Ashfield
DISTRICT COUNCIL

Report To:	CABINET	**Date:**	23rd MARCH 2017
Heading:	THE COUNCIL'S TREASURY MANAGEMENT STRATEGY		
Portfolio Holder:	CLLR JACKIE JAMES - CORPORATE SERVICES		
Ward/s:			
Key Decision:	YES		
Subject To Call-In:	YES		

Purpose Of Report

The Council's Treasury Management Strategy underpins the Council's approach to its treasury management activities. This report will highlight the risks involved with treasury management and the actions that will be undertaken to minimise these risks.

To seek approval for the Council's Treasury Management Activities Prudential Indicators:-

- Estimate of financing costs to net revenue stream for the period split between the Housing Revenue Account and the General Fund;
- Estimate of the incremental impact of capital investment decisions on the Council Tax and Rent Levels;
- Net borrowing and Capital Financing Requirement split between the General Fund and the Housing Revenue Account;
- Estimate of Capital expenditure for the period split between the General Fund and Housing Revenue Account;
- The increase in the Authorised Boundary from £120m to £130m and increase in the Operational Boundary limit from £110m to £120m;
- Changes to Minimum Revenue Provision Policy to allow for use of option 4 Depreciation Method. Any capital receipts from assets where option 4 Depreciation is used will be set aside to reduce debt liability;
- Agree changes to Annual Investment Strategy.

Recommendation(s)

Members are requested to approve and recommend to Council to approve:

1) that any capital receipts from assets where option 4 Depreciation Method for MRP is used will be earmarked for the repayment of the debt liability;
2) Agree the Treasury Management Strategy Statement in Section 4; and
3) Agree the Prudential Indicators in Section 5.

Reasons For Recommendation(s)

The Treasury Management Strategy Statement recommendations will allow for effective Treasury Management operations within the Authority and the Prudential Indicator ratios offer a benchmark by which any future capital expenditure decisions should be made.

Alternative Options Considered (With Reasons Why Not Adopted)

None.

Detailed Information

1. Treasury Management Defined

This Council defines its treasury management activities as:

(a) 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.

(b) The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the Council.

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

2. Scope of the Treasury Management Strategy Statement

2.1 This Strategy Statement sets out the Council's approach to financing (borrowing) and investment for the financial year but also sets the context for the following two years.

2.2 The Council has adopted the Chartered Institute of Public Finance and Accountancy's (CIPFA's) Code of Practice for Treasury Management in the Public Services (the "TM Code"). This requires local authorities to determine the Treasury Management Strategy Statement (TMSS) on an annual basis.

2.3 This Strategy statement also incorporates the formal investment strategy which is necessary to comply with guidance issued by the Communities and Local Government (CLG).

2.4 The Strategy sets out the context to Treasury Management in terms of the Council's financial resources as measured in its balance sheet and external factors e.g. interest rates.

3. Approach to risk

3.1 As mentioned in paragraph 1(b) above the Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its Treasury Management activities will be measured. The main risks to the Council's Treasury activities are:

- Credit and Counterparty Risk (security of investments)
- Liquidity Risk (adequacy of cash resources)
- Market or Interest Rate Risk (exposure or fluctuations in interest rate levels)
- Inflation Risk (Exposure to Inflation)
- Refinancing Risk (impact of debt maturing in future years)
- Legal and Regulatory Risk (compliance with statutory powers and regulatory requirements)
- Fraud, Error and Corruption and Contingency Management (maintenance of sound systems and procedures)

4. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) FOR 2017/18

4.1 Introduction

The TMSS covers two main areas:

- Capital issues
    - the Capital Plans and the Prudential Indicators (4.2)
    - the Minimum Revenue Provision (MRP) strategy (4.3)

- Treasury Management issues
    - the current treasury position (4.4)
    - prospects for interest rates (4.5)
    - borrowing strategy (4.6)
    - policy on borrowing in advance of need (4.7)
    - debt rescheduling (4.8)
    - Annual Investment Strategy (AIS) including policies on creditworthiness and external service providers(AIS) (4.9)

The elements within these areas cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, The CLG MRP Guidance, the CIPFA Treasury Management Code, and the CLG Investment Guidance.

