LICENSING & GENERAL PURPOSES COMMITTEE
29 JANUARY 2018

HEAD OF FINANCIAL SERVICES
REPORT NO. FIN1802

ANNUAL TREASURY MANAGEMENT STRATEGY 2018/19 AND PRUDENTIAL INDICATORS FOR CAPITAL FINANCE

SUMMARY AND RECOMMENDATIONS:

SUMMARY:

The Council is required to approve a Treasury Management Strategy for 2018/19 before 1 April 2018.

CIPFA has conducted reviews of the "Prudential Code" and the "Treasury Management Code of Practice" in 2017, and the Ministry of Housing, Communities and Local Government (MHCLG) has also recently undertaken consultation on treasury management issues. However, at the current time neither of these institutions have produced additional definitive new reference and guidance. The attached Treasury Management Strategy Statement (TMSS) for 2018/19 at Appendix A is therefore prepared in accordance with the existing 2011 CIPFA Treasury Management Code of Practice and the 2010 MHCLG Investment Guidance.

RECOMMENDATION:

Members are requested to recommend to Cabinet:

(i) Approval of the Treasury Management Strategy, Annual Borrowing Strategy and Annual Investment Strategy attached at Appendix A;
(ii) Approval of the Prudential Indicators set out in Appendix B; and
(iii) Approval of the Minimum Revenue Provision (MRP) Statement set out in Appendix C.

1. INTRODUCTION

1.1 This report sets out the proposed Treasury Management Strategy for the year 2018/19, including the borrowing and investment strategies and treasury management indicators, the Prudential Indicators for capital finance for 2018/19 and the Minimum Revenue Provision Statement.

1.2 The Council has 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.

1.3 CIPFA has conducted reviews of the “Prudential Code” and the “Treasury Management Code of Practice”. These reviews have been particularly focused on ‘non-treasury’ investments, especially the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or the use of existing cash balances) to raise the cash to finance such activities. However, whilst CIPFA produced finalised codes in December 2017 associated guidance and explanatory advice remains outstanding. The MHCLG have also undertaken consultation on treasury management issues during 2017 but no definitive new guidance has been produced at the current time.

1.4 In the absence of detailed guidance and explanatory advice therefore the Treasury Management Strategy (TMSS) for 2018/19 at Appendix A is therefore prepared in accordance with the 2010 MHCLG Investment Guidance and the 2011 CIPFA Treasury Management Code of Practice.

1.5 It is expected that CIPFA and the MHCLG will provide further definitive guidance possibly within months. Should this be the case then revision and update to the Treasury Management Strategy for 2018/19 may be required during the year 2018/19.

2. PURPOSE

2.1 The purpose of the treasury management operation is to ensure that cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in counterparties or instruments commensurate with the Council’s low risk approach, pursuing optimum performance while ensuring that security of the investment is considered ahead of investment return. The Council is required to operate a balanced budget, which broadly means that cash raised during the year will meet cash expenditure.

2.2 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 the Council can meet its capital spending obligations. The management of longer term cash may involve the arrangement of long and/or short term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing).

2.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management 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”.*

2.4 The purpose of Prudential Indicators is to set a framework for affordable, prudent and sustainable capital investment.

2.5 The appendices (A to C) set out the Treasury Management Strategy and the Prudential Indicators for 2018/19 to 2021/22 and fulfil key legislative requirements as follows:

Appendix A

- The **Treasury Management Strategy** which sets out how the Council's treasury service will support capital decisions taken during the period, the day to day treasury management and the limitations on activity through treasury prudential indicators, in accordance with CIPFA's Code of Practice on Treasury Management and Prudential Code;
- The **Annual Borrowing Strategy** which sets out the Council's objectives for borrowing together with the approved sources of long and short-term borrowing and;
- **Annual Investment Strategy** which sets out the Council's criteria for choosing investment counterparties and limiting exposure to the risk of loss, in accordance with MHCLG Investment Guidance.

