investments will be for whatever period is considered appropriate by officers at the time that the investment is made. Regard will be had to relevant matters such as likely future capital values and the Council's forecast need to realise investments in the future in order to finance capital expenditure or for any other purpose. The principles concerning time limits contained in the Schedule to the Treasury Management Practices will be followed.

There will be a limit placed upon the amount which may be invested for periods in excess of 364 days. This limit has been set using one of the Prudential Indicators required by the Chartered

Institute of Public Finance and Accountancy Prudential Code for Capital Finance in Local Authorities. Investments will be regarded as commencing on the date the commitment to invest is entered into, rather than on the date on which the funds are actually paid over to the Counterparty.

This Prudential Indicator is intended to limit the Council's exposure to the possibility of loss that might arise as a result of it having to seek early repayment of sums invested. It consists of the amount that it is considered prudent to have invested for a period greater than 364 days in each of the next three years. The limits as set out in the table below will apply:

	£000's
Beyond 31/03/19	5,000
Beyond 31/03/20	5,000
Beyond 31/03/21	5,000

It should be noted that in practice the sums available for investment are unlikely to be sufficient to allow amounts of this magnitude to be invested for such extended periods.

4 Return on Investments (Yield)

4.1 Current Economic Climate

Due to ongoing global economic uncertainties, investment returns are likely to remain relatively low during 2018/19. Interest rates on Instant access deposit accounts and Notice accounts have previously been more attractive than interest rates being offered by the market. However, banks have now reduced the rates they offer on their instant access and notice accounts.

4.2 Prudent Investments

Priority will be given to the security and liquidity of all investments. Consistent with achieving the proper levels of security and liquidity, the highest rate of return will be sought for any investment made.

5 Specific Strategy 2018/19

5.1 Capital Receipts in Hand and Balances Held in Reserves

Amount Available for Investment

It is estimated that there shall be minimal receipts in hand or reserve balances for investing as at 1 April 2018.

Period of Investment

This will be determined in accordance with 3 - Liquidity of Investments above.

Forward Commitment

This involves agreeing in advance to place an investment with a borrower at a future specified date at an agreed interest rate. It is done in order to obtain the benefit of what are considered to be better rates than might be available later, when physical funds are likely to be available. No forward commitment has taken place to date in 2017/18. It is possible that forward commitments may be employed in 2018/19 in instances where market conditions warrant it.

Return on Investment

The overriding consideration is safeguarding the Council's capital. At all times the risk to the Council will be minimised. Within these constraints, the aim will be to maximise the return on investments.

5.2 Investment of Money Borrowed in Advance of Need

It is not the Council's intention to undertake any borrowing in advance of need during 2018/19.

5.3 Other Temporary Surpluses

Amount Available for Investment

In addition to the receipts and reserve balances referred to above, the Council will, from time to time, find itself in possession of funds in excess of its immediate requirements. This may occur, for example, if income is received at a faster rate than expenditure is incurred or if grant payments are made to the Council in advance of the expenditure being incurred to which they relate. This is not a permanent state of affairs and the extent to which it will occur and, therefore, the amounts available at any time cannot be predicted.

Prudent financial management dictates that these temporary surpluses should be invested or used to redeem temporary loans if any are outstanding. Such surpluses may be placed in short term deposit accounts and current accounts, or, where the size of the surplus warrants, short term investments will be made in the market.

Capital receipts which arise during the year, as a result of asset sales, will be held in the Capital Receipts Account pending use until the monies are invested. When useable receipts are required to finance capital expenditure, or for any other purpose, the amount will be disinvested and utilised.

Period of Investment

All temporary surplus funds will be invested on a short term basis in order that they will be available for use as and when required. This requirement has been recognised in the calculation of the Prudential Indicator relating to total principal sums invested for periods longer than 364 days set out earlier.

Return on Investment

The aim will be to obtain the maximum rate of return which is available at the time the investment is made with an external body. This must, however, be consistent with the safeguarding of the Council's capital. At all times the risk to the Council will be minimised.

5.4 Current Treasury Management Advisors – view on Interest Rates

Part of the service provided by the Council's treasury management advisors is to assist the Council in the formulation of a view on interest rates; the following gives their view of the Bank of England base rate for financial year ends:

- 31st March 2019 – 0.50%
- 31st March 2020 – 0.50%
- 31st March 2021 – 0.50%

There are negative risks to these forecasts (i.e. increases in Bank Rate occur later) if economic growth weakens. However, should the pace of growth quicken, there could be benefits.

Counterparty Listing Criteria

This Council applies the creditworthiness service provided by Arlingclose Ltd. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies - Fitch, Moody's and Standard and Poor's.

Arlingclose Ltd. then recommend the maximum unsecured duration that monies should be invested for with individual banks and building societies.

The creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system, does not give undue superiority to just one agency's ratings. All credit ratings will be monitored daily. The Council is alerted to changes to ratings of all three agencies through its use of the advisor's creditworthiness service.

If a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on any external support for banks to help support its decision making process. The Council will also consider using other Local Authorities when making fixed investments.

Country and Counterparty Limits

The Council has determined that it will only use approved counterparties from countries with a minimum sovereign credit rating of A+ from Fitch Ratings (or equivalent from other agencies if Fitch does not provide).

In accordance with Treasury Management Practice (TMP) 4 – Approved Instruments, Methods and Techniques, a £7,000,000 counterparty limit will be used during 2018/19. This limit will not apply to the Government's Debt Management Account Deposit Facility offered by the Debt Management Office.

Minimum Revenue Provision Policy

1.0 Background

- 1.1** In instances whereby Local Authorities have a positive Capital Financing Requirement (CFR), Department of Communities and Local Government (DCLG) Guidance requires them to adopt a prudent approach in order to fund the repayment of debt. This may be achieved by setting aside a minimum amount from revenue, known as the Minimum Revenue Provision (MRP). This means that the Council would be required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the MRP).

DCLG Regulations and Guidance have been issued which require the Full Council to approve an **MRP Statement** in advance of each year. Four options for prudent provision of the MRP are provided to councils, these being:

• **Option 1 – Regulatory Method**

For debt which is supported by the Government through the Revenue Support Grant system, authorities may continue to use the formulae in the current regulations, since the Revenue Support Grant is calculated on that basis. Although the existing regulation 28 is revoked by regulation 4(1) of the 2008 Regulations, authorities will be able to calculate MRP as if it were still in force. Solely as a transitional measure, this option will also be available for all capital expenditure incurred prior to 1 April 2008.

• **Option 2 – Capital Financing Requirement Method**

This is a technically much simpler alternative to Option 1 which may be used in relation to supported debt. While still based on the concept of the CFR, which is easily derived from the balance sheet, it avoids the complexities of the formulae in the old regulation 28 (though for most authorities it will probably result in a higher level of provision than Option 1).

• **Option 3 – Asset Life Method**

For new borrowing under the Prudential system for which no Government support is being given and is therefore self-financed, there are two options included in the guidance.

Option 3 is to make provision over the estimated life of the asset for which the borrowing is undertaken. This is a possibly simpler alternative to the use of depreciation accounting (Option 4), though it has some similarities to that approach.

Within option 3, two methods are identified. The first of these, the equal instalment method, will normally generate a series of equal annual amounts over the estimated life of the asset. The original amount of expenditure (“A” in the formula) remains constant.

The cumulative total of the MRP made to date (“B” in the formula) will increase each year. The outstanding period of the estimated life of the asset (“C” in the formula) reduces by 1 each year.

For example, if the life of the asset is originally estimated at 25 years, then in the initial year when MRP is made, C will be equal to 25. In the second year, C will be equal to 24, and so on. The original estimate of the life is determined at the outset and should not be varied thereafter, even if in reality the condition of the asset has changed significantly

The formula allows an authority to make voluntary extra provision in any year. This will be reflected by an increase in amount B and will automatically ensure that in future years the amount of provision determined by the formula is reduced.

The alternative is the annuity method, which has the advantage of linking MRP to the flow of benefits from an asset where the benefits are expected to increase in later years. It may be

particularly attractive in connection with projects promoting regeneration or administrative efficiencies or schemes where revenues will increase over time.

- **Option 4 – Depreciation Method**

Alternatively, for new borrowing under the Prudential system for which no Government support is being given, Option 4 may be used.

This means making the MRP in accordance with the standard rules for depreciation accounting. A step in this direction was made in the last set of amendments to the MRP rules [SI 2007/573]. However, the move to reliance on guidance rather than regulations will make this approach more viable in future.

Authorities will normally need to follow the standard procedures for calculating depreciation provision. But the guidance identifies some necessary exceptions:

- a. The MRP continues until the total provision made is equal to the original amount of the debt and may then cease.
- b. If only part of the expenditure on the asset was financed by debt, the depreciation provision is proportionately reduced.

2.0 MRP Policy in respect of Finance Leases

- 2.1 The introduction of International Financial Reporting Standards in 2011/12 resulted in some leases being reclassified as finance leases instead of operating leases. This resulted in a positive CFR and as such the need to set aside a MRP.

In accordance with the revised DCLG Guidance this Council will set aside an annual MRP equal to the amount of the lease that has been taken to the Balance Sheet to reduce the finance lease liability i.e. the principal amount of the finance lease. This approach will produce an MRP charge which is the same as Option 3 in the guidance (Asset Life Method – annuity method). The revised guidance aims to ensure that authorities are in the same position as if the change in accounting standards had not occurred.