4.2 The Capital Prudential Indicators 2017/18 to 2019/20

At the meeting on 24 March 2016 Cabinet considered a set of Prudential Indicators and referred them for approval by Council on 14 April 2016. Since that meeting there have been revisions to the proposed Capital Programme. The latest version of the Capital Programme was agreed by Cabinet 20 February 2017 and then agreed by Council 27 February 2017. The Prudential Indicators now reflect the latest Capital Programme; the revised figures are included in Section 5.

a. Capital Expenditure

The Council's capital expenditure plans are a key driver of treasury management activity. The output of the capital expenditure plans is reflected in the Prudential Indicators, which are designed to assist members with their overview and confirmation of those capital expenditure plans.

b. Capital Financing Requirement (CFR)(the Council's borrowing need)

The CFR represents the total historic capital expenditure which has not yet been paid for from either revenue or capital resources. It is essentially a measure of the Council's underlying borrowing need. Any capital expenditure not immediately financed, for example by capital grants, will increase the CFR.

c. Ratio of financing costs to net revenue stream

This indicator identifies the trend in the cost of capital (borrowing and other long-term obligation costs, net of investment income) against the net revenue stream of the Council. Estimates of financing costs include current commitments, and the effects of the proposals within the current cycle.

d. Incremental impact of 2017/18 – 2019/20 capital investment decisions on council tax

This indicator identifies the revenue costs associated with the capital programme,

4.3 Minimum Revenue Provision (MRP) Policy Statement

Capital expenditure is expenditure on assets with a life expectancy of more than one year, for example, buildings, vehicles, machinery etc. Each year, the Council is required to pay off part of its accumulated capital expenditure by way of a revenue charge, i.e. a "minimum revenue provision" (MRP).

CLG regulations require the Council to approve an MRP Statement in advance of each financial year. The Council must determine an amount of MRP that it considers to be "prudent", the broad aim being to ensure that borrowing is repaid over a period that reflects the useful lives of the assets acquired. The Council is obliged to have regard to the CLG guidance, but it is not prescriptive. The guidance does not, however, define "prudent", instead making recommendations on the interpretation of the term. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent MRP, having had regard to the guidance and its own circumstances.

The following MRP Policy Statement is proposed for 2017/18:

a. The Council will assess MRP in accordance with the recommendations within the guidance issued under section 21(1A) of the Local Government Act 2003

b. Option 1, the regulatory method, will be used for calculating MRP in respect of all capital expenditure incurred up to and including 31 March 2008.

c. Option 3, the Asset Life Method, will be used for calculating MRP in respect of capital expenditure incurred on and after 1 April 2008 where appropriate. An equal instalment approach will be adopted.

d. Where appropriate and prudent the Council will consider using from 2017/18 Option 4, the Depreciation Method, this follows the standard accounting depreciation procedures. Any capital receipts for assets where Option 4 Depreciation is used will be set aside to reduce debt liability.

e. The Chief Financial Officer (CFO) will determine estimated asset lives.

f. In view of the economic climate and significant budgetary pressures, the Council will not provide for an additional voluntary contribution to MRP in 2017/18.

g. MRP is charged in the following accounting year after expenditure is incurred. Based on the above policy, the total MRP charge for 2017/18 has been calculated as £1,630k, as detailed below. The exact amount of MRP will be subject to the out-turn of 2016/17 Statement of Accounts.

	£000's
Option 1 – Regulatory Method	717
Option 3 – Asset Life Method	913
Total MRP	1,630

4.4 The Council's current Treasury portfolio position

The Council must ensure that its total debt, does not, except in the short term, exceed the total of the CFR in the preceding year (the opening CFR), plus the estimates of any additional CFR for the coming year and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes.