Appendix B

- The setting of **Prudential Indicators** and the expected capital activities for the period as required by CIPFA's Prudential Code for Capital Finance in Local Authorities.

Appendix C

- The Council's **Minimum Revenue Provision (MRP) Statement,** which sets out how the Council will pay for capital assets through revenue each year, as required by the Local Government Act 2003 (Regulations 27 and 28 in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003). It should be noted that Government guidance expected to be issued in the coming months is most likely to include a reference to the maximum useful economic life of 50 years for freehold land and 40 years for other assets. The Council's Minimum Revenue Provision (MRP) Statement is therefore suitably updated in expectation of this guidance.

2.6 These policies and parameters provide an approved framework within which officers undertake the day-to-day capital and treasury activities.

3. SCOPE

3.1 This report covers the Council's treasury management activities as set out in paragraphs 2.1 and 2.2 above. The funds invested consist of short-term cash available due to timing of income and expenditure i.e. from movements in working capital, or from reserves that need to be available in the short term, and potentially longer-term investment funds derived from the Council's capital receipts.

3.2 Arlingclose advice continues to indicate that the Council should diversify investment risk (spreading smaller amounts over an increasing number of counterparties) wherever possible. The Council is now progressively incurring further borrowing, and Arlingclose have advised that in the circumstances of some current specific investments reaching their maturity date(s) the Council should not replace them. This strategy allows for a natural reduction in overall investments balance during a period when borrowing is increasing.

3.3 The Council incurred prudential code borrowing in 2016/17 in the sum of £6.548m in relation to its capital expenditure. Further borrowing to support the financing of its approved capital programme in the year 2017/18 will also be required. It therefore commences the year 2018/19 in a position where its investment holdings continue to remain significant (although, less than in previous financial years) but it also carries some accumulating debt. There will be an inevitable requirement to incur some further borrowing to service capital expenditure in future years.

3.4 Careful observation of the Prudential Indicator "gross debt v capital financing requirement" will need to be undertaken progressively throughout the financial year. This means that the Council will may need to redeem an element of its core pooled fund investments at some time in the future in order to adhere to the requirements of this Indicator.

AMANDA FAHEY **HEAD OF FINANCIAL SERVICES**

Background papers:

1. Treasury Management in the Public Services (CIPFA)
2. The Prudential Code for Capital Finance (CIPFA)
3. SI 2003/3146 - Local Authorities (Capital Finance and Accounting) (England) Regulations 2003
4. SI 2004/3055 - Local Authorities (Capital Finance and Accounting) (Amendment)

APPENDIX A

TREASURY MANAGEMENT STRATEGY 2018/19

1. INTRODUCTION

1.1 This strategy has been prepared in accordance with CIPFA's Treasury Management in the Public Sector: Code of Practice, which requires the Council to approve a Treasury Management Strategy before the start of each financial year.

1.2 In addition, MHCLG issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an Investment Strategy before the start of each financial year.

1.3 The Council approves an annual strategy to be prepared in advance of the year, a mid-year review and an annual report after its close. The Licensing and General Purposes Committee is the nominated Committee responsible for the effective scrutiny of the Treasury Management Strategy and policies.

1.4 The Council has invested sums of money and is therefore exposed to financial risks including 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 Council's Treasury Management Strategy.

1.5 This strategy covers:

- External context
- Current borrowing and investment portfolio position
- Annual Borrowing Strategy
- Annual Investment Strategy
- Specified & Non-specified Investments
- Performance Indicators

2. EXTERNAL CONTEXT (commentary provided by Arlingclose)

2.1 **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 remains 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.

2.2 Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. However, this effect is expected to fall out of year-on-year inflation measures during 2018, removing pressure on the Bank of England to raise interest rates.

2.3 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.

2.4 **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.

2.5 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.

2.6 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.

2.7 **Interest rate forecast**: The Bank of England raised the UK base rate to 0.5% in early November 2017. Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.5% during 2018/19**.** The risk of a cut to zero or negative rates has diminished and there is now a chance that rates will rise despite the economic fundamentals.

