Agenda Item No:

Report to: Audit Committee

Date of Meeting: 25 January 2017

Report Title: Treasury Management and Annual Investment Strategy 2017/18, including quarterly monitoring reports for 2017/18

Report By: Peter Grace

Assistant Director – Financial Services and Revenues

Purpose of Report

To consider the draft Treasury Management and Annual Investment Strategy and draw any concerns or recommendations to Cabinet and Council as appropriate, to ensure that there is an effective framework for the management of the Council's investments, cash flows and borrowing activities. The Council has £20.5 million of debt, and investments which fluctuate between some £15 million and £30 million in the year.

There is a statutory requirement to determine, by full Council, the Treasury Management Strategy Statement, Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy (2017/18) prior to the start of the new financial year.

Recommendation(s)

1. **The Committee recommend that the Council approve the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy and Annual Investment Strategy (2017/18)**
2. **The Committee consider whether investments should be made within one or more Property Funds and make a recommendation to Cabinet and Council**
3. **The Committee consider whether an investment is made specifically with CCLA (Local Authority Property Fund) and make a recommendation to Cabinet and Council.**

Reasons for Recommendations

The Council seeks to minimise the costs of borrowing and maximise investment income whilst ensuring the security of its investments. The Council is seeking to increase opportunities for income generation, particularly where there are benefits to the residents of Hastings in doing so, and this will involve the Council in taking on additional borrowing. The sums involved are large and the assumptions made play an important part in determining the annual budget. Compliance with the CIPFA Code of Practice represents best practice and ensures compliance with statutory requirements.

The Council has the ability to diversify its investments into other Property Funds and should consider carefully the level of risk against reward against a backgorund of low interest rates being forecast for some years ahead. Such an investment would help to close the gap in the budget in the years ahead and thus help to preserve services.

Introduction

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

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

3. Treasury management in this context is defined as:

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

4. The reporting arrangements proposed, in accordance with the requirements of the revised Code, are summarised below:-

Area of Responsibility	Council/ Committee/ Officer	Frequency
Treasury Management Strategy / Annual Investment Strategy / MRP policy	Cabinet and Council	Annually before the start of the year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – Mid Year report	Cabinet and Council	Mid year
Treasury Management Strategy / Annual Investment Strategy / MRP policy – updates or revisions at other times	Cabinet and Council	As required
Annual Treasury Outturn Report	Cabinet and Council	Annually by 30 September after the end of the year
Treasury Management Practices	S151 Officer	Reviewed as required (minimum - annually)
Scrutiny of Treasury Management Strategy	Audit Committee	Annually before the start of the year
Scrutiny of treasury management performance and strategy	Audit Committee	Quarterly Monitoring reports, Mid Year report,

5. The CIPFA Code of Practice on Treasury Management has been adopted by this Council and its requirements and subsequent revisions are fully complied with. The purpose and requirements of the Code are identified as Appendix 8.

6. The Audit Committee is required to determine the Prudential Indicators as part of the Treasury Management Strategy; these are identified in Appendix 4.

Investment Performance 2016-17

7. The performance for the first 9 months of 2016/17 provided an average return of 0.6% (excludes Local Authority Mortgage (LAM) scheme).This compares to 0.64% for the same period last year. These figures also exclude the interest receivable in respect of loans to other organisations.

8. The total interest earned for the first 9 months is £120,000 (excluding Local Authority Mortgage Scheme and loans to other institutions). This compares to £125,000 for the same period last year.

9. The Committee, Cabinet and full Council have considered a Mid Year report on Treasury Management based on the performance and activities and issues that may have arisen since setting the strategies before the start of the financial year. The current strategy and policies were considered to be entirely appropriate and no changes were made.

10. The first loan in respect of the Local Authority Mortgage scheme was repaid (after 5 years) in December 2016 (£1million). This loan was taken out to fund the first tranche of the Local Authority Mortgage scheme and was matched with a deposit of £1m with Lloyds Bank at an interest rate of 4.45% (repaid to the Council in January 2017).The remaining £1million loan is due to be repaid in 2018.

Treasury Management Strategy for 2017/18

11. The Local Government Act 2003 (the Act) and supporting regulations require the Council to 'have regard to' the CIPFA Prudential Code and the CIPFA Treasury Management Code of Practice to set Prudential and Treasury Indicators for the next three years to ensure that the Council's capital investment plans are affordable, prudent and sustainable.

12. The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

13. The suggested strategy for 2017/18 in respect of the following aspects of the treasury management function is based upon the Council officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Capita Asset Services (previously Sector).

14. The strategy covers two remain areas:

    (i) Capital issues
    - the capital plans and the prudential indicators;
    - the minimum revenue provision (MRP) policy.

    (ii) Treasury management issues
    - the current treasury position;
    - treasury indicators which limit the treasury risk and activities of the Council;
    - prospects for interest rates;
    - the borrowing strategy;
    - policy on borrowing in advance of need;
    - debt rescheduling;
    - the investment strategy;
    - creditworthiness policy; and
    - policy on use of external service providers.

Key Changes to the Strategy

15. The key changes from the previous year's strategy are:

    i. The Council has taken on additional borrowing in 2016/17 mainly in respect of Aquila House (now Muriel Matters House) and the retail park. The level of borrowing has risen significantly but remained within the authroised boundary.

ii. The income generation plans of the Council are expected to involve considerable new borrowing in 2017/18 and the years ahead. The new borrowing limits proposed in the strategy are therefore significantly increased to allow for this and to include the necessary headroom to borrow for the current and forthcoming schemes within the Capital programme. The overall authorised borrowing limits increasing to £40m in 2016/17, £70m in 2017/18 , £80m in 2018/19 and £90m in 2019/20.

iii. Some of the new borrowing in future years will be for Capital purposes, but there will inevitably be a smaller requirement for loans that are revenue in nature e.g. initial loans to housing company for running costs. Such monies can not be borrowed from the Public Works Loan Board, and are likely to be funded from existing Council reserves.

iv. The Council is required to make a Minimum Revenue Provision in respect of its borrowing – to ensure debt is repaid over an appropriate period. Where the Council is making significant investments in property, housing or other programmes the Council's MRP policy will, if approved,enable the Council to match the principal repayments made on loans arranged with an equal MRP payment (an annuity methodology).

v. That investment returns are expected to reduce further over the next year as current investments mature in a lower interet rate environment.

vi. The Council to invest some of its existing reserves in a Property Fund.

