Report to: **Cabinet**

Date of Meeting: 12 February 2018

Report Title: **Treasury Management, Annual Investment Strategy and Capital Strategy 2018/19**

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Purpose of Report

To consider the draft Treasury Management, Annual Investment Strategy and Capital Strategy and make recommendations to Cabinet and Full 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 some £41.1 million of debt as at 23 January 2018, and investments which can 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 prior to the start of the new financial year.

Recommendations

Cabinet recommends to Council that:

1. **Council adopts the new CIPFA Treasury Management Code of Practice (2017).**
2. **Council formally adopts, as part of the Council's Constitution and financial rules the four clauses recommended by the Code of Practice as detailed in Appendix 8.**
3. **The Council approve the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy, Annual Investment Strategy, and that a Capital Strategy is developed for 2019/20.**
4. **That the strategies continue to be reviewed in 2018/19 in the light of the requirements of the new Codes of Practice and that the Financial rules and Financial Operating Procedures of the Council are reviewed and amendments proposed as necessary.**
5. **That the authorised limit for external debt is increased by £10m to allow for short term borrowing for cash flow purposes at year end in particular.**

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 continue to 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. A new CIPFA Code of Practice (2017 Edition) has been released to take account of the more commercialised approach being adopted by councils and the enhanced levels of transparency required. The Code represents best practice and helps ensure compliance with statutory requirements.

The Council has the ability to diversify its investments and must consider carefully the level of risk against reward against a background still of historically low interest rates. Investments can 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 needs of the Council, essentially the longer term cash flow planning to ensure the Council can meet its capital spending operations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses, and on occasion any debt previously drawn may be restructured to meet Council risk or cost objectives.

3. Treasury management in this context is defined by CIPFA as:

   "The management of the organisation'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"

4. In December 2017, CIPFA issued a revised Treasury Management Code of Practice and a revised Prudential Code. These revisions have particularly focused on non-treasury investments and especially on the purchase of property with a view to generating income. Such purchases could involve undertaking external borrowing to raise the cash to finance these purchases, or the use of existing cash balances. Both actions would affect treasury management. As the Localism Act 2011 only gave English local authorities a General Power of

Competence, these changes in the revised codes are particularly relevant therefore to the activities of English authorities.

5. CIPFA has issued a statement that accepts that the issue of revised codes at this late stage in the current 2018-19 budget cycle will make it very difficult for most authorities to fully implement both codes. Accordingly, full implementation is not expected until 2019-20 across all authorities.

6. The treasury management role of the chief financial officer'. The specific roles of this officer have been extended to include a series of new roles in respect of the capital strategy and also a specific role in respect of investment in non-financial assets. Amendments are included within the Appendices

7. Treasury Management Practices will be revised to take account of changes in the Codes. The Council's advisors will be producing new templates to assist with this in due course.

8. **Investment guidance**

   The Ministry of Housing, Communities and Local Government (MHCLG) consultation on investment guidance closed on 22 December 2017 and so we are currently waiting for the revised guidance to be issued. This will focus particularly on non-financial asset investments. Any changes in this area of investment guidance will need to be complied with and amendments to the Strategy made as necessary. Any significant updates may require further Council approval. One small area of change that is expected and is already included within this document is the expected 364 day limit specified in the previous investment guidance will be changed to 365 days.

9. **Minimum Revenue Provision (MRP) guidance**

   The MHCLG consultation on MRP guidance also closed on 22 December 2017 and so we are currently waiting for the revised guidance to be issued. This will focus particularly on expenditure on purchasing non-financial asset investments. This could materially affect the Council's Housing Company and particularly any monies that constitute equity.

The Primary Requirements of the Code

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

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

12. 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.

13. 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.

14. 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.

Reporting Arrangements

15. The reporting arrangements proposed, in accordance with the requirements of the 2017 Code, are summarised below:-

Area of Responsibility	**Council/ Committee/ Officer**	**Frequency**
Treasury Management Strategy / Annual Investment Strategy / MRP policy/ Capital Strategy (in future years)	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,

16. The CIPFA Code of Practice on Treasury Management has been adopted by this Council for many years. The 2017 edition now includes areas of council activity that would not have been captured fully under the previous code. The main clauses to be adopted are included in Appendix 8.