2.8 Longer-term interest rates have risen in the past year, reflecting the possibility of increasing short-term rates. Arlingclose forecasts these to remain broadly constant during 2018/19, but with some volatility as interest rate expectations wax and wane with press reports on the progress of EU exit negotiations.

3. CURRENT BORROWING & INVESTMENT PORTFOLIO POSITION

3.1 The Guidance on Local Government Investments in England gives priority to security and liquidity, and the Council's aim has been to achieve a yield commensurate with these principles. The Council continues to follow Arlingclose advice in the knowledge that whilst long-term interest rate forecasts remain low it should generate enhanced returns with counterparties other than banks and to invest across a diverse investment portfolio.

3.2 During 2017/18 the Council has generated returns from existing long-term pooled fund investments together with diversification within the Council's investment portfolio. The Council held the following investments at 31st December 2017:

- £19.6m in pooled funds (providing a balance across a range of 5 different types of fund).
- £1 million Yorkshire BS at a fixed rate of 1.33% (until Apr 18)
- £1 million Yorkshire BS at a fixed rate of 1.18% (until Apr 18)
- £2 million Leeds BS at a fixed rate of 1.47% (until Dec 18)
- £1 million Leeds BS at Libor + 0.27% (until Feb 18)
- Various temporary investments of minor amounts held in Money Market funds all for durations of 6 months or less

3.3 An interpretation of IFRS 9 for the future may mean that under-performing pooled fund marginal losses may have to be recorded in the General Fund Revenue Account. In the light of this potential accounting requirement (even though the Council's pooled fund holding in Aberdeen Absolute Fund was providing regular yield returns in accordance with expectations) its capital value was under-performing. A decision was therefore taken in during December 2017 to redeem the entire holding and an element of the CCLA holding and purchase a pooled fund holding in M & G Investment Strategic Corporate. The result of the decision produced a favourable revenue effect of £28,000 in 2017/18. The graph below has been produced by Arlingclose and demonstrates that during the nine months to 31 December 2017 the Council's income (only) returns on its total investment portfolio was 1.5**%**. Total Return (income and capital) was 2.5%.