Balanced Budget

16. It is a statutory requirement under the Local Government Finance Act 1992, for the Council to calculate its Council Tax requirement. In particular, Section 31 requires a local authority in calculating the Council Tax requirement for each financial year to include the revenue costs that flow from capital financing decisions. Thus any increases in costs (running costs & borrowing costs) from new capital projects must be limited to a level which is affordable within the projected income of the Council for the foreseeable future.

PRUDENTIAL AND TREASURY LIMITS FOR 2017/18 TO 2019/20

17. The treasury indicators for borrowing activity are the Operational Boundary and the Authorised Limit for external debt.

18. The Operational Boundary is the limit beyond which external debt is not normally expected to exceed.

19. The Authorised Limit, which is a limit beyond which external debt is prohibited, needs to be set or revised by the full Council; it is a statutory duty under Section 3 of the Act and supporting regulations. Essentially the Council is required to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future Council Tax levels is 'acceptable'.

20. Whilst termed an "Affordable Borrowing Limit", the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements (certain leases). The Authorised Limit and

operational boundary are to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

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

22. The CFR does not increase indefinitely, as the minimum revenue provision (MRP) reduces the balance. The Council needs to ensure that its total debt does not exceed the CFR.

23. Prudential Indicators are set out in Appendix 4 to this report.

CURRENT PORTFOLIO POSITION

24. The Council's debt position at 31 December 2016 comprised:

Table 1 - Borrowing

Debt	1 April 2016 Principal	Rate	Maturity	31 December 2016 Principal	Rate
PWLB Loan 1	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB Loan 2	£1,000,000	2.02%	2016		
PWLB Loan 3	£1,000,000	1.63%	2018	£1,000,000	1.63%
PWLB Loan 4	£2,000,000	0.56% (Variable)	2019	£2,000,000	0.40% (*Variable)
PWLB Loan 5	£909,027	3.78%	2044	£909,027	3.78%
PWLB Loan 6	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB Loan 7 (Annuity)	£300,000	1.66%	2026	£286,149	1.66%
PWLB Loan 8			2056	£1,000,000	2.92%
PWLB Loan 9			2046	£1,000,000	3.08%
PWLB Loan 10			2036	£1,000,000	3.01%
PWLB Loan 11			2026	£1,000,000	2.30%
PWLB Loan 12			2054	£2,000,000	2.80%
PWLB Loan 13			2028	£1,000,000	2.42%
Total Debt	**£14,497,262**	**3.55%**		**£20,483,411**	**3.34%**

* rate at October (rates change every 3 months)

25. The Council has loaned money to other organisations. As at 30 September 2016 four longer term loans are outstanding.Namely:

Table 2 – Loans to Other Organisations

3rd Party Organisations	*Rate/ Return (%)*	*Start Date*	*End Date*	*Principal £*	*Term*
AMICUS	*3.780*	*04/09/2014*	*02/09/2044*	*1,788,235*	*Fixed*
The Foreshore Trust	*1.660*	*21/03/2016*	*20/03/2026*	*286,149*	*Annuity*
The Source	*2.430*	*17/12/2015*	*16/12/2024*	*25,000*	*Annuity*
The Foreshore Trust	*1.820*	*21/03/2016*	*21/03/2026*	*127,000*	*Annuity*
			Total	*2,226,384*	

26. Borrowing from the PWLB was taken to fund the Amicus Horizon loan (£1,788,235-Maturity loan) and one of the loans to the Foreshore Trust (£300,000 originally borrowed – Annuity loan); these correspond to PWLB loans 6 & 7 respectively in Table 1 above.

27. The interest receivable for 2016/17 on these loans amounts to £75,312, albeit the smaller Foreshore Trust loan (£127,000) will terminate on the completion of a land swap – subject to receiving Charity Commission approval.

PROSPECTS FOR INTEREST RATES

28. The Council has appointed Capita Asset Services as treasury adviser to the Council and part of their service is to assist the Council to formulate a view on interest rates (Appendix 2 – Economic Review).

29. Capita Asset Services' bank base rate and PWLB rate forecast is:-

	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%

BORROWING STRATEGY

30. The level of long term borrowing will need to be determined by the relative merits of using alternative funding sources, including the reduction of investments, based on an assessment of market conditions as set out in the borrowing strategy below. Borrowing will not exceed the figures set out in the Prudential Indicators.

31. The Council purchased Aquila House for £4.4m (including stamp duty) at the start of this financial year. In addition there has been the purchase of a retail park for some £7.275m, the construction of a new industrial unit (BD Foods - £1,400,000) and all the remaining schemes in the Cpaital programme to finance. A further grant to Amicus Horizon (Phase 2 of the Coastal Space project - £875,000) is committed as is a phase 3.

32. Prior to the referendum vote in the summer interest rates look set to increase. The opportunity was taken to take new borrowing to finance Muriel Matters (formerly Aquila House) in particular and lock in the savings that were achieved by purchasing the property rather than renting it. In addition, given the low historical rates of interest, the level of internal borrowing was also reduced. In total some £7m of new borrowing from the PWLB has been taken to date this financial year.

33. The Council is currently still 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 flow has been used as a temporary measure. This strategy has been considered prudent as investment returns are low and counterparty risk is still an issue that needs to be considered.

34. The Council has at the time of writing some £20.5m of PWLB debt, and could potentially borrow up to the projected level of the CFR (£31m) .

35. Whilst the borrowing rates are attractive on a historical basis the difference between the return on investment and the cost of borrowing remains – the additional revenue cost falling on the Council taxpayer. There is however still a case for taking new borrowing before rates increase again or restrictions are placed on the amount and levels of borrowing that authorities can undertake (particularly from the PWLB) and a balanced view will be taken.

36. The plans for income generation, which would require substantial new borrowing by the Council in the future, play a part in the consideration as to when to borrow and the level of internal borrowing. Given the historically low interest rates and the ability of the Council to look at other investment opportunities which are providing higher returns than the cost of borrowing e.g. property acquisitions or property funds, there is a much stronger case for reducing the level of internal funding now in order to ensure a lower level of borrowing risk in the future.

37. In determining what would be a prudent level of borrowing, the Council needs to ensure that it would still be able to provide core services if its investments or income generating initiatives failed – at least in part. As a guide each £1m of new borrowing, financing an asset with a life of 40 years would currently cost the Council some 5.5 % p.a (based on a maturity loan with a 3% interest rate) i.e.