The Council's estimated treasury portfolio position at 31 March 2017, together with forward projections, is summarised below. The table shows the expected actual external debt against the underlying capital borrowing need (the CFR).

	31/03/2017 Estimate £m	31/03/2018 Estimate £m	31/03/2019 Estimate £m	31/03/2020 Estimate £m
Capital Financing Requirement	99.530	101.807	101.116	100.305
Less: Profile of Current Borrowing	75.449	75.449	75.449	75.449
Cumulative Maximum External Borrowing Requirement	24.081	26.358	25.667	24.856

Further to the Capital Strategy the Council wants to set up a £10m investment fund to give scope for the purchase of capital assets with the potential to generate income or make savings.

If this is approved the CFR and borrowing requirement will change as outlined below.

	31/03/2017 Estimate £m	31/03/2018 Estimate £m	31/03/2019 Estimate £m	31/03/2020 Estimate £m
Capital Financing Requirement	99.530	111.807	111.116	110.305
Less: Profile of Current Borrowing	75.449	75.449	75.449	75.449
Cumulative Maximum External Borrowing Requirement	24.081	36.358	35.667	34.856

4.5 Prospects for Interest Rates

The Council has appointed Capita Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives their central view.

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

a) UK Economy

UK GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.6%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. The central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2 2019 (unchanged from our previous forecast). However, it would not be possible, as yet, to discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though this is thought unlikely. Forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on forecasts.

The pace of Bank Rate increases on the forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3 i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a ‘business as usual’ mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in quarter 4 grew reasonably strongly, increasing by 1.2% and added 0.1% to GDP growth. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, by December it had fallen back to -7 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 +1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics’ GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do ‘whatever is needed’ i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority. The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned that the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools. The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on 23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the dollar, and 8% down against the euro (as at the MPC meeting date – 15.12.16). This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.6% in December. However, prices paid by factories for inputs are rising very strongly although producer output prices are still lagging well behind.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

b) USA Economy

The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.5% signalled a rebound to strong growth. The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%. Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office. However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

c) Eurozone Economy.

In the Eurozone, the ECB commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015 meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach -0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn. These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim. It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.
There are also significant specific political and other risks within the EZ: -

- Greece continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.

- Spain has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- The under capitalisation of Italian banks poses a major risk. Some German banks are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- 4 December Italian constitutional referendum on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in. A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%. These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.

- Dutch general election 15.3.17; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.

- French presidential election; first round 13 April; second round 7 May 2017.

- French National Assembly election June 2017.

- German Federal election August – 22 October 2017. This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

- The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc (Czech Republic, Hungary, Poland and Slovakia) of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

4.6 Borrowing Strategy

The Council is currently maintaining an under-borrowed position. This means that the capital borrowing need (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

Against this background and the risks within the economic forecast, caution will be adopted with the 2017/18 treasury operations. The Deputy Chief Executive (Chief Finance Officer) will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- if it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around relapse into recession or of risks of deflation), then long term borrowings will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- if it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from an acceleration in the start date and in the rate of increase in central rates in the USA and UK, an increase in world economic activity or a sudden increase in inflation risks, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they will be in the next few years.

Any decisions will be reported to the Cabinet as part of the half-year or full year out-turn treasury management reports.

Treasury management limits on activity

There are three debt related treasury activity limits. The purpose of these are to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. However, if these are set to be too restrictive they will impair the opportunities to reduce costs / improve performance. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments

- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates;

- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits. Consider local indicator covering both fixed and variable debt.

4.7 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment of the extra sums borrowed, since this is illegal. Any decision to borrow in advance of need will be within the forward-approved CFR estimates, and will be considered carefully to ensure value for money can be demonstrated, and that the Council can ensure the security of such funds.