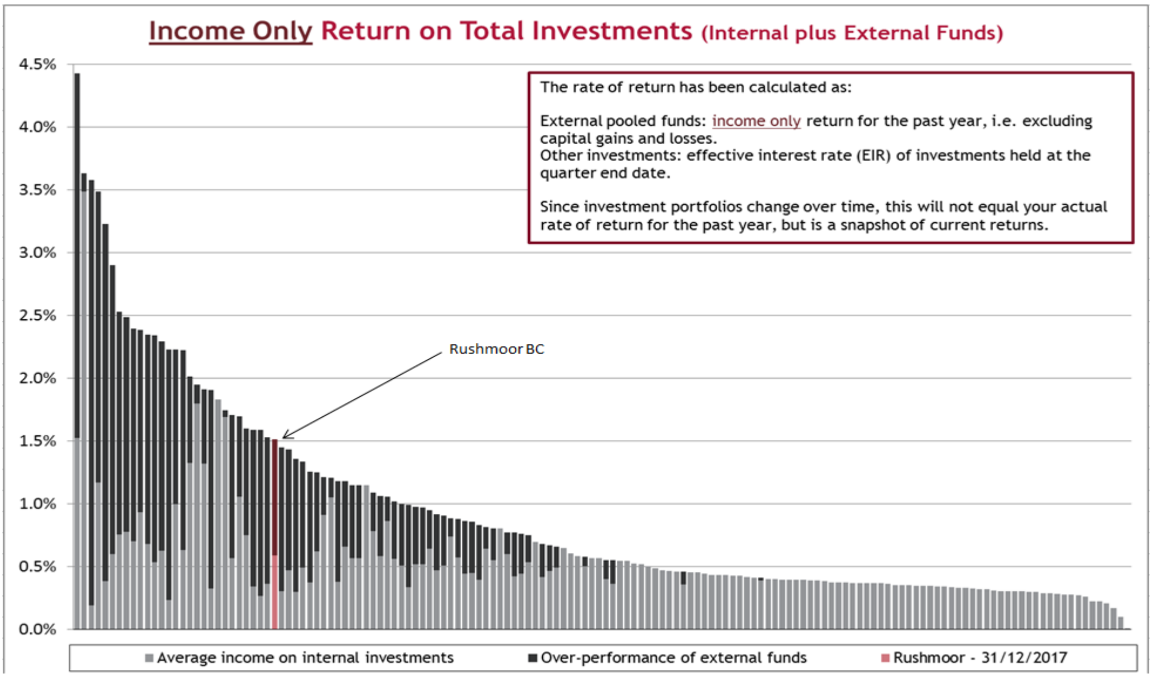

Table 1: – Existing Investment & Debt Portfolio Position

	Actual Portfolio at 31st Dec 17 £m	Average Rate %
Total External Borrowing		
Borrowing from the M3 LEP	2.1	0.0
Borrowing from other Local Authorities	12.0	0.53
Other external Borrowing	-	
Total Gross External Debt	14.1	0.45
Investments:		
Managed in-house:		
Short-term investments	-	-
Long Term Investments	5.5	1.2
Money Market Funds	13.2	0.3
Call accounts	-	-
Managed externally:		
Pooled Funds:		
Payden & Rygel's Sterling Reserve	5.0	0.66
CCLA LAMIT Property Fund	3.6	4.75
M&G Investments Strategic Corporate Bond Fund	4.0	3.22
UBS Multi Asset Fund	5.0	4.01
Threadneedle Investments	2.0	3.64
Total Investments	38.3	1.92

Table 1 Illustrates the Council's investment and debt portfolio position as at 31st December 2017.

4. ANNUAL BORROWING STRATEGY 2018/19

4.1 The Council has made use of funds from the Enterprise M3 (LEP) by borrowing £3 million in an earlier year to progress the Aldershot regeneration schemes. External contributions will be received over a seven-year period to fully finance this amount. At the commencement of 2018/19 £2.1m of this borrowed amount remains outstanding.

4.2 Capital expenditure in the previous financial year (2017/18) is programmed to be substantial, including a significant amount for investment property acquisitions, property purchases in Union Street Aldershot and the continuation of the new Council Depot construction. Capital expenditure in relation to the Farnborough International Loan will be concluded within 2017/18 utilising a significant proportion of the Council's remaining available capital receipts. Prudential code borrowing will therefore be required in order to achieve overall financing. The Council will incur some further borrowing during 2018/19 in order assist in the financing of its capital programme.

4.3 **Objectives**: The Council's chief objective when borrowing money will be to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required.

Sources: The approved sources of long-term and short-term borrowing are detailed within TMP 4 (Approved Instruments, Methods and Techniques), and are summarised below:

- Public Works Loan Board (PWLB)
- Money market loans (long term & temporary)
- Any bank or building society authorised to operate in the UK
- UK Local Authorities
- UK public and private sector pension funds (except the Local Government Pension Scheme administered by Hampshire County Council)
- Capital market bond investors
- UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issues.
- Lottery monies

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

5. ANNUAL INVESTMENT STRATEGY 2018/19

5.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. Advice was received during 2017/18 from Arlingclose that as the Council is now progressing further into the use of borrowing to finance capital expenditure, that in the circumstances of an investment maturity date arising the Council should not seek to replace the investment. This allows for the natural reduction in overall investment holding whilst the Council incurs increasing elements of borrowing. Market investments are expected to further decline in 2018/19. These reductions are mainly due to the Council's capital expenditure requirements linked to the Prudential Code requirement to ensure that Gross Debt does not exceed the Capital Financing Requirement.

5.2 **Objectives**: Both the CIPFA Code and the MHCLG Guidance require the Council 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 Council'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.