3.0 MRP Policy – Other Capital Expenditure

3.1 Capital Financing Requirement (CFR)

The Council's CFR is currently positive. This means that there is a requirement to set aside a MRP for the redemption of debt. The Prudential Indicator for the CFR, shown at 2.2 in the Treasury Management Strategy, indicates that the CFR will become positive within the period covered by the Strategy. This is based on the assumption that there will be a general overall increase in expected capital expenditure, which cannot be funded from revenue or capital resources. Accordingly, the Council needs to determine the option it will employ to make the necessary MRP in respect of the amount borrowed, when this occurs.

3.2 Option for making MRP.

The most appropriate of the four options permitted by the Regulations is Option 3, the Asset Life Method, within which there are two further options, an equal instalment method and an annuity method (as detailed in 1.1 – option 3). The Council is permitted to apply either of these two further options to projects on a scheme by scheme basis.

It should be noted that MRP does not commence until the year following that in which the asset concerned became operational, however, voluntary MRP can be made at any given time if considered prudent.

ANNEX D

Treasury Management – Glossary of Terms

- **Basis Points** – there are 100 basis points to 1%.
- **CDS** – ‘Credit Default Swap’ is an additional assessment of credit worthiness by providing a risk analysis of changes in credit quality as perceived by the market.
- **CFR** – the Capital Financing Requirement is the total historic outstanding capital expenditure which has not yet been paid for from either revenue or capital resources.
- **CIPFA** – the Chartered Institute of Public Finance and Accountancy, is the professional body for accountants working in Local Government and other public sector organisations.
- **Counterparty** – an institution with whom a borrowing or investment transaction is made.
- **CPI** – a measure that examines the weighted average of prices of a basket of consumer goods and services. The Consumer Price Index is calculated by taking price changes for each item in the predetermined basket of goods/services and averaging them; the goods are weighted according to their importance. Changes in CPI are used to assess price changes associated with the cost of living.
- **Credit Rating** – is an opinion on the credit-worthiness of an institution, based on judgements about the future status of that institution. The main rating agencies are Fitch. Standard and Poor’s and Moody’s.
- **DCLG** – Department for Communities and Local Government.
- **Depreciation** – the measure of the cost or revalued amount of the benefits of the fixed asset that have been consumed during the period. Consumption includes wearing out, using up or other reduction in the useful life of a fixed asset whether arising from use, time or obsolescence through either changes in technology or demand for the goods and services produced by the asset.
- **DMADF and DMO** – the DMADF is the ‘Debt Management Account Deposit Facility’ which is a highly secure fixed term deposit account with the Debt Management Office, part of Her Majesty’s Treasury.
- **Forward Commitments** - agreeing in advance to place an investment with a borrower at a future specified date at an agreed interest rate.
- **GDP** – Gross Domestic Product is the market value of all officially recognised final goods and services produced within a country in a given period of time.
- **GILTS** – the name given to bonds issued by the UK Government. Gilts are issued bearing interest at a specified rate, however, they are traded on the markets like shares and their value rises or falls accordingly. The ‘yield’ on a gilt is the interest paid divided by the market value of that gilt.
- **IFRS (International Financial Reporting Standards)** – International accounting standards that govern the treatment and reporting of income and expenditure in an organisation’s accounts, which came fully into effect from 1 April 2010.
- **Impairment Charges** – a reduction in the value of a fixed asset below its carrying amount on the balance sheet.
- **Intangible Assets** – non-financial fixed assets that do not have physical substance but are identifiable and are controlled by the Council through custody or legal rights. Specifically purchased software licenses are included in this category of asset.

- **Leasing** - a lease is a contractual arrangement calling for the lessee (user) to pay the lessor (owner) for use of an asset.
- **Liquidity** – relates to the amount of readily available or short term investment money which can be used for either day to day or unforeseen expenses. For example Call Accounts allow instant daily access to invested funds.
- **Money Market Funds (MMF)** – Money Market Funds are investment funds that are invested by a Fund Manager in a wide range of money market instruments. MMF's are monitored by the official ratings agencies and due to many requirements that need to be fulfilled; the funds usually receive the highest quality rating (AAA) so provide minimal risk. They are very flexible and can be withdrawn in the same way as any other call deposit.
- **MPC** – interest rates are set by the Bank of England's Monetary Policy Committee. The MPC sets an interest rate it judges will enable the inflation target to be met
- **MRP** – the Minimum Revenue Provision represents the revenue charge for the repayment of debt.
- **PWLB** – the Public Works Loan Board is a statutory board that is run within the UK Debt Management Office (DMO), its function is to lend money to Local Authorities and other prescribed bodies.
- **Section 151 Officer** – it is a legal requirement that councils must appoint a named accountant to give them financial advice. The accountant in question is usually a chief finance officer, director of finance or treasurer.
- **Supranational Bonds** – bonds issued by institutions such as the European Investment Bank.