COMMITTEE:	Audit & Governance Committee
DATE:	27th March 2017
SUBJECT:	Treasury Management Strategy Statement 2017/18
REPORTING OFFICER:	Alison Monteith
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PORTFOLIO HOLDER:	Cllr Dawn Hill
WARDS AFFECTED:	All

EXECUTIVE SUMMARY

This report sets out the Treasury Management Strategy Statement for 2017/18 including Minimum Revenue Provision Strategy, Annual Investment Strategy and all relevant Prudential Indicators.

It has been established that this authority is likely to have a significant amount of core cash available in the near future, so the emphasis for our day-to-day cash strategy will be to put investments out to longer dates where appropriate in order to secure higher yields.

RECOMMENDATIONS

To recommend the following to Council for approval:

1. Treasury Management Strategy for 2017/18
2. Annual Investment Strategy 2017/18
3. Minimum Revenue Provision Policy Statement
4. Capital and Treasury Prudential Indicators

	Seen by:	Name	Date (or Not Applicable)
REPORT SIGN OFF:	Monitoring Officer	Melanie Wellman	10.2.17
	S151 Officer	Alison Turner	10.2.17
	Executive Member	Deputy Leader of Council	10.2.17

Treasury Management Strategy Statement 2017/18

1. Purpose of Report

To set out the Treasury Management Strategy Statement for 2017/18 incorporating the Annual Investment Strategy, Minimum Revenue Provision Policy Statement and all relevant Prudential Indicators.

2. Background

In March 2010 the Authority adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

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

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

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

3. External Context

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

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

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

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates further in 2017 (the last increase was in December). The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

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

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

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

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

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

4. Local Context

The Authority currently has £51.8m of borrowing and almost £40m of investments. This is set out in further detail at ***Appendix B***. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance Sheet Summary and Forecast

	31.3.16 Actual £m	**31.3.17 Forecast £m**	**31.3.18 Forecast £m**	**31.3.19 Forecast £m**	**31.3.20 Forecast £m**
General Fund CFR	12.057	12.131	11.682	11.242	11.131
HRA CFR	55.237	56.547	56.480	56.412	56.345
Total CFR	**67.294**	**68.678**	**68.162**	**67.654**	**67.476**
Less: External borrowing	-51.821	-51.821	-51.821	-51.821	-51.821
Internal borrowing	**15.473**	**16.857**	**16.341**	**15.833**	**15.655**
Less: Usable reserves	-27.492	-25.250	-26.993	-27.543	-28.839
Less: Working capital	-15.000	-15.000	-15.000	-15.000	-15.000
Investments	**27.019**	**23.393**	**25.652**	**26.710**	**28.184**

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Authority's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

The Authority has a stable CFR due to minimal borrowing for the capital programme, but increasing investments and will therefore not require further borrowing over the forecast period.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2017/18.

5. Borrowing Strategy

The Authority currently holds £51.821 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2017/18. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £80 million.

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

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

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

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

In addition, the Authority may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

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

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

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

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

The Authority has previously raised all of its long-term borrowing from the PWLB but it continues to investigate other sources of finance, such as local authority loans and bank loans, which may be available at more favourable rates.

Municipal Bond Agency: UK Municipal Bonds Agency plc was established in 2014 by the Local Government Association as an alternative to the PWLB. It plans to issue bonds on the capital markets and lend the proceeds to local authorities. This will be a more complicated source of finance than the PWLB for two reasons: borrowing authorities may be required to provide bond investors with a joint and several guarantee over the very small risk that other local authority borrowers default on their loans; and there will be a lead time of several months between committing to borrow and knowing the interest rate payable. Any decision to borrow from the Agency will therefore be the subject of a separate report to full Council.

LOBOs: The Authority currently holds no LOBO (Lender's Option Borrower's Option) loans.

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

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

6. Investment Strategy

The Authority currently holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £30 and £40 million, and similar levels are expected to be maintained in the forthcoming year.

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

Negative Interest Rates: If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries.

In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Strategy: Given the increasing risk and falling returns from short-term unsecured bank investments, the Authority may further diversify into more secure and/or higher yielding asset classes during 2017/18 for the estimated £25m that is available for longer-term investment. All of the Authorities surplus cash is currently invested in short-term unsecured bank deposits and money market funds. This diversification will represent a continuation of the new strategy adopted in 2017/18.

Approved Counterparties: The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 2: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	£ Unlimited 50 years	n/a	n/a
AAA	£5m 5 years	£3m 20 years	£3m 50 years	£1.5m 20 years	£1.5m 20 years
AA+	£5m 5 years	£3m 10 years	£3m 25 years	£1.5m 10 years	£1.5m 10 years
AA	£5m 4 years	£3m 5 years	£3m 15 years	£1.5m 5 years	£1.5m 10 years
AA-	£5m 3 years	£3m 4 years	£3m 10 years	£1.5m 4 years	£1.5m 10 years
A+	£5m 2 years	£3m 3 years	£1.5m 5 years	£1.5m 3 years	£1.5m 5 years
A	£5m 13 months	£3m 2 years	£1.5m 5 years	£1.5m 2 years	£1.5m 5 years
A-	£5m 6 months	£3m 13 months	£1.5m 5 years	£1.5m 13 months	£1.5m 5 years
BBB+	nil	£1.5m 6 months	nil	nil	nil
None	£1m 6 months	n/a	£3m 25 years	n/a	£1.5m 5 years
Pooled funds	£3m per fund				

This table must be read in conjunction with the notes below

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

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

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

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

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

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

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

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

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur.

Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

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

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

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

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

Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government,
    - a UK local authority, parish council or community council, or
    - a body or investment scheme of "high credit quality".

The Authority defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country

with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£15m
Total non-specified investments	£15m

Investment Limits: A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£5m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£5m per group
Any group of pooled funds under the same management	£5m per manager
Negotiable instruments held in a broker’s nominee account	£10m per broker
Foreign countries	£3m per country
Registered Providers	£8m in total
Unsecured investments with Building Societies	£5m in total
Loans to unrated corporates	£3m in total
Money Market Funds	£22m in total

Liquidity Management: The Authority uses cash flow monitoring to determine the maximum period for which funds may prudently be committed. The forecast is

compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

7. Treasury Management Indicators

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

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

	2017/18	2018/19	2019/20
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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

	Upper	Lower
Under 12 months	10%	0%
12 months and within 24 months	10%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	55%	0%
10 years and within 15 years	20%	0%
15 years and above	20%	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

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

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£15m	£15m	£15m

8. Other Items

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

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 (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). 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 Authority 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 Authority is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

Policy on Apportioning Interest to the HRA: On 1st April 2012, the Authority notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured annually and interest transferred between the General Fund and HRA at the Authority's average interest rate on investments, adjusted for credit risk.

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

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

Investment Advisers: The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

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

The total amount borrowed will not exceed the authorised borrowing limit of £80 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

8. Minimum Revenue Provision Policy Statement 2017/18

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

The broad aim of the CLG 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.

The CLG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance as well as locally determined prudent methods.

For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £785,507.

For 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 in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.

Where loans are made to other bodies for their capital expenditure, no MRP will be charged. However, the capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead.

No MRP will be charged in respect of assets held within the Housing Revenue Account.

Capital expenditure incurred during 2017/18 will not be subject to a MRP charge until 2018/19.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31st March 2017, the budget for MRP has been set as follows:

	31.03.2017 Estimated CFR £m	**2017/18 Estimated MRP £**
Capital expenditure before 01.04.2008	**6.2**	224,824
Unsupported capital expenditure after 31.03.2008	**5.9**	223,904
Loans to other bodies	**0.0**	Nil
Total General Fund	**12.1**	
Assets in the Housing Revenue Account	**9.2**	Nil
HRA subsidy reform payment	**47.3**	Nil
Total Housing Revenue Account	**56.5**	
Total	**68.6**	

9. Capital Prudential Indicators 2017/18 – 2019/20

The Local Government Act 2003 requires the Authority 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 Authority has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Authority's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
General Fund	1.445	**1.717**	0.669	0.700
HRA	8.951	**7.883**	4.773	6.893
Total Expenditure	**10.396**	**9.600**	**5.442**	**7.593**
Capital Receipts	0.840	1.273	1.029	0.413

Government Grants	0.701	1.054	0.468	0.400
Reserves	6.887	4.943	3.945	4.675
Revenue	0.096	2.330	0	1.805
Borrowing	1.872	0	0	0.300
Contributions	0	0	0	0
Total Financing	**10.396**	**9.600**	**5.442**	**7.593**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.17 Revised £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
General Fund	12.131	**11.682**	11.242	11.131
HRA	56.547	**56.480**	56.412	56.345
Total CFR	**68.678**	**68.162**	**67.654**	**67.476**

The CFR is forecast to remain stable over the next three years as capital expenditure financed by debt roughly equals resources put aside for debt repayment.

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 Authority 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.

Debt	**31.03.17 Revised £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
Borrowing	51.821	**51.821**	51.821	51.821
Total Debt	**51.821**	**51.821**	**51.821**	**51.821**

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the Authority's estimate of most likely (i.e. prudent but not worst case) scenario for external debt. It links directly to the Authority's estimates of 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 lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Authority's debt.

Operational Boundary	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing	51.821	**70.000**	70.000	70.000
Total Debt	**51.821**	**70.000**	**70.000**	**70.000**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Authority can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing	60.000	**80.000**	80.000	80.000
Total Debt	**60.000**	**80.000**	**80.000**	**80.000**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed 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	2016/17 Revised %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
General Fund	1.26	**1.69**	1.64	1.48
HRA	9.22	**9.11**	9.11	9.11

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 £
General Fund - increase in annual band D Council Tax	Nil	Nil	Nil

Adoption of the CIPFA Treasury Management Code: The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in*

the Public Services: Code of Practice 2011 Edition in March 2010.

10. Link to Corporate Priorities

The council has a priority theme of “customers & efficiency”. It is essential that we have an effective Treasury Management strategy in place.

11. Finance Comments (Section 151 Officer)

All relevant information is contained within the body of the strategy.

12. Legal Comments (Monitoring Officer)

The Local Government Act 2003 and subsequent regulations require the Council to set out its annual strategy with regard to both borrowing and the repayment of external debt. These are set out in the Treasury Management Strategy and the Minimum Revenue Position (MRP) Strategy respectively. The Act and subsequent regulations require the Council to have regard to the CIPFA Prudential Code for Capital Finance and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable. Having regard to its investment plans the Council also has a duty to determine a prudent MRP.

The Council’s Constitution requires the approval, adoption or changing of the budget (which includes the allocation of financial resources to different services and projects, proposed contingency funds, the council tax base, setting the council tax and decisions relating to the control of the Council’s borrowing requirement, the control of its capital expenditure and the setting of virement limits) to be exercised by full Council and the Strategies and Statements within this report should therefore be recommendation for approval to full Council.

13. Health & Wellbeing Comments

There are no health & Wellbeing implications to be reported.

14. Risk Management Implications

Risk	Consequence to the customer	Probability	Impact	Action to mitigate	Will the report recommendations mitigate the risk?
That our investments are not secure	Inefficient use of financial instruments could result in the loss of tax payers money	2	Financial business loss Reputation	Approve an investment policy that has robust investment criteria	Yes

That we do not approve a Treasury Management Strategy		1	Failure in Statutory or legal obligation Reputation	Approve the Treasury Management Strategy	Yes

15. Equalities Impact Assessment

1. Does the proposal, policy, application or function affect employees or protected groups?	**No**
2. Does it help the council meet our general equality duties?	**No**

16. Economic Development Implications

There are no Economic Development Implications to report.

17. Appendices

Appendix A - Arlingclose Economic & Interest Rate Forecast - January 2017
Appendix B – Existing Investment & Debt Portfolio Position

Appendix A – Arlingclose Economic & Interest Rate Forecast - January 2017

Underlying assumptions:

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

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

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

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

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

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

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

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

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

Forecast:

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

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

- Gilt yields have risen, but remain at low levels. The Arlingclose central case is for yields to decline or remain stable during 2017.

	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.13
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	0.25
Downside risk	-0.25	-0.25	-0.25	-0.25	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.42
3-month LIBID rate														
Upside risk	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.19
Arlingclose Central Case	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	0.29
Downside risk	-0.25	-0.25	-0.25	-0.30	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.40	-0.36
1-yr LIBID rate														
Upside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.24
Arlingclose Central Case	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**	**0.95**	0.68
Downside risk	-0.15	-0.15	-0.15	-0.20	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.30	-0.26
5-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**0.60**	**0.50**	**0.45**	**0.45**	**0.50**	**0.50**	**0.50**	**0.55**	**0.60**	**0.65**	**0.70**	**0.75**	**0.80**	0.58
Downside risk	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.48
10-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.10**	**1.05**	**0.95**	**0.95**	**0.95**	**0.95**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**1.20**	**1.25**	1.05
Downside risk	-0.45	-0.45	-0.45	-0.45	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.50	-0.48
20-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.65**	**1.55**	**1.50**	**1.50**	**1.50**	**1.50**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**	**1.80**	1.60
Downside risk	-0.55	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.58
50-yr gilt yield														
Upside risk	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	**1.55**	**1.45**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	1.50
Downside risk	-0.55	-0.55	-0.55	-0.55	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.60	-0.58

Appendix B – Existing Investment & Debt Portfolio Position

	7th February 2017 **Actual Portfolio** **£m**	7th February 2017 **Average Rate**
External Borrowing:		
PWLB – Fixed Rate	51.821	2.86%
PWLB – Variable Rate	0	0
Local Authorities	0	0
Total Gross External Debt	**51.821**	**2.86%**
Investments:		
Investments on call	4.905	0.40%
Term Investments – maturing with 12 months	25.000	0.70%
Money Market Funds	10.019	0.65%
Pooled funds	3.000	4.77%
Total Investments	**42.924**	
Net Debt	**8.897**	