5.3 **Strategy**: The Council continues to maintain a diverse range of secure and/or higher yielding asset classes during 2018/19, whilst retaining short-term accessibility.

5.4 Table 2 outlines the approved investment counterparties with whom the Council may invest its surplus funds, subject to the cash, investment and time limits shown. The schedule of approved counterparties is underpinned by a detailed list of named counterparties. This list is maintained within Financial Services for treasury management operational purposes.

Table 2: Approved Investment Counterparties

Counterparty		**Cash limit per counterparty**	**Investment Limit (per type of counterparty)**	**Time limit †**
Banks Unsecured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£20m in total	5 Years*
	AA+	£2m		5 Years*
	AA	£2m		4 years*
	AA-	£2m		3 years*
	A+	£2m		2 years
	A	£2m		13 months
	A-	£2m		6 months
	BBB+	£1m		100 days
Banks Secured whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	20 years
	AA+	£4m		10 years
	AA	£4m		5 years
	AA-	£4m		4 years
	A+	£4m		3 years
	A	£4m		2 years
	A-	£4m		13 months
	BBB+	£2m		6 months
	BBB or BBB-	£2m		100 days
Government whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	Unlimited	50 Years
	AA+	£4m		25 Years
	AA	£4m		15 Years
	AA-	£4m		10 Years
	A+	£2m		5 Years
	A	£2m		5 Years
	A-	£2m		5 Years
	BBB+	£1m		2 Years
	None	£4m		25 Years

Counterparty		Cash limit per counterparty	Investment Limit (per type of counterparty)	Time limit †
Corporates whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£2m	£6m in total	20 Years
	AA+	£2m		10 Years
	AA	£2m		10 Years
	AA-	£2m		10 Years
	A+	£2m		5 Years
	A	£2m		2 Years
	A-	£1m		13 months
	BBB+	£1m		6 months
	none	£0.5m		5 Years
Registered Providers whose lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's is:	AAA	£4m	£10m in total	20 Years
	AA+	£4m		10 Years
	AA	£4m		10 Years
	AA-	£4m		10 Years
	A+	£4m		5 Years
	A	£4m		5 Years
	A-	£4m		5 Years
	BBB+	£4m		5 Years
	None	£4m		5 Years
The Council's current account bank if it fails to meet the above criteria		£2m	£2m	next day
UK Building Societies without credit rating		£1m	£4m	1 Year
Money market funds		£5m	£20m in total	n/a
Collective Investment Schemes (pooled funds)		£5m per fund	£20m in total	These funds do not have a defined maturity date

** no longer than 2 years in fixed-term deposits and other illiquid instruments*

5.5 Investments may be made with banks or any public or private sector organisations that meet the above credit rating criteria. The Council may also invest with organisations and pooled funds without credit ratings, following an external credit assessment and advice from the Council's treasury management adviser.

5.6 Further information as to why certain counterparties have been included in Table 2 is set out below:

- **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 highest 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.

  Investments in unrated small businesses may provide considerably higher rates of return. They will however only be made following a favourable external credit assessment and on the specific advice of the Council's treasury management adviser.

- **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 a high likelihood of receiving government support if needed.

- **Money Market Funds**: These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. We will continue to use funds that offer same-day liquidity as an alternative to instant access bank accounts, while funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

- **Other Pooled Funds**: The Council will continue to use pooled bond, equity and property funds that offer enhanced returns over the longer term, but are potentially more volatile in the shorter term. These allow the Council 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 Council's investment objectives will be monitored regularly.