£55,000 p.a. . The Council if investing money in property based assets as against other ventures would have assets to sell if necessary – thus reducing overall risk.

38. The recommendation is to increase the operational and authorised boundaries for 2016/17 to £40m, 2017/18 to £70m, 2018/19 to £80m and 2019/20 to £90m (Appendix 4). Individual income generating schemes will of course need to be shown to be viable and fully risk assessed, with due diligence checks completed.

39. An addition to the authorised borrowing limit does not give permission to spend money. The Council's governance arrangements would still require the approval of individual schemes or purchases before they could proceed. In the event that the Council looked to finance additional Capital expenditure of say £50m over the next few years the impact on the revenue account in a full year could be £2,750,000 depending upon the life of the assets and actual interest rates at the time.

40. In taking on such levels of additional debt the Council has to ensure that it can afford to do so. It also needs to ensure that it has an affordable exit strategy in the event that expected returns are not realised. Where property is concerned there is normally an asset to dispose of and such schemes are not therefore at the higher end of the risk spectrum. In arriving at a figure of an additional £50m on the authorised borrowing limit, it is assessed that the Council currently has sufficient reserves to ensure that it could dispose of assets in a reasonable period and not be forced into an immediate fire sale. In the event that property values fell by say 20% the Council would not be forced to sell assets providing the rental streams were secure.

41. The Council again registered for the PWLB certainty rate earlier in the year which has given a 20 basis point reduction in the average rate of borrowing. The Council will look to do so again for 2017/18.

42. In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. The Chief Finance Officer, in conjunction with the treasury advisers, will continually monitor both the prevailing interest rates and the market forecasts, adopting the following responses to a change of sentiment:

    a. if it were 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

    b. if it were 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 a greater than expected 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 were still relatively cheap.

43. Given that rates look set to increase and given an increased borrowing requirement relating to income generation it is recommended above that the authorised borrowing limits be increased for 2016/17 to enable additional borrowing to take place whilst rates are at historically low levels.

External versus Internal Borrowing

44. The Council's underlying need to borrow for capital expenditure is termed the Capital Financing Requirement (CFR). This figure is a gauge of the Council's debt position. The CFR results from the capital activity of the Council and what resources have been used to pay for the capital spend.

45. Part of the Council's treasury activities is to address the funding requirements for the Council's borrowing need. Depending on the capital expenditure programme, the treasury service organises the Council's cash position to ensure sufficient cash is available to meet the capital plans and cash flow requirements. This may be sourced through borrowing from external bodies (such as the Government, through the Public Works Loan Board [PWLB] or the money markets), or utilising temporary cash resources within the Council.

46. The Council's underlying borrowing need (CFR) is not allowed to rise indefinitely. Statutory controls are in place to ensure that capital assets are broadly charged to revenue over the life of the asset. The Council is required to make an annual revenue charge, called the Minimum Revenue Provision – MRP, to reduce the CFR. This is effectively a repayment of the borrowing need. This differs from the treasury management arrangements which ensure that cash is available to meet capital commitments. External debt can also be borrowed or repaid at any time, but this does not change the CFR.

47. The total CFR can also be reduced by:

    - the application of additional capital financing resources (such as unapplied capital receipts); or

    - charging more than the statutory revenue charge (MRP) each year through a Voluntary Revenue Provision (VRP).

48. The Council's CFR for the year is shown below, and represents a key prudential indicator. It includes leasing schemes on the balance sheet, which increase the Council's borrowing need. No borrowing however is actually required against any such schemes.

Table 2 CFR: General Fund	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's
Opening balance	18,572	18,352	31,063	31,097
Add unfinanced capital expenditure	300	13,225	875	0
Less MRP	-511	-505	-832	-845
Less finance lease arrangements	-9	-9	-9	-9
Closing balance	18,352	31,063	31,097	30,243

Borrowing activity is constrained by prudential indicators particularly the CFR, and by the authorised limit.

Table 3 Internal Borrowing	2015/16 Actual £000's	2016/17 Estimate £000's	2017/18 Estimate £000's	2018/19 Estimate £000's
Capital Financing Requirement	18,352	31,063	31,097	30,243
External Borrowing	14,497	20,483	20,483	20,483
Net Internal Borrowing	3,855	10,580	10,614	9,860

49. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure. Net borrowing should not therefore, except in the short term, have exceeded the CFR for 2016/17 plus the expected changes to the CFR over 2016/17 and 2017/18 from financing the capital programme. This indicator allows the Council some flexibility to borrow in advance of its immediate capital needs should it so choose.

50. The table above highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council. The Council has complied with this prudential indicator.

51. The general aim of this treasury management strategy is to minimise the costs of borrowing in both the short and longer term. In the short term it can consider avoiding new borrowing and using cash balances to finance new borrowing. However to minimise longer term costs it needs to borrow when rates are a historically low levels. The timing of new borrowing is therefore important to minimise the overall costs to the Council.

52. Over the next two to three years, investment rates are expected to be below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by avoiding new external borrowing and by using internal cash balances to finance new capital expenditure or to replace maturing external debt (this is referred to as internal borrowing). This would maximise short term savings.

53. However, short term savings by avoiding new long term external borrowing in 2017/18 will also be weighed against the potential for incurring additional long term extra costs by delaying new external borrowing until later years when PWLB long term rates are forecast to be significantly higher. A balanced position will be sought.

54. The Council is currently maintaining an under-borrowed position as identified above. 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 has been prudent to date as investment returns are low and counterparty risk has been relatively high, but given future income generation plans new borrowing may be taken if good rates are available.

Summary

55. The Council's borrowing requirements have increased substantially over the last year and look likely to continue to do so. This is now being set against a period within which rates are forecast to increase.

56. The cheapest borrowing will be internal borrowing by running down cash balances and foregoing interest earned at historically low rates. However, in view of the overall forecast for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against the potential increase in long term costs as rates rise. As such some additional new borrowing will be taken.

57. The use of PWLB variable rate loans for up to 10 years will be considered as they can be repaid early without early redemption premiums. They can also be converted into longer dated fixed rate debt should it be considered prudent to do so.

58. The use of fixed rate market loans will also be considered should rates be below PWLB rates for the equivalent maturity period.

59. The use of either PWLB maturity and annuity loans will be considered in order to minimise annual borrowing costs.

Policy on borrowing in advance of need

60. The Council will not borrow more than or in advance of its needs purely in order to profit from the investment of the extra sums borrowed. Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds.