4.8 Debt Rescheduling

As short-term borrowing rates will be considerably cheaper than longer-term fixed interest rates, there may be potential for some residual opportunities to generate savings by switching from long-term to short-term debt, however, these savings will need to be considered in the light of the premiums incurred, their short nature, and the likely cost of refinancing them once they mature, compared to the current rates on longer term debt in the existing debt portfolio. Any such rescheduling is likely to cause a flattening of the Council's maturity profile, as in recent years there has been a skew towards longer dated PWLB.

The reasons for any rescheduling to take place will include:

- The generation of cash savings and/or discounted cashflow savings, at minimum risk
- Helping to fulfil the treasury strategy
- Enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility)

All rescheduling will be reported to Cabinet within the half-year or full year out-turn treasury management reports.

4.9 Annual Investment Strategy 2017/18

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

4.9.1 The Council's general policy objective is to invest its surplus funds prudently. The Council's investment priorities are:

highest priority - security of the invested capital;

followed by - liquidity of the invested capital (this enables the Council to react to changing circumstances);

finally - an optimum yield which is proportionate with security and liquidity.

4.9.2 Investments made by the Council's Officers are restricted to the following organisations:-

(a) Banks or Building Societies who currently meet the Capita suggested investment duration

(b) Nationalised Industries and Statutory Corporations

(c) Other Government Institutions

(d) Other Local Authorities

(e) Money Market Funds

(f) Bills of Exchange which have been accepted by authorised institutions

(g) United Kingdom Gilt-edged Securities

(h) Negotiable instruments such as Certificates of Deposit, Treasury Bills and Corporate Bonds

(i) Approved counterparties from countries with a minimum sovereign credit rating of AAA from all three rating agencies, with the exception of UK.

Total investments with any one institution shall not exceed £5 million.

Total investments of over 364 days shall not exceed £5 million in total.

4.9.3 Appointment of External Fund Managers

External Fund managers may be appointed to administer the investment of the Council's surplus funds and reserves. Any appointments will be made by the appropriate portfolio holder, having received an analysis of the capabilities and performance of the Fund Manager by the Deputy Chief Executive. Fund Managers will be bound by the restrictions contained within the Treasury Management Policy Statement. The performance of the Fund Managers will be contained in the annual report on the treasury management operation.

4.9.4 Appointment of External Service Providers

The Council uses Capita Asset Services as its external treasury management advisers, however it recognises that responsibility for treasury management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon external service providers.

The Council also recognises that there is value in employing external providers of treasury management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

5. Prudential Indicators

The overriding requirement of the prudential code is that borrowings or credit should be both prudent and affordable and remain within sustainable limits.

To demonstrate this, the Council is required to determine a number of limits before the start of the financial year to control the extent of exposure to credit. The Deputy Chief Executive then has a duty to monitor borrowing and credit against these indicators and report on the authority's compliance or otherwise at the end of the year in question. The indicators may be revised during the year if necessary but the amendments must be approved by Cabinet.

Members are therefore requested to consider the Prudential Indicators detailed in this report.

5.1 Prudential Indicators of Affordability

The Council is therefore required to consider all of its available resources in the medium term (usually defined as three years) together with total plans for expenditure. Any known significant variations beyond this timeframe also need to be taken into account. Tables included in a) and b) below do not include the £10m discussed in paragraph 4.4 above as the expected income from these schemes is expected to be greater than the capital financing costs associated with these schemes.

The Prudential indicators for affordability are as follows:

a) Estimate of ratio of financing costs to net revenue stream for the next three years split between the Housing Revenue Account and the General Fund

For the next three years the Council is required to calculate an estimated ratio of its financing costs to net revenue stream for both the General Fund and the Housing Revenue Account. This takes into account predicted future levels of Government funding.

It is suggested that the following indicator be set for the next three years:

	2017/2018 %	2018/2019 %	2019/2020 %
Housing Revenue Account	14.63	14.90	15.15
Non HRA (General Fund)	10.78	11.32	12.88

b) Estimate of the incremental impact of capital investment decisions on the Council Tax and Rent Levels

Authorities are required to estimate for the next three years the impact on the Council Tax (General Fund) and Rent levels (HRA) of the capital programme including running costs and financing costs. These indicators have been prepared using the revised Capital Programme which was agreed by Council 27th February 2017.

It is estimated that the incremental impact for the next three years will be as follows:

	2017/2018 £	2018/2019 £	2019/2020 £
General Fund (Band D)	5.32	1.57	1.54
HRA (52 weeks)	0	0	0

There is not expected be any new borrowing for the HRA between 2017/18 – 2019/20 as the Authority has reached the borrowing cap. The ratio for the General Fund is calculated by estimating the interest payable on the average capital borrowing requirement and dividing this by the estimated number of Band D equivalents.

c) Net borrowing and the Capital Financing Requirement (CFR) split between the General Fund and the Housing Revenue Account

In order to ensure that in the medium term borrowing is only undertaken for capital purposes, local authorities are required to ensure that external borrowing does not exceed, except in the short term, the total of their capital financing requirement over the planning period. In broad terms the capital financing requirement reflects an authority's need to borrow for capital purposes and is a measure of the assets contained on the balance sheet which have as yet not been fully financed, i.e. there is still some indebtedness outstanding.

It is necessary to estimate the capital financing requirement at the end of the forthcoming year and the subsequent two years for both the Housing Revenue Account and General Fund activities:

	31st March 2018	31st March 2019	31st March 2020
	£m	£m	£m
Housing Revenue Account	80	80	80
General Fund	22	21	20

As discussed in paragraph 4.4 if the £10m Investment Fund is created then the Capital Financing Requirement will change as follows:

	31st March 2018	31st March 2019	31st March 2020
	£m	£m	£m
Housing Revenue Account	80	80	80
General Fund	32	31	30

d) Capital Expenditure

Estimates of capital expenditure for the next three years split between the General Fund and the Housing Revenue Account

The estimated net capital expenditure requiring funding, as detailed in the Capital Programme Report is:

	2017/2018	2018/2019	2019/2020
	£m	£m	£m
Housing Revenue Account	9.0	10.9	9.4
General Fund	6.5	3.2	1.9

External Debt

e) Authorised Limit

For the next three years the authority is required to set an authorised limit for its total external debt, gross of investments. This is calculated by taking into account current external debt, new borrowing for loans which mature or for capital purposes and the need to borrow on a short term basis to cover for temporary shortfalls in revenue income and expenditure.

It is estimated that the following will be a suitable authorised limit for the next three years:

	2017/2018	2018/2019	2019/2020
	£m	£m	£m
Borrowing	130	130	130
Other Financial Instruments	0	0	0

The Authorised Limit has increased by £10m to allow for the increased capital borrowing as agreed in the Capital Strategy which was agreed by Cabinet 20th February 2017.

f) Operational Boundary

As well as an authorised limit the local authority must also set an operational boundary for its external debt for the next three years. The operational boundary is based on the most likely or prudent but not worst case scenario in relation to cash flow.

It is estimated that the following will be a suitable operational boundary for the next three years:

	2017/2018	2018/2019	2019/2020
	£m	£m	£m
Borrowing	120	120	120
Other Financial Instruments	0	0	0

The Operational Boundary has increase by £10m to allow for the increased capital borrowing as agreed in the Capital Strategy which went to Cabinet 20th February 2017.

5.2 Prudential Indicators for Prudence including Capital Expenditure, External Debt and Treasury Management

The prudential indicators for prudence have to be set taking into account those relating to affordability as outlined above and are as follows:

Treasury Management

a) Interest rate exposure

Local authorities are required to set limits for the next three years for the upper limits on exposure to the effects of changes in interest rates. The indicators relate to both fixed and variable rate interest, and are net of any investments.