5.7 **Risk Assessment and Credit Ratings**: The Council uses long-term credit ratings from the three main rating agencies Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services to assess the risk of investment default. The lowest available counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available. Credit ratings are obtained and monitored by the Council'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 with that entity
- we will recall or sell any existing investments with that entity where we can do so at no cost
- due consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

5.8 **Other Information on the Security of Investments**: The Council will also take account of 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. The Council will not proceed with an investment with an organisation if it has 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 reflected in general credit-ratings. In these circumstances, where the Council feels the whole market has been affected, it 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. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council's cash balances, then the surplus will be deposited with the UK Government, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

6. SPECIFIED AND NON-SPECIFIED INVESTMENTS

6.1 **Specified Investments**: The MHCLG 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
  - a body or investment scheme of "high credit quality".

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

6.2 **Non-specified Investments**: Any investment not meeting the definition of a specified investment is classified as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure e.g. company shares.

Non-specified investments at the Council are limited to longer term investments e.g. pooled funds, or other long-term (12 months +) investments with other LAs, banks or building societies, and investments with bodies and schemes not meeting the definition of high credit quality. Limits on non-specified investments are shown in Table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£40m
Total investments without credit ratings or rated below A-	£30m
Total non-specified investments	£40m

6.3 **Approved Instruments**: The Council may lend or invest money using any of the instruments detailed in Treasury Management Practice (TMP) 4, held within Financial Services. The approved instruments are summarised as follows:

- interest-bearing bank accounts

- fixed term deposits and loans
- callable deposits and loans where the Council may demand repayment at any time (with or without notice)
- callable deposits and loans where the borrower may repay before maturity
- certificates of deposit
- bonds, notes, bills, commercial paper and other marketable instruments
- shares in money market funds and other pooled funds
- reverse repurchase agreements (repos)

Investments may be either made at a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

6.4 **Liquidity management**: The Council produces cash flow forecasts to determine the maximum period for which funds may be committed. Limits on long-term investments are set by reference to the Council's medium-term financial plan and cash flow forecast.

7. TREASURY MANAGEMENT INDICATORS

7.1 The Treasury Management Code requires that local authorities set a number of indicators for treasury management performance, which have been set out below at paragraphs 7.3 to 7.5. The Council has also adopted a voluntary measure for credit risk as set out in paragraph 7.2

7.2 **Credit Risk (Credit Score Analysis)**: Counterparty credit quality is assessed and monitored by reference to credit ratings. Credit ratings are supplied by rating agencies Fitch, Standard & Poor's and Moody's. Arlingclose assign values between 1 and 26 to credit ratings in the range AAA to D, with AAA being the highest credit quality (1) and D being the lowest (26). Lower scores mean better credit quality and less risk.

The advice from Arlingclose is to aim for an average A-, or higher, average credit rating, with an average score of 7 or lower. The scores are weighted according to the size of our deposits (value-weighted average) and the maturity of the deposits (time-weighted average).

	Target
Portfolio average credit rating	A-
Portfolio average credit score	7.0

7.3 **Interest Rate Exposure**: This indicator is set to monitor the Council's exposure to the effects of changes in interest rates. The indicator calculates the relationship between the Council's net principal sum outstanding on its borrowing to the minimum amount it has available to invest. The upper limits on fixed and variable rate interest rate exposures expressed as the amount of net principal borrowed is:

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Upper limit on fixed interest rate exposure	35	55	85	100
Upper limit on variable interest rate exposure	-50	-50	-50	-50

It is expected that for most Councils the interest rate exposure calculation would result in a positive figure. As the Council has more funds available to invest than it intends to borrow, the calculation has resulted in a negative figure for variable rate funds.

7.4 **Maturity Structure of Borrowing**: This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

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.

7.5 **Principal Sums Invested for Periods Longer than 364 days**: The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21	2021/22
Limit on principal invested beyond year end at any one time	£40m	£40m	£40m	£40m

8. OTHER ITEMS

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

8.2 **Policy on Use of Financial Derivatives**: Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk, and to reduce costs or increase income at the expense of greater risk. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Embedded derivatives, including those present in pooled funds, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

8.3 **Investment Training**: The needs of the Council's treasury management staff for training in investment management are assessed on a continuous basis, discussed as part of the staff appraisal process and reviewed as the responsibilities of individual members of staff change.