17. The Audit Committee is required to consider the Prudential Indicators as part of the Treasury Management Strategy and make recommendations to Cabinet and full Council; these are identified in the report and Appendix 4.

Investment Performance 2017-18

18. The performance for the first 9 months of 2017/18 provided an average return of 0.34% (excludes Local Authority Mortgage (LAM) scheme).This compares to 0.6% for the same period last year. These figures also exclude the interest receivable in respect of loans to other organisations.

19. The total interest receivable for the first 9 months is £82,000 (2016/17 £110,000) including the Local Authority Mortgage Scheme and £67,000 (2016/17 £78,000) excluding LAMS. These figures exclude the interest receivable in respect of the three loans to other organisations and income from the Property Fund investment. If all the interest received is included this would amount to some £178,500. The remaining £1million loan in respect of LAMS is due to be repaid in 2018.

20. The Audit 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.

Treasury Management Strategy for 2018/19

21. 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.

22. 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. There is now a new requirement to produce a Capital Strategy – this will be developed in the year ahead as guidance and best practice develops.

23. The suggested strategy for 2018/19 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, Link Asset Services (previously Capita Asset Services).

24. 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.

25. These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

Key Changes to the Strategy

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

    i. The Council has taken on additional borrowing in 2017/18 in respect of the Capital programme and the Income Strategy. The level of borrowing has risen significantly but remained within the operational and authorised boundaries.

    ii. The income generation plans of the Council are expected to involve considerable new borrowing again in 2018/19 and the years ahead. The new borrowing limits proposed in the strategy are those agreed when determining the budget for 2017/18 plus the income generation strategy approved in September 2017and allow some headroom to borrow for the current and forthcoming schemes within the Capital programme without reliance on the capital receipts from land and property sales.

    iii. The one proposed change is to increase the Authorised limit by £10m to allow for temporary borrowing for cash flow purposes, lease liabilities and any debt rescheduling or guarantees agreed by Council. Currently the operational and authorised boundary amounts are the same. This amendment would result in the overall authorised borrowing limits increasing to £80m in 2017/18, £90m in 2018/19 and £100m in 2019/20 and the years beyond – the Operational Boundary limits remaining unaltered.

    iv. The majority 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 cannot be borrowed from the Public Works Loan Board, and will be funded from existing Council reserves.

    v. 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 enables the Council to match the principal repayments made on loans arranged with a near equal MRP payment (an annuity methodology).

vi. Investment returns should increase in the next few years as the bank rate increases, albeit marginally. The overall cash return is however likely to decrease as the Council's reserves deminish.

vii. The Council invested some of its existing reserves in a Property Fund – up to a limit of £2m by 31 March 2018. There are no proposals to invest further monies at this stage given the potential calls on reserves.

Balanced Budget

27. 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 2018/19 TO 2020/21

The Council's Capital Position (Prudential Indicators)

28. The Council's capital expenditure plans are the 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' overview and confirm capital expenditure plans.

29. This part of the report is structured to update:

The Council's capital expenditure plans;

How these plans are being financed;

The impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow; and

Reviewing the limits in place for borrowing activity.

30. The Cipfa code of practice has resulted in a few changes to the prudential indicators:

(i) Change the principal invested for longer than 364 days indicator to principal invested over 365 days in line with financial reporting definitions

(ii)Remove the interest rate exposure indicator and require the Treasury Management Strategy to state how interest rate exposure is managed and monitored, and

(iii) Extend the maturity structure of borrowing indicator to cover variable as well as fixed rate debt.

(iv) Net Debt and the CFR prudential indicator have been updated to Gross Debt and the CFR (this had previously only been updated in the Prudential

Code *Guidance*, 2013).

(v)The prudential indicator requirement to note the approval of the Treasury Management Code has been removed.

(vi) The incremental impact on the Council tax / Housing Rents prudential indicators have been removed.

Prudential Indicator for Capital Expenditure

31. This table shows the revised estimates for capital expenditure and the changes since the capital programme was agreed at the Budget.

	Revised 2017/18 £'000s	2018/19 £'000s	2019/20 £'000s	2020/21 £'000s
Gross Capital Expenditure	17,027	32,938	8,767	7,162
Net Capital Expenditure	13,145	28,691	7,210	5,623
Financing from own resources	968	1,531	210	123
Borrowing Requirement	12,177	27,160	7,000	5,500

32. In terms of net cost, the 2017/18 programme has been revised to £13,145,000 from £15,310,000. The 2018/19 programme amounts to £28,691,000 (£32,938,000 Gross).