Depending on the level of interest rates and their expected movement in the year, the Council may take up all of its new borrowings in the form of either fixed or variable rate debt. The figures below give the following maximum levels, when compared to the operational boundary, of exposure to fixed and variable interest rates, which are prudent limits for the forthcoming years:

Principal Outstanding	2017/2018	2018/2019	2019/2020
	£m	£m	£m
Fixed Rates	130	130	130
Variable Rates (No more than 40% of the operational boundary).	52	52	52

b) Maturity Structure of borrowing

For the next three years the authority is required to set both upper and lower limits for the maturity structure of its borrowing. This indicator relates only to fixed rate debt and is therefore a measure of the longer term exposure to interest rate risk.

Given the current structure of the Council's debt portfolio it is proposed the following limits for all three years be made for the maturity of the debt:

	Lower £m	Upper £m
Less than 12 months	0	20
12 months to 24 months	0	20
24 months to 5 years	0	25
5 years to 10 years	0	50
10 year and over	10	100

c) Principal sums invested for more than 364 days

Where a local authority invests, or plans to invest for periods of more than 364 days it must set an upper limit for each year for the maturity of such investments. The purpose of setting this limit is to contain any exposure to losses which might arise in the event of having to seek early repayment of the investment and / or adverse movements in shorter term interest rates.

It is suggested that the use of longer term investments be limited to a maximum of £5m maturity in each of the next three years to tie in with the Council's already approved policy of not investing more than £5m with any one bank or building society at the same time.

Glossary of Terms

GDP *Gross Domestic Product*

This is the monetary value of all the finished goods and services produced by a country within its borders in a specific time period, usually a year.

G7 G7 Countries

This is an international organisation established to facilitate economic cooperation among the seven wealthiest developed nations –Canada, France, Germany, Great Britain, Italy, Japan, USA.

CPI *Consumer Price Index*

RPI *Retail Price Index*

Both CPI and RPI measure inflation by measuring changes in the price levels of a sample of representative goods and services purchased by households. They use different items and different formulae for the calculations which means that CPI is often lower than RPI.

y/y *Year on year*

Year on year is a method of evaluating two or more measured events to compare the results of one time period with those of a comparable time period on an annualised basis.

MPC *Monetary Policy Committee*

This is a committee of the Bank of England which decides the official interest rate in the UK (the Bank of England Base Rate) and also directs other monetary policy such as quantitative easing and forward guidance.

PWLB *Public Works Loan Board*

The PWLB is a statutory body operating within the UK Debt Management Office to lend money from the National Loan Fund to local authorities and to collect the repayments.

Fed. *The Federal Reserve System*

The Federal Reserve System, often referred to as the Federal Reserve or simply "the Fed," is the central bank of the United States. It was created by the US Congress to provide the nation with a safer, more flexible, and more stable monetary and financial system.

Gilt A gilt is a UK Government liability in sterling, issued by HM Treasury and listed on the London Stock Exchange. The term "gilt" or "gilt-edged security" is a reference to the primary characteristic of gilts as an investment: their security. This is a reflection of the fact that the British Government has never failed to make interest or principal payments on gilts as they fall due.

Implications

Corporate Plan:

NA

Legal:
There are no significant legal implications outline in the report.

Finance:

This report is effective from 01/04/2017 and has the following financial implications:

Budget Area	Implication
General Fund – Revenue Budget	No General Fund Revenue Implications
General Fund – Capital Programme	No General Fund Capital Implications
Housing Revenue Account – Revenue Budget	No Housing Revenue Account Revenue Implications
Housing Revenue Account – Capital Programme	No Housing Revenue Account Capital Implications

Human Resources / Equality and Diversity:
No direct HR implications contained within the report.

Other Implications:

NA

Reason(s) for Urgency (if applicable):

Background Papers

None

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