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

8.4 **Investment Advisers:** The Council jointly tendered the treasury management service together with three other District Councils located within the Hampshire area, and appointed Arlingclose Limited for a further 3 year contract in April 2016. This contract enables the Council to receive specific advice on investment, debt and capital finance issues. The quality of this service will be reviewed on an ongoing basis as part of the process of monitoring the Council's investment portfolio.

8.5 **Investment of Money Borrowed in Advance of Need**: The Council 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 Council is aware that it will be exposed to the risk of loss of the borrowed sums, and potential interest rate changes. These risks will be managed as part of the Council's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £63 million during 2018/19. The maximum period between borrowing and expenditure is expected to be two years.

8.6 **Financial Implications -** Investments**:** The budget for investment income in 2018/19 is £846k (gross of borrowing interest), based on an average investment portfolio of £30 million at interest rates ranging from 0.4% liquid MMF and other short-term investments to 5% on the highest yielding long-term pooled property investment fund.

Performance of investments against budget will be reviewed on an ongoing basis and as part of our quarterly budget monitoring process. The investment income will reduce depending on the pace and size of capital expenditure that arises from the 8-Point Plan work and strategic projects.

8.7 **Financial Implications -** Borrowing**:** The budget for interest costs in relation to borrowing in 2018/19 is £296k (not including IFRIC 4 lease accounting interest). It is determined using estimated short-term interest rates. The Council's actual borrowing at the end of 2018/19 is estimated to be in the region of £52 million.

8.8 **Other Options Considered:** The HLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Finance Officer continues to believe that the above strategy represents an appropriate balance between risk management and cost effectiveness. An alternative strategy might be to invest in a narrower range of counterparties and/or for shorter periods. The likely impact of this alternative would be lower interest income alongside a reduced risk of loss from credit-related defaults. Investing in a wider range of counterparties and/or for longer periods would result in the opposite impact i.e. interest income would be higher but there would be a greater risk of loss. When final guidance becomes available from the HLG and CIPFA (discussed in paragraph 1.3 of this report) consideration will be made on how to incorporate changes to the Council's strategy

APPENDIX B

PRUDENTIAL INDICATORS

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

1 **Estimates of Capital Expenditure:** The Council's planned core capital expenditure and financing may be summarised as follows:

Capital Expenditure and Financing	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
General Fund	32.401	28.718	35.123	16.093	30.543
TOTAL EXPENDITURE	**32.401**	**28.718**	**35.123**	**16.093**	**30.543**

Capital Receipts	5.325	0.733	0.885	-	-
Capital Grants & Contributions	2.189	7.646	5.478	1.078	1.078
Revenue (related to utilisation of earmarked reserve introduced in GF revenue account)	0.261	-	-	-	0.750
Borrowing	24.626	20.339	28.760	15.015	28.715
TOTAL FINANCING	**32.401**	**28.718**	**35.123**	**16.093**	**30.543**

2 **Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for capital purposes.

Capital Financing Requirement	31.03.18 Estimate £m	31.03.19 Estimate £m	31.03.20 Estimate £m	31.03.21 Estimate £m	31.03.22 Estimate £m
General Fund	30.9	39.3	67.1	80.1	105.8
Adjustment ref IFRIC 4 lease accounting	3.2	2.9	2.6	2.3	2.0
Total CFR	**34.1**	**42.2**	**69.7**	**82.4**	**107.8**

Grants and external contributions are expected to be received for some specific capital schemes, but the Council will need to borrow to finance a significant element of its core capital expenditure. This is in addition to the existing use of Local Enterprise Partnership funding for which borrowing is incurred but repayment of the borrowing is achieved by the receipt of external contributions.