Capital Expenditure – Financing

33. The new Capital schemes, approved since the budget, will generally be financed by borrowing, unless Capital receipts from the sale of assets are available.

34. The Priory Meadow Capital investment contribution is expected to be at least self financing although the timing and size of the spend and income streams are, as yet, uncertain.

35. The Cabinet approved the Income Generation Strategy on the 11 September 2017. This includes Capital expenditure of £50m spread over a period of 3 years to be financed from borrowing.

36. The larger schemes in the capital programme which are expected to require financing in 2017/18 from borrowing are:-

- A capital grant to Optivo (previously Amicus Horizon) in respect of Phase 2 of the Coastal Space project in the sum of £875,000 (or % thereof).
- The balance of the monies due in respect of BD Foods factory (£110,000)
- The purchase of Bexhill Road retail park (£8.8m)
- Housing Company (Loans estimated at between £1m and £1.5m in 2017/18)

37. The table above summarises the capital expenditure plans and how these plans are being financed – either by own resources e.g. Section 106, Capital receipts or finally through borrowing.

Impact on the prudential indicators

38. There has been, not unexpectedly, a big impact of the changes in the capital expenditure plans on the prudential indicators and the underlying need to borrow.

39. The Capital Financing Requirement has increased significantly over the last 18 months. It is expected to reach some £75m by 2021/22 (based on the capital programme approvals to date).

40. The first key control over the treasury activity is a prudential indicator to ensure that over the medium term, net borrowing (borrowings less investments) will only be for a capital purpose. Gross external borrowing should not, except in the short term, exceed the total of CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and next two financial years.

41. A further prudential indicator controls the overall level of borrowing. This is the Authorised Limit which represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term. It is the expected maximum borrowing need with some headroom for unexpected movements. This is the statutory limit determined under section 3 (1) of the Local Government Act 2003.

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

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

44. 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'.

45. 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.

46. 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.

47. 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.

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

49. **Treasury Indicators: limits to borrowing activity**

50. Currently the operational and authorised limits are the same. It is recommended that the authorised limits be increased by £10m based on the budget approvals and the need to provide cover for short term cash flow requirements and any potential rescheduling of debt. The operational limit to remain unaltered.

51. The operational boundary. This is the limit beyond which external debt is not normally expected to exceed. In most cases, this would be a similar figure to the CFR, but may be lower or higher depending on the levels of actual debt and the ability to fund under-borrowing by other cash resources.

Operational boundary	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	65,000,000	75,000,000	85,000,000	85,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	70,000,000	80,000,000	90,000,000	90,000,000

52. The authorised limit for external debt. A further key prudential indicator represents a control on the maximum level of borrowing. This represents a limit beyond which external debt is prohibited, and this limit needs to be set or revised by the full Council.

The Council is asked to approve the following authorised limit:

Authorised limit	**2017/18 Estimate £**	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Debt	75,000,000	85,000,000	95,000,000	95,000,000
Other long term liabilities	5,000,000	5,000,000	5,000,000	5,000,000
Total	80,000,000	90,000,000	100,000,000	100,000,000

53. The authorised limit is the statutory limit determined under section 3 (1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans, or those of a specific council, although this power has not yet been exercised.

PROSPECTS FOR INTEREST RATES

54. The Council has appointed Link Asset Services (previously Capita Asset Services) as treasury advisor to the Council and part of their service is to assist the Council to formulate a view on interest rates (Appendix 2 – Economic Review). The following table gives their view.

	Dec-17	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%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

55. As expected, 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%. The Link Asset Services forecast as above includes increases in Bank Rate of 0.25% in November 2018, November 2019 and August 2020.

56. 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. The sharp rise in bond yields since the US Presidential election in November 2016 has called into question whether the previous trend may go into reverse, especially now the Fed. has taken 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.

57. 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.

58. 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 and

emerging market developments. Such volatility could occur at any time during the forecast period.

59. 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.

60. 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.

61. 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.
    - Political risks in European countries e.g. Germany, Austria
    - Rising protectionism under President Trump
    - A sharp Chinese downturn and its impact on emerging market countries

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

- 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 returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields.

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.

BORROWING STRATEGY

63. CURRENT PORTFