

<b>Report To:</b>	<b>CABINET</b>	<b>Date:</b>	<b>5 MARCH 2018</b>
<b>Heading:</b>	<b>COUNCIL'S TREASURY MANAGEMENT STRATEGY</b>		
<b>Portfolio Holder:</b>	<b>CORPORATE RESOURCES AND FINANCE</b>		
<b>Ward/s:</b>	<b>ALL</b>		
<b>Key Decision:</b>	<b>YES</b>		
<b>Subject to Call-In:</b>	<b>NO</b>		

### **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;
- 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 Authorised Boundary and Operational Boundary limits.
- Changes to Minimum Revenue Provision Policy.
- Note Statutory Changes relating to Minimum Revenue Provision and Local Government Investments.

### **Recommendation(s)**

Members are requested to approve and recommend to Council to approve both the Treasury Management Strategy Statement in Section 5 and the Prudential Indicators in Section 6.

## **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**

None.

## **Detailed Information**

### **1. Treasury Management Defined**

This Council defines its treasury management activities as:

(a) The management of the Council's borrowing, 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 that is necessary to comply with guidance issued by the Ministry of Housing, Communities and Local Government (MHCLG).

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. Capital Strategy**

In December 2017, CIPFA issued revised Prudential and Treasury Management Codes. As from 2019-20, all local authorities will be required to prepare an additional report, a Capital Strategy report, which is intended to provide the following: -

- a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services
- an overview of how the associated risk is managed
- the implications for future financial sustainability
- The aim of this report is to ensure that all elected members on the full council fully understand the overall strategy, governance procedures and risk appetite entailed by this Strategy.

The Capital Strategy will include capital expenditure, investments and liabilities and treasury management in sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured.

### **5. TREASURY MANAGEMENT STRATEGY STATEMENT (TMSS) FOR 2018/19**

#### **5.1 Introduction**

**The TMSS covers two main areas:**

- **Capital issues**
  - **the Capital Plans and the Prudential Indicators (5.2)**
  - **the Minimum Revenue Provision (MRP) strategy (5.3)**
- **Treasury Management issues**
  - the current treasury position (5.4)
  - prospects for interest rates (5.5)
  - borrowing strategy (5.6)
  - policy on borrowing in advance of need (5.7)
  - debt rescheduling (5.8)
  - Annual Investment Strategy (AIS) including policies on creditworthiness and external service providers(AIS) (5.9)

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

## 5.2 The Capital Prudential Indicators 2018/19 to 2020/21

At the meeting on 23 March 2017, Cabinet considered a set of Prudential Indicators and referred them for approval by Council on 20 April 2017. Since that meeting, there have been revisions to the proposed Capital Programme. The latest version of the Capital Programme was agreed by Cabinet 19th February 2018 and then to be considered by Council 1st March 2018. The Prudential Indicators now reflect the latest Capital Programme; the revised figures are included in Section 6.

### 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 2018/19 – 2020/21 capital investment decisions on council tax

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

## 5.3 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).

MHCLG 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 MHCLG 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 2018/19:

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 Option 4, the Depreciation Method, this follows the standard accounting depreciation procedures. The Council is currently reviewing its future approach to Investment Properties. As this method is no longer suitable for Investment Properties.

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 2018/19.

g. MRP is charged in the following accounting year after expenditure is incurred. Based on the above policy, the total MRP charge for 2018/19 has been calculated as £1.809m, as detailed below. The exact amount of MRP will be subject to the out-turn of 2017/18 Statement of Accounts.

	£000's
Option 1 – Regulatory Method	1,092
Option 3 – Asset Life Method	913
Option 4 – Depreciation Method	0
<b>Total MRP</b>	<u><u>1,809</u></u>

#### 5.4 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 2018, together with forward projections, is summarised below. The table shows the expected actual external debt against the underlying capital borrowing need (the CFR).

	<b>31/03/2018 Estimate £m</b>	<b>31/03/2019 Estimate £m</b>	<b>31/03/2020 Estimate £m</b>	<b>31/03/2021 Estimate £m</b>
<b>Capital Financing Requirement</b>	117.682	117.157	116.435	114.823
<b>Less:</b>				
Profile of Current External Borrowing	74.748	74.748	74.748	74.748
<b>Under over borrowing position (Headroom)</b>	42.934	42.409	41.687	40.075

## 5.5 Prospects for Interest Rates

The Council has appointed Link 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 our central view.

	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank rate	0.50%	0.75%	0.75%	1.00%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%	1.50%	1.50%	1.50%
5yr PWLB rate	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%
10yr PWLB rate	2.50%	2.50%	2.60%	2.70%	2.70%	2.80%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
25yr PWLB rate	2.80%	2.90%	3.00%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

The Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November. This removed the emergency cut in August 2016 after the EU referendum. The MPC also gave forward guidance that they expected to increase Bank rate only twice more by 0.25% by 2020 to end at 1.00%. At its February 2018 meeting, there was no change in Bank Rate but the forward guidance changed significantly to warn of “earlier, and greater than anticipated” rate of increases in Bank compared to their previous forward guidance. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in May and November 2018, November 2019 and August 2020.

The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected, that at some point, there would be a more protracted move from bonds to equities after a historic long-term trend, over about the last 25 years, of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial Quantitative Easing, added further impetus to this downward trend in bond yields and rising bond prices. Quantitative Easing has also directly led to a rise in equity values as investors searched for higher returns and took on riskier assets. There was a sharp rise in bond yields after the US Presidential election in November 2016 and yields have risen further more recently as a result of an agreement to a big increase in the government deficit aimed at stimulating economic growth and the Fed. taking the lead in reversing monetary policy by starting, in October 2017, a policy of not fully reinvesting proceeds from bonds that it holds when they mature. We have also seen a sharp selloff in equities and bonds in February 2018 that has given further impetus to a rise in bond yields.

Until 2015, monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as stronger economic growth becomes more firmly established. The Fed. has started raising interest rates and this trend is expected to continue during 2018 and 2019. These increases will make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US are likely to exert some upward pressure on bond yields in the UK and other developed economies. However, the degree of that upward pressure is likely to be dampened by how strong or weak the prospects for economic growth and rising inflation are in each country, and on the degree of progress towards the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

From time to time, gilt yields – and therefore PWLB rates - can be subject to exceptional levels of volatility due to geo-political, sovereign debt crisis, emerging market developments and sharp changes in investor sentiment. Such volatility could occur at any time during the forecast period. Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts

for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments.

The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- The Bank of England takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than we currently anticipate.
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows.
- A resurgence of the Eurozone sovereign debt crisis, possibly Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- Weak capitalisation of some European banks.
- Germany is still without a fully agreed and stable coalition government after the inconclusive result of the general election in October. In addition, Italy is to hold a general election on 4 March and the anti EU populist Five Star party is currently in the lead in the polls, although it is unlikely to get a working majority on its own. Both situations could pose major challenges to the overall leadership and direction of the EU as a whole and of the individual respective countries. Hungary will hold a general election in April 2018.
- The result of the October 2017 Austrian general election has now resulted in a strongly anti-immigrant coalition government. In addition, the Czech ANO party became the largest party in the October 2017 general election on a platform of being strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump
- A sharp Chinese downturn and its impact on emerging market countries

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include: -

- The Fed causing a sudden shock in financial markets through misjudging the pace and strength of increases in its Fed. Funds Rate and in the pace and strength of reversal of Quantitative Easing, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.
- The Bank of England is too slow in its pace and strength of increases in Bank Rate and, therefore, allows inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- UK inflation, whether domestically generated or imported, returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

### **Investment and borrowing rates**

- Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.
- Borrowing interest rates have been volatile so far in 2017-18 and increased sharply after the result of the general election in June 2017, after the September MPC meeting, (when financial markets reacted by accelerating their expectations for the timing of Bank Rate increases), and again in January and February 2018. Increases have been sharper in periods up to 10 years than in longer maturities.. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed

to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt;

- There will remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will, most likely, incur a revenue cost – the difference between borrowing costs and investment returns.

### **a) Eurozone Economy**

Economic growth in the Eurozone (EZ), (the UK's biggest trading partner), had been lack lustre for several years after the financial crisis despite the ECB eventually cutting its main rate to -0.4% and embarking on a massive programme of QE. However, growth picked up in 2016 and has now gathered substantial strength and momentum thanks to this stimulus. GDP growth was 0.6% in quarter 1 (2.1% y/y), 0.7% in quarter 2 (2.4% y/y) and +0.6% in quarter 3 (2.6% y/y). However, despite providing massive monetary stimulus, the European Central Bank is still struggling to get inflation up to its 2% target and in December inflation was 1.4%. It is therefore unlikely to start on an upswing in rates until possibly 2019. It has, however, announced that it will slow down its monthly QE purchases of debt from €60bn to €30bn from January 2018 and continue to at least September 2018.

### **b) USA Economy**

Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 started erratically with quarter 1 coming in at an annualised rate of only 1.2%, quarter 2 at 3.1%, quarter 3 3.2% and Q4 2.6%. This gave an overall figure for annual growth in 2017 of 2.6%, an acceleration from 1.5% in 2016. Unemployment in the US has also fallen to the lowest level for seventeen years, reaching 4.1%, while wage inflation pressures, and inflationary pressures in general, have been building. The Fed has started on a gradual upswing in rates with five increases in all and four increases since December 2016; the latest rise was in December 2017 and lifted the central rate to 1.25 – 1.50%. There could then be another four increases in 2018. At its September meeting, the Fed said it would start in October to gradually unwind its \$4.5 trillion balance sheet holdings of bonds and mortgage backed securities by reducing its reinvestment of maturing holdings.

### **d) China and Japan**

China - Economic growth has been weakening over successive years, despite repeated rounds of central bank stimulus; medium term risks are increasing. Major progress still needs to be made to eliminate excess industrial capacity and the stock of unsold property, and to address the level of non-performing loans in the banking and credit systems.

Japan - GDP growth has been gradually improving during 2017 to reach an annual figure of 2.1% in quarter 3. However, it is still struggling to get inflation up to its target of 2%, despite huge monetary and fiscal stimulus. It is also making little progress on fundamental reform of the economy.

## **5.6 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 2018/19 treasury operations. The Corporate Finance Manager (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.

### **5.7 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.

### **5.8 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.

## **5.9 Annual Investment Strategy 2018/19**

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.

5.9.1 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.

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

- (a) Banks or Building Societies who currently meet the Link Asset Services suggested investment duration
- (b) Nationalised Industries and Statutory Corporations
- (c) Other Government Institutions
- (d) Other Local Authorities
- (f) Money Market Funds
- (g) Bills of Exchange which have been accepted by authorised institutions
- (h) United Kingdom Gilt-edged Securities
- (i) Negotiable instruments such as Certificates of Deposit, Treasury Bills and Corporate Bonds
- (j) 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 365 days shall not exceed £5 million in total.

### 5.9.3 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 Chief Financial Officer. 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.

### 5.9.4 Appointment of External Service Providers

The Council uses Link 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.

## 6. 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 Chief Financial Officer 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.

### 6.1 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.

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:

	2018/2019 %	2019/2020 %	2020/2021 %
Housing Revenue Account	14.50	14.60	14.26
Non HRA (General Fund)	11.19	14.86	16.63

**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 went to Cabinet 19th February 2018.

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

	<b>2018/2019</b>	<b>2019/2020</b>	<b>2020/2021</b>
	<b>£</b>	<b>£</b>	<b>£</b>
General Fund (Band D)	1.72	2.04	1.11
HRA (52 weeks)	0	0	0

There is not expected be any new borrowing for the HRA between 2018/19 – 2020/21 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 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:

	<b>31st March 2019</b>	<b>31st March 2020</b>	<b>31st March 2021</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Housing Revenue Account	80	80	80
General Fund	37	36	35

**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:

	<b>2018/2019</b>	<b>2019/2020</b>	<b>2020/2021</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Housing Revenue Account	9.3	8.5	8.5
General Fund	4.3	2.6	1.8

## 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 that 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:

	<b>2018/2019</b>	<b>2019/2020</b>	<b>2020/2021</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	130	130	130
Other Financial Instruments	0	0	0

### 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:

	<b>2018/2019</b>	<b>2019/2020</b>	<b>2020/2021</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
Borrowing	120	120	120
Other Financial Instruments	0	0	0

## **6.2 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:

<b>Principal Outstanding</b>	<b>2016/2017</b>	<b>2017/2018</b>	<b>2018/2019</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>
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:

	<b>Lower £m</b>	<b>Upper £m</b>
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 365 days

Where a local authority invests, or plans to invest for periods of more than 365 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 that 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.

## **7. Statutory Guidance Updates February 2018**

The Government update its Statutory guidance on both Minimum Revenue Provision (MRP) and Local Government Investment. Copies of each of these guidance is included at the end of the report. Details on how the new guidance will affect the Authority are provided below:

### **7.1 Statutory Guidance on MRP**

The new guidance states that MRP Option 4 is no longer a suitable approach for calculating the MRP to be charged in respect of investment properties. The Option 4 method that was previously used meant that MRP was charged on the difference between the completion cost and its fair value. If the fair value was greater than the completion cost there was not any requirement to charge any MRP other than the MRP on the cost of purchase.

The change required in the guidance will mean that MRP will be charged on the full asset cost. The Authority does not expect this change to be effective until the 2019/20 financial year. It is seeking clarification from KPMG its external auditors regarding this.

### **7.2 Statutory Guidance on Local Government Investments**

The disclosures in the statutory guidance will be included in full in the next version of the Strategy in 2018/19. The Strategy requires a risk assessment stating the Authority's approach to assessing risk of loss, for non-financial investments the Strategy should set out the procedures for ensuring that the funds can be accessed when they are needed, for example to repay capital borrowed. The Strategy should detail how reliant the service delivery objectives are on its investing activities.

The strategy also should disclose the action taken to ensure elected members and statutory officers involved in investment decisions have appropriate capacity, skill and information to enable them to take informed decisions.

## **Glossary of Terms**

Call Deposits	Call Deposit Meaning: In deposit terminology, the term Call Deposit refers to a specific type of interest bearing investment account that allows a person to withdraw their money from the account without a penalty.
Fed.	The Federal Reserve System is the central banking system of the United States.
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	This is an international organisation established to facilitate economic cooperation among the seven wealthiest developed nations – Canada, France, Germany, Great Britain, Italy, Japan and USA
CPI	Consumer Price Index
LIBID	The London Interbank Bid Rate, that is, the interest rate at which banks bid to take short-term deposits from other banks
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 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.
QE	Quantitative Easing is an unconventional form of monetary policy where a Central Bank creates new money electronically to buy financial assets, like government bonds. This process aims to directly increase private sector spending in the economy and return inflation to target.

The decision is not subject to call in as the matter will be considered for approval by Council at the Extraordinary meeting being held after Cabinet.

## **Implications**

### **Corporate Plan:**

### **Legal:**

Approval of the Council's Treasure Management Strategy ensures compliance with legislation and guidance.

**Finance:**

<b>Budget Area</b>	<b>Implication</b>
General Fund – Revenue Budget	No General Fund Revenue Implications.
General Fund – Capital Programme	No General Fund Capital Implications.
Housing Revenue Account – Revenue Budget	No HRA Revenue Implications.
Housing Revenue Account – Capital Programme	No HRA Capital Implications.

**Risk:**

<b>Risk</b>	<b>Mitigation</b>
The Minimum Revenue Provision (MRP) policy is no longer suitable.	Careful monthly monitoring of Capital Expenditure should ensure an appropriate and prudent MRP provision is made annually.
The Annual Investment Strategy is no longer appropriate for the Authority.	Information received from our Treasury Management Advisors should allow the Authority to take necessary action to mitigate against any risks.

**Human Resources:**

There are no HR implications.

**Equalities:**

None.

**Other Implications:**

*(if applicable)*

**Reason(s) for Urgency**

*(if applicable)*

**Reason(s) for Exemption**

*(if applicable)*

**Background Papers**

*(if applicable)*

**Report Author and Contact Officer**

Sharon Lynch  
CORPORATE FINANCE MANAGER  
[s.lynch@ashfield.gov.uk](mailto:s.lynch@ashfield.gov.uk)