61. In determining whether borrowing will be undertaken in advance of need the Council will:

    a. ensure that there is a clear link between the capital programme and maturity profile of the existing debt portfolio which supports the need to take funding in advance of need.

    b. ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered.

    c. evaluate the economic and market factors that might influence the manner and timing of any decision to borrow.

    d. consider the merits and demerits of alternative forms of funding.

    e. consider the appropriate funding period.

    f. consider the impact of borrowing in advance on temporarily (until required to finance capital expenditure) increasing investment cash balances and the

consequent increase in exposure to counterparty risk, and the level of such risks given the controls in place to minimise them.

Debt Rescheduling

62. The introduction by the PWLB in 2007 of a spread between the rates applied to new borrowing and repayment of debt, which has now been compounded since 20 October 2010 by a considerable further widening of the difference between new borrowing and repayment rates, has meant that PWLB to PWLB debt restructuring is now much less attractive than it was before both of these events. In particular, consideration would have to be given to the large premiums which would be incurred by prematurely repaying existing PWLB loans and it is very unlikely that these could be justified on value for money grounds if using replacement PWLB refinancing.

63. The Council also keeps under review the potential for making premature debt repayments in order to reduce borrowing costs as well as reducing counterparty risk by reducing investment balances. However, the cost of the early repayment premiums that would be incurred and the increase in risk exposure to significantly higher interest rates for new borrowing, continue to make this option unattractive. When last reviewed the early repayment cost of the £7.5m PWLB loan, maturing in 2033, would amount to some £3m. No debt rescheduling is being contemplated at present.

64. The reasons for any rescheduling to take place will include:

    a. the generation of cash savings and / or discounted cash flow savings,
    b. helping to fulfil the strategy outlined above
    c. enhancing the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Minimum Revenue Provision (MRP)

65. Appendix 1 of this report provides the detail on what the MRP is and the basis of the calculation. Basically, authorities are required each year to set aside some of their revenues as provision for debt repayment. Unlike depreciation which is reversed out of the accounts, this provision has a direct impact on the Council Tax requirement. The provision is in respect of capital expenditure that is financed by borrowing or credit arrangements e.g. leases.

66. The Council is required to make a “Prudent Provision” which basically ensures that revenue monies are set aside to repay the debt over the useful life of the asset acquired i.e. the Minimum Revenue Provision (MRP). This can be achieved by equal annual instalments (current practice) or an annuity method – annual payments gradually increasing over the life of the asset. It is recommended that where an annuity loan is taken, the Council’s policy (Appendix 1) be amended to reflect the matching, as far as possible, of the MRP with the actual principal repaid (within each debt repayment).

67. The MRP for 2017/18 is estimated at £831,669 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

68. The Council will have regard to the government's Guidance on Local Government Investments ("the Guidance") and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are: -

    a. the security of capital and

    b. the liquidity of its investments.

69. The Council will also aim to achieve the optimum return on its investments commensurate with proper levels of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments.

70. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

71. Investment instruments identified for use in the financial year are listed in Appendix 4 under the 'Specified' and 'Non-Specified' Investments categories. Counterparty limits will be as set through the Council's Treasury Management Practices – Schedules.

72. In accordance with guidance from the DCLG and CIPFA, and in order to minimise the risk to investments, the Council has below clearly stipulated the minimum acceptable credit quality of counterparties for inclusion on the lending list. The creditworthiness methodology used to create the counterparty list fully accounts for the ratings, watches and outlooks published by all three ratings agencies with a full understanding of what these reflect in the eyes of each agency. Using the Capita ratings, potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

Creditworthiness Policy

73. This Council uses the creditworthiness service provided by Capita Asset Services. This service has been progressively enhanced over the last couple of years and now uses a sophisticated modelling approach with credit ratings from all three rating agencies - Fitch, Moody's and Standard and Poor's, forming the core element. However, it does not rely solely on the current credit ratings of counterparties but also uses the following as overlays: -

    - credit watches and credit outlooks from credit rating agencies
    - Credit Default Swap (CDS) spreads to give early warning of likely changes in credit ratings
    - sovereign ratings to select counterparties from only the most creditworthy countries

74. This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of

CDS spreads for which the end product is a series of colour code bands which indicate the relative creditworthiness of counterparties. These colour codes are also used by the Council to determine the duration for investments and are therefore referred to as durational bands. The Council is satisfied that this service now gives a much improved level of security for its investments. It is also a service which the Council would not be able to replicate using in house resources.

75. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Sector's weekly credit list of worldwide potential counterparties. The Council will therefore use counterparties within the following durational bands: -

- Purple 2 years (but HBC will only invest for up to 1 year – except LAMS)
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 3 months
- No Colour not to be used

76. This Council will not use the approach suggested by CIPFA of using the lowest rating from all three rating agencies to determine creditworthy counterparties as Moody's tend to be more aggressive in giving low ratings than the other two agencies. This would therefore be unworkable and leave the Council with few banks on its approved lending list. The Capita creditworthiness service does though, use ratings from all three agencies, but by using a risk based scoring system, does not give undue weighting to just one agency's ratings.

77. The Council is alerted to the changes to credit ratings of all three agencies through its use of the Capita creditworthiness service. These are monitored on a daily basis with lists updated weekly by Capita Asset Services.

78. Sole reliance will not be placed on the use of this external service. In addition this Council will also use market data and market information, information on government support for banks and the credit ratings of that government support.

79. The Council only use approved counterparties from countries with a minimum sovereign credit rating of AA- from Fitch Ratings (or equivalent from other agencies if Fitch does not provide). The list of countries that qualify using this credit criteria as at the date of this report are shown in Appendix 6. This list will be added to, or deducted from, by officers should ratings change in accordance with this policy. The maximum investment in any non UK country is not to exceed £10m.

80. The Local Authority Mortgage Scheme (LAMS) – The Council is currently participating in the cash backed mortgage scheme which requires the Council to place a matching five year deposit to the life of the indemnity. This investment is an integral part of the policy initiative and is outside the criteria above.

81. The Council transferred to Lloyds Bank on 1st December 2014, whilst the counterparty limit is set at £5 million for most institutions, the level of investments that is held with Lloyds Bank is £5 million plus up to £500,000 short term. In

addition there is £1 million invested in respect of LAMS – a total exposure of up to £6.5 million at any one time. One of the deposits with Lloyds (£1 million) being repaid in January 2017) thus reducing the exposure from £7.5m to £6.5m.

Investment Strategy

82. The table below provides a snapshot of where the investments are placed (as at 31 December 2016). The level varies daily.

Counterparty	Rate/ Return (%)	Start Date	End Date	Principal (£)	Term
Natwest	0.25	15/06/2011		72,760	Call
Lloyds LAMS	4.45	05/01/2012	10/01/2017	1,000,000	Fixed
Lloyds LAMS	1.97	26/03/2013	23/03/2018	1,000,000	Fixed
Natwest	0.35	21/08/2013		5,000,021	Call
Lloyds Bank	1.05	11/05/2016	11/05/2017	5,000,000	Fixed
National Australia	0.76	03/06/2016	05/06/2017	3,000,000	Fixed
Toronto	0.55	16/08/2016	16/05/2017	5,000,000	Fixed
Nordea	0.43	30/09/2016	30/06/2017	5,000,000	Fixed
Barclays	0.40	25/04/2012		1,292	Call
Santander	0.10	01/04/2011		1,816	Call
Santander	0.10	01/04/2011		5	Call
Amicus	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Source	2.43	17/12/2015	17/12/2025	25,000	Fixed
Foreshore trust	1.66	21/03/2016	20/03/2026	286,149	Fixed Annuity
			Total	**27,175,279**	

83. Priority is given to security and liquidity of investments in order to reduce counterparty risk to the maximum possible extent.

84. The Council has various limits depending upon the credit rating e.g. £5m with any one institution with a minimum short term rating of F1+, and a long term rating of A+ or above, supported by a red (6 month) rating by Capita Asset Services. The £5m limit generally represents a level of up to 20% of the investment portfolio with any one institution or group at any one time. It is also necessary, at times, to invest sums of this size in order to attract the larger institutions which have the higher credit ratings.

85. The Eurozone and Brexit have led to a number of downgrades to banks' credit ratings, making it increasingly difficult to spread investments across a number of institutions. The Chief Finance Officer has the authority to amend the limits on a daily basis if necessary to ensure that monies can be placed with appropriate institutions.

86. The net interest on the deposits in respect of the LAM scheme for the year are transferred into the mortgage reserve in order to meet potential defaults (none at present). If at the end of the five year period there are no defaults and arrears

exceeding 3 months the Council will receive its deposit back in full and would then be able to consider the use of the reserve monies. Such considerations will be included in future budget reports.

Investment Strategy – Property Fund

87. It was recommended in the Mid year review that the option for diversification of some of the investments into a property fund be explored, given the higher returns being achieved in some parts of the country. The investments would be in respect of the Council's reserves that are not required for a period of at least 5 years in order that any fall in values and entry costs into such funds can be covered.

88. Before any recommendations are to be put before Council, the Audit Committee and Cabinet will need to consider the implications. To this end the Council's Treasury advisers were approached to identify options for investments into property funds for consideration within this Treasury Management Strategy report. There is however a cost of doing such an exercise which would amount to some £7,500 and a further £5,000 p.a. should we wish to involve them on an ongoing basis to monitor the fund's performance and managers. Before incurring any such expenditure on choice of fund manager, it would be helpful to have approval to invest in such funds before spending such monies. Alternatively, if the Council is content with the use of such funds, to take a decision to make an initial investment with a single property fund (CCLA) that only works with local authorities and charities and is owned by its investors – more details below.

89. The attraction of a property fund investment is that it has both bond and equity like features. On the positive side it has a high and reliable income yield, but this comes at a price of security and liquidity and hence diversification is key. It does overcome the disadvantages of investing directly (management burden, cost, liquidity, asset availability) and effectively diversifies the Council's portfolio on a geographical (national) basis as well as gaining entry to asset classes and sectors that may not practically be available to the Council.

90. One such fund is managed by CCLA (Churches, Charities and local Authorities). Since 2013 the CCLA fund has attracted some 150 local authorities to invest £571m in the Local Authority property Fund. The fund is managed exclusively for local authority investors (£658m as at 30 November 2016 with 166 investors). The average income yield being 4.9% as at end of September 2016. In terms of income diversification it is split Shops (6.4%), retail warehouses (23.9%) offices (46.4%) and industrial (23.3%). 96.7 of current tenant rental income is from tenants with a lower than average risk.

91. The Council could consider an investment of £2m with CCLA. This would provide a higher rate of return than current investment (some 4% higher) as well as potentially achieving capital appreciation. The Council would receive the income, an additional £80,000 p.a. in the form of dividends. An early decision would help to reduce the call on the use of the Council's diminishing reserves in 2017/18 and beyond.

Investment Strategy – Income Generation

92. The income generation proposals that the Council is looking at will require substantial investments to be made by the Council and will necessitate new borrowing. The levels of new borrowing that the Council can afford to take on board for new commercial property purchases and development, housing and energy schemes, etc, will be dependent upon the individual proposals and credit worthiness of the counterparties involved. Due to the timescales within which some property purchasing and disposal decisions have to be made the Council's existing governance arrangements and delegated authorities may need to be reviewed.

93. The additional risks that the Council will consider taking on will need to be considered in the context of the totality of risk that the Council faces e.g. Pier claim, rates revaluation, robustness of income streams, economic downturns, etc. Where there is more risk and volatility in income streams the Council will need to ensure that it maintains sufficient reserves to ensure the Council's ability to deliver key services is not jeopardised.

94. The income generation proposals may well require revenue loans to be provided to Council owned companies. Such funding would not be available from the Public Works Loan Board, but would be from existing reserves and balances. The rates of interest that would be charged to the company (s) would be determined at the time but would need to comply with state aid rules where thresholds are exceeded – a market rate being payable. Given the start up nature of such a company there may also be a necessity to roll up interest repayments until such time as the company produces sufficient revenue to repay interest and principal. By making such loans the investment interest received by the Council in the short term could be reduced.

Investment Strategy – view on Interest Rates

95. The economic review is included in Appendix 3 . The overall balance of risks for interest rates is currently probably slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If growth expectations disappoint and inflationary pressures are minimal, the start of increases in Bank Rate could be pushed back. On the other hand, should the pace of growth quicken and / or forecasts for increases in inflation rise (as appears to be happening and given the slide in the exchange rate), there could be an upside risk i.e. Bank Rate increases occur earlier and / or at a quicker pace.

96. The Council will avoid locking into longer term cash investment deals while investment rates are down at historically low levels unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile (up to 1 year) and within the risk parameters set by this council.

97. For 2016/17 and 2017/18 the Council's revised budget estimates an investment interest return of 0.50%.

98. For its cash flow generated balances, the Council will seek to use Business Reserve accounts, call accounts, and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of year investment report

99. At the end of the financial year, officers will report to Council on its investment activity as part of its Annual Treasury Report (to be presented by no later than 30 September).

Policy on use of external service providers

100. The Council uses Capita Asset Services (Sector previously) as its external treasury management advisers. There is currently value in employing external providers of treasury management services in order to acquire access to credit worthiness information and specialist advice.

Scheme of Delegation

101. Please see Appendix 9.

Role of the Section 151 Officer

102. Please see Appendix 10.

RISK MANAGEMENT

103. The strategy prioritises security of investments over return. Where investments are made they are limited in size and duration. External treasury advisers are used to advise the Council and have been used to train members. The Council has introduced further checks on credit worthiness of counterparties over the last four years as and when these have been further developed by its advisers.

104. Whilst there is no absolute security for investments made, the Council has limited its investments to the higher rated institutions, in order to mitigate the risk as far as practical and looks to reduce the risk by spreading its investment portfolio. The Council has adopted the CIPFA Code of Practice.

105. The CIPFA Code requires the responsible officer to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. As such a member training session was held in the summer of 2016 prior to the Treasury end of year report being presented to Audit Committee and Cabinet. A further training session for all members being arranged for 10 Janurary 2017 prior to the consideration of this strategy by the Audit Committee, Cabinet, and full Council.

106. The training needs of treasury management officers are periodically reviewed.

ECONOMIC/FINANCIAL IMPLICATIONS

107. The Council generally has investments in the year of between £15 million and £30 million at any one time, and is estimated to have longer term borrowings of £20.5 million by the end of March 2017. Management of its investments, borrowing and cash flow remains crucial to the proper and effective management of the

Council. The Strategies and Policies detailed in the report directly influence the Council's Medium Term Financial Strategy and the annual budget.

ORGANISATIONAL CONSEQUENCES

108. The Cabinet is responsible for the development and review of the Treasury Management Strategy, The Minimum Revenue Provision (MRP) Policy and the Investment Strategy. The Audit Committee is responsible for scrutinising these strategies, policies and performance throughout the year. Full Council, as the budget setting body, remains responsible for the approval of the Treasury Management Strategy, MRP Policy, and Investment Strategy.

109. Monitoring reports will be produced and will be presented to Cabinet and the Audit Committee. A mid year report is presented to full Council on any concerns arising since approving the initial strategies and policies. Only full Council will be able to amend the Treasury Management Strategy, MRP Policy or Investment Strategy. The Chief Finance Officer will determine the Treasury Management Practices and associated schedules.

Wards Affected

None

Area(s) Affected

None

Policy Implications

Please identify if this report contains any implications for the following:

Equalities and Community Cohesiveness	No
Crime and Fear of Crime (Section 17)	No
Risk Management	Yes
Environmental Issues	No
Economic/Financial Implications	Yes
Human Rights Act	No
Organisational Consequences	Yes
Local People's Views	No

Background Information

Supporting Documents
APPENDICES
1. MRP Introduction and Policy Statement
2. Interest Rate Forecasts
3. Economic Review
4. Prudential and Treasury Indicators
5. Specified and non Specified Investments
6. Approved Countries for Investments

7. Treasury Management Policy Statement
8. Purpose and Requirements of the Code
9. Treasury Management Scheme of Delegation
10. The Treasury Management Role of the Section 151 Officer

Other Supporting Documents:-
CIPFA - Treasury Management Code of Practice (Revised 2011)
CIPFA - The Prudential Code (Revised second edition 2011)

Officer to Contact

Peter Grace
pgrace@hastings.gov.uk
01424 451503

APPENDIX 1

Minimum Revenue Provision – An Introduction

1. What is a Minimum Revenue Provision?
Capital expenditure is generally expenditure on assets which have a life expectancy of more than one year e.g. buildings, vehicles, machinery etc. It would be impractical to charge the entirety of such expenditure to revenue in the year in which it was incurred therefore such expenditure is spread over several years in order to try to match the years over which such assets benefit the local community through their useful life. The manner of spreading these costs is through an annual Minimum Revenue Provision, which was previously determined under Regulation, and will in future be determined under Guidance.

2. Statutory duty
Statutory Instrument 2008 no. 414 s4 lays down that:

"A local authority shall determine for the current financial year an amount of minimum revenue provision that it considers to be prudent."

The above is a substitution for the previous requirement to comply with regulation 28 in S.I. 2003 no. 3146 (as amended).

There is no requirement to charge MRP where the Capital Financing Requirement is nil or negative at the end of the preceding financial year.

3. Government Guidance
Along with the above duty, the Government issued guidance which came into force on 31st March 2008 which requires that a Statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which the provision will relate.

The Council is legally obliged to "have regard" to the guidance, which is intended to enable a more flexible approach to assessing the amount of annual provision than was required under the previous statutory requirements. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. The requirement to 'have regard' to the guidance therefore means that: -

Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

It is the responsibility of each authority to decide upon the most appropriate method of making a prudent provision, after having had regard to the guidance.

Option 1: Regulatory Method
Under the previous MRP regulations, MRP was set at a uniform rate of 4% of the adjusted CFR (i.e. adjusted for "Adjustment A") on a reducing balance method (which in effect meant that MRP charges would stretch into infinity). This historic approach must continue for all capital expenditure incurred in years before the start of this new approach. It may also be used for new capital expenditure up to the amount which is deemed to be supported through the SCE annual allocation.

Option 2: Capital Financing Requirement Method
This is a variation on option 1 which is based upon a charge of 4% of the aggregate CFR without any adjustment for Adjustment A, or certain other factors which were brought into account under the previous statutory MRP calculation. The CFR is the measure of an authority's outstanding debt liability as depicted by their balance sheet.

Option 3: Asset Life Method.
This method may be applied to most new capital expenditure, including where desired that which may alternatively continue to be treated under options 1 or 2.

Under this option, it is intended that MRP should be spread over the estimated useful life of either an asset created, or other purpose of the expenditure. There are two useful advantages of this option: -
Longer life assets e.g. freehold land can be charged over a longer period than would arise under options 1 and 2.
No MRP charges need to be made until the financial year after that in which an item of capital expenditure is fully incurred and, in the case of a new asset, comes into service use (this is often referred to as being an 'MRP holiday'). This is not available under options 1 and 2.

There are two methods of calculating charges under option 3:
equal instalment method – equal annual instalments,
annuity method – annual payments gradually increase during the life of the asset.

Option 4: Depreciation Method
Under this option, MRP charges are to be linked to the useful life of each type of asset using the standard accounting rules for depreciation (but with some exceptions) i.e. this is a more complex approach than option 3.

The same conditions apply regarding the date of completion of the new expenditure as apply under option 3.

Minimum Revenue Provision Policy Statement 2017/18

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 , and will assess the MRP for 2017/18 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

A major proportion of the MRP for 2017/18 relates to the more historic debt liability that will continue to be charged at the rate of 4%, in accordance with option 1 of the guidance. Certain expenditure reflected within the debt liability at 31st March 2017 will under delegated powers be subject to MRP under option 3, which will be charged over

a period which is reasonably commensurate with the estimated useful life applicable to the nature of expenditure, using the equal annual instalment method. For example, capital expenditure on a new building, or on the refurbishment or enhancement of a building, will be related to the estimated life of that building.

Estimated life periods will be determined under delegated powers. To the extent that expenditure is not on the creation of an asset and is of a type that is subject to estimated life periods that are referred to in the guidance, these periods will generally be adopted by the Council. However, the Council reserves the right to determine useful life periods and prudent MRP in exceptional circumstances where the recommendations of the guidance would not be appropriate.

As some types of capital expenditure incurred by the Council are not capable of being related to an individual asset, asset lives will be assessed on a basis which most reasonably reflects the anticipated period of benefit that arises from the expenditure. Also, whatever type of expenditure is involved, it will be grouped together in a manner which reflects the nature of the main component of expenditure and will only be divided up in cases where there are two or more major components with substantially different useful economic lives.

The Council participates in LAMS using the cash backed option. The mortgage lenders require a 5 year deposit from the local authority to match the 5 year life of the indemnity. The deposit placed with the mortgage lender provides an integral part of the mortgage lending, and is treated as capital expenditure and a loan to a third party. The Capital Financing Requirement (CFR) will increase by the amount of the total indemnity. The deposit is due to be returned in full at maturity, with interest paid either annually or on maturity. Once the deposit matures and funds are returned to the local authority, the returned funds are classed as a capital receipt, and the CFR will reduce accordingly. As this is a temporary (5 year) arrangement and the funds will be returned in full, there is no need to set aside prudent provision to repay the debt liability in the interim period, so there is no MRP application.

Repayments included in finance leases are applied as MRP. It should also be noted that the Council will not make any MRP in regards of the loans to Amicus Horizon in respect of the Coastal Space scheme. Amicus Horizon will meet the costs of the loan (Principal and Interest). Likewise for any loan to the Foreshore Trust being made in 2016/17 - as the interest and principal repayments to be made by the Council will be funded in full from the sums payable by the Trust no separate MRP will be made by the Council.

The Council is seeking to generate additional income from capital Investments. The Council will look to make a prudent provision for the repayment of debt over the expected life of the asset. In doing so, where an annuity loan is taken or may be taken at some stage in the future to finance the purchase the MRP made will reflect as far as possible the principal elemnt of the actual loan repayments. The interest rate to be calculated at the outset to be determined by the Chief Finance Officer.

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Capita Asset Services Interest rate forecast – 2017 - 2020

Capita Asset Services Interest Rate View													
	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 View	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%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB Rate	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%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB Rate	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%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Bank Rate													
Capita Asset Services	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%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5yr PWLB Rate													
Capita Asset Services	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%
Capital Economics	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10yr PWLB Rate													
Capita Asset Services	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%
Capital Economics	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%
25yr PWLB Rate													
Capita Asset Services	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%
Capital Economics	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%
50yr PWLB Rate													
Capita Asset Services	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%
Capital Economics	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%

APPENDIX 3 Economic Review

1. The Monetary Policy Committee, (MPC), cut Bank Rate from 0.50% to 0.25% on 4th August in order to counteract what it forecast was going to be a sharp slowdown in growth in the second half of 2016. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August has indicated much stronger growth in the second half 2016 than that forecast; also, inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently, Bank Rate was not cut again in November or December and, on current trends, it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth. During the two-year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects, (i.e. by raising Bank Rate), which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in, as in the table above, until quarter 2 2019, after those negotiations have been concluded, (though the period for negotiations could be extended). However, if strong domestically generated inflation, (e.g. from wage increases within the UK), were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

2. 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.

3. 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 start to a switch back from bonds to equities after a historic long term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008, in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election, has called into question whether, or when, this trend has, or may, reverse, especially when America is likely to lead the way in reversing monetary policy. 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 strong economic growth becomes more firmly established. The expected substantial rise in the Fed. rate over the next few years may 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 would be likely to exert some upward pressure on bond yields in other developed countries but 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 in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

4. PWLB rates and gilt yields have been experiencing exceptional levels of volatility that have been highly correlated to geo-political, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future.

5. The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

6. Apart from the above uncertainties, downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

   - Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries, combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.
   - Major national polls:
     - Italian constitutional referendum 4.12.16 resulted in a 'No' vote which led to the resignation of Prime Minister Renzi. This means that Italy needs to appoint a new government.
     - Spain has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016. This is potentially highly unstable.
     - Dutch general election 15.3.17;
     - French presidential election April/May 2017;
     - French National Assembly election June 2017;
     - German Federal election August – October 2017.
   - A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats
   - Weak capitalisation of some European banks, especially Italian.
   - Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.
   - UK economic growth and increases in inflation are weaker than we currently anticipate.
   - Weak growth or recession in the UK's main trading partners - the EU and US.

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

- UK inflation rising to significantly higher levels than in the wider EU and in the US, causing an increase in the inflation premium in gilt yields.
- A rise in US Treasury yields as a result of Fed. funds rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.
- The pace and timing of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

- Investment returns are likely to remain low during 2017/18 and beyond;
- Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances, has served the Council well over the last few years. However, this position needs to be carefully reviewed to avoid incurring higher borrowing costs in later years when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt;

8. This challenging and uncertain economic outlook has several key treasury management implications:

- Even though the Eurozone seems to have calmed down in the short term the Eurozone sovereign debt difficulties provide a clear indication of higher counterparty risk. This continues to suggest the use of higher quality counterparties for shorter time periods;
- Investment returns are likely to remain relatively low during 2017/18 and for a period beyond;
- The rates at which money can be borrowed are expected to rise over the next few years and so it is necessary consider the timing of any borrowing to ensure the best deals are obtained;
- There will remain a cost of carry – any borrowing undertaken that results in an increase in investments will incur a revenue loss between borrowing costs and investment returns.

APPENDIX 4 Prudential Indicators

The Council's Capital expenditure plans are the key driver of treasury management activity. The output of the Capital expenditure plans (detailed in the budget) is reflected in the prudential indicators below.

PRUDENTIAL INDICATOR	2015/16	2016/17*	2017/18	2018/19	2019/20
(2). TREASURY MANAGEMENT PRUDENTIAL INDICATORS	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt -					
borrowing	£20,000	£35,000	£65,000	£75,000	£85,000
other long term liabilities	£10,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£30,000	£40,000	£70,000	£80,000	£90,000
Operational Boundary for external debt -					
borrowing	£20,000	£35,000	£65,000	£75,000	£85,000
other long term liabilities	£10,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£30,000	£40,000	£70,000	£80,000	£90,000
Upper limit for fixed interest rate exposure Net principal re fixed rate borrowing / investments OR:-	100 %	100 %	100 %	100 %	100 %
Upper limit for variable rate exposure Net principal re variable rate borrowing / investments OR:-	100 %	100%	100%	100%	100%
Upper limit for total principal sums invested/deposited for over 364 days e.g.LAMS Scheme, Coastal Space	£5,620	£6,000	£9,000	£9,000	£9,000
	2016/17* - proposed revision to operational and authorised boundaries from £30m to £40m.				

Maturity structure of fixed rate borrowing during 2017/18	upper limit	lower limit
under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%
10 years and above	100%	0%

APPENDIX 5 Specified and Non-Specified Investments

Specified Investments:

The idea of specified investments is to identify investments offering high security and high liquidity. All these investments should be in sterling and with a maturity of less than one year.

Schedule A

	Security / Minimum Credit Rating	Maximum Maturity Period
Local authorities	N/A	1 year
DMADF – UK Government	N/A	1 year
Money market funds	AAA	Liquid
Term deposits with banks and building societies	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
Certificates of deposits (CDs) issued by credit rated deposit takers (banks and building societies)	Blue Orange Red Green No Colour	Up to 1 year Up to 1 year Up to 6 months Up to 3 months Not for use
UK Government Gilts	UK sovereign rating	364days
UK Government Treasury Bills	UK sovereign rating	364days

Non-Specified Investments

These are any investments which do not meet the specified investment criteria. The aim is to ensure that proper procedures are in place for undertaking risk assessments of investments made for longer periods or with bodies which do not have a “high” credit rating. As far as this Council is concerned the risks are in relation to the value of the investments, which may rise or fall, rather than deficient credit rating.

There is no intention to invest in Non-Specified Investments, other than those Property Funds where there are no Capital accounting implications, without taking specialist advice first. The limits on Investments in Property Funds will need to be agreed as part of the this Treasury Management Strategy and Investment Policy. For clarity any increase in the level of the investment would need Council approval.

Schedule B

Investment	Security / Minimum credit rating	(A) Why use it? (B) Associated risks
Property Funds	*The use of these instruments can be deemed capital expenditure, and as such will be an application (spending) of capital resources. This Authority will seek guidance on the status of any fund it may consider using. Appropriate due diligence will also be undertaken before investment of this type is undertaken.*	
UK Government Gilts with maturities in excess of 1 year Custodial arrangement required prior to purchase	Government backed	(A) (i) Excellent credit quality. (ii) Very liquid. (iii) if held to maturity, known yield (rate of return) per annum – aids forward planning. (iv) If traded, potential for capital gain through appreciation in value (i.e. sold before maturity) (v) No currency risk. (B) (i) 'Market or interest rate risk': Yield subject to movement during life of sovereign bond which could negatively impact on price of the bond i.e. potential for capital loss.

APPENDIX 6 Approved Countries for Investments

Countries that meet our criteria 1, 2, 3 (at 16.12.2016)

1. AAA
   - Australia
   - Canada
   - Denmark
   - Germany
   - Luxembourg
   - Netherlands
   - Norway
   - Singapore
   - Sweden
   - Switzerland

2. AA+
   - Finland
   - Hong Kong
   - U.S.A.

3. AA
   - Abu Dhabi (UAE)
   - France
   - Qatar
   - U.K.

4. AA-
   - Belgium

Examples of Countires that do not meet our criteria:

Japan
Abu Dhabi (U.A.E)
Qatar
Kuwait
Greece
Spain

APPENDIX 7 Treasury Management Policy Statement

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

The 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 organisation.

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 comprehensive performance measurement techniques, within the context of effective risk management.”

APPENDIX 8 Purpose and Requirements of the Code

The primary requirements of the Code are as follows:

1. Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities.

2. Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives.

3. Receipt by the full council of an annual Treasury Management Strategy Statement - including the Annual Investment Strategy and Minimum Revenue Provision Policy - for the year ahead, a Mid-year Review Report and an Annual Report (stewardship report) covering activities during the previous year.

4. Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions.

5. Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Audit Committee.

APPENDIX 9 Treasury Management Scheme of Delegation

(i) Full Council

1.Approval of the Treasury Management Strategy - prior to the new financial year

2.Approval of the Investment Strategy - prior to the new financial year

3.Approval of the MRP Policy - prior to the start of the new financial year

4.Approval of any amendments required to the Strategy during the year

5.Receipt of a Mid year report on the Treasury Management Strategy, to include consideration of any recommendations of the Cabinet or Audit Committee arising from any concerns since the original approval.

(ii) Cabinet

1. Developing and determining the Treasury Management strategy, Investment Strategy and MRP policy and recommending them to full Council - prior to the start of the new financial year

2. Receipt of a Mid year report on the Treasury Management Strategy and any concerns since the original approval and making recommendations to Council as appropriate.

3. Receiving, and reviewing reports on treasury management policies, practices, activities, and performance reports (based on quarterly reporting).
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(iii) Audit Committee

1. Scrutinising the Council's Treasury Management Strategy, Investment Strategy and MRP policy, Treasury Management Policy Statement and Treasury Management Practices and making recommendations to Cabinet and Council as appropriate.

2. Receiving and reviewing monitoring reports (based on quarterly reporting) and making recommendations as appropriate.

APPENDIX 10 The Treasury Management Role of the Section 151 Officer

Chief Finance Officer (S151 Officer)

- recommending clauses, treasury management policy for approval, detemining Treasury Management Practices, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.