3 **Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium-term debt will only be for a capital purpose, the Council should ensure that debt does not, except in the short-term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

Gross Debt and the Capital Financing Requirement	**2017/18 Revised £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Capital Financing Requirement (measured in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years)	69.7	82.4	107.8	127.5	147.2
Total Gross Debt	34.3	52.1	81.1	95.5	123.6
Difference	35.4	30.3	26.7	32.0	23.6

4 **Operational Boundary for External Debt:** The operational boundary is based on the Council's estimate of most likely (i.e. prudent, but not worst-case) scenario for external debt. It links directly to the Council's estimates of core capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance leases, Private Finance Initiatives and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	**2017/18 Revised £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**	**2021/22 Estimate £m**
Borrowing	40.0	58.0	87.0	102.0	130.0
Total Debt	**40.0**	**58.0**	**87.0**	**102.0**	**130.0**

5 **Authorised Limit for External Debt:** The authorised limit is the affordable borrowing limit determined in compliance with Section 3(1) the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. It is measured on a daily basis against all external borrowing items on the Balance Sheet (i.e. long and short term borrowing,

overdrawn bank balances and long-term liabilities. This Prudential Indicator separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved Treasury Management Policy Statement and practices. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2017/18 Revised £m	2018/19 Estimate £m	2019/20 Estimate £m	2020/21 Estimate £m	2021/22 Estimate £m
Borrowing	44.0	62.0	91.0	106.0	134.0
Other long-term liabilities	1.0	1.0	1.0	1.0	1.0
Total Debt	**45.0**	**63.0**	**92.0**	**107.0**	**135.0**

6 **Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed core capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2017/18 Revised %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %	2021/22 Estimate %
General Fund	**-5.2**	**2.8**	**7.1**	**20.5**	**34.4**

7 **Incremental Impact of Capital Investment Decisions:** This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

Incremental Impact of Capital Investment Decisions	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £	2021/22 Estimate £
General Fund - increase in annual band D Council Tax	**-**	**(29.43)**	**(67.18)**	**(86.84)**	**(87.94)**

Adoption of the CIPFA Treasury Management Code: The prudential indicator in respect of treasury management is that the Council adopt CIPFA's Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The aim is to ensure that treasury management is led by a clear & integrated forward treasury management strategy, with recognition of the existing structure of the Council's borrowing and investment portfolios. The revised edition of the Code (November 2011) was adopted by the Council on 20th February 2014.

APPENDIX C

MINIMUM REVENUE PROVISION STATEMENT

1.1 Where the Council finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008.

1.2 The Local Government Act 2003 requires the Council to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* (the MHCLG Guidance) most recently issued in 2012.

1.3 The broad aim of the MHCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

1.4 The MHCLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. This statement only incorporates options recommended in the Guidance.

1.5 For any unsupported capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure for all other assets or on capital expenditure not related to fixed assets but which has been capitalised by regulation or direction (revenue expenditure financed by capital under statute), will be charged over 40 years.

1.6 For assets acquired by finance lease or private finance initiative, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

1.7 Where loans are made to other bodies and designated as capital expenditure, no MRP will be charged. However, the capital receipts generated by the repayments on those loans will be aside to repay debt instead.

1.8 It should be noted that the Council continues to make use of two revolving infrastructure funds from the Local Enterprise Partnership (LEP). The related capital expenditure does not however give rise to MRP as a contract of structured external repayments will eliminate the need to incur MRP.

1.9 At the commencement of 2017/18 the Council had, a Capital Financing Requirement (CFR) of £6.548m in relation to a specific elements of capital expenditure incurred in the previous financial year (2016/17). The Council has incurred further amounts of capital expenditure in 2017/18 and will need to engage in an element of Prudential Code borrowing in that financial year to achieve total financing of its capital programme. It is inevitable therefore that the borrowing that is required in 2017/18 will require MRP to be charged to the Council's General Fund Revenue Account in 2018/19 and future years.

1.10 The implementation of International Financial Reporting Standards (IFRS) has meant that the accounting treatment for assets used within major contracts may result in embedded finance leases appearing on the Balance Sheet, leading to a requirement for MRP. This is purely an accounting requirement and does not give rise to any requirement to borrow to fund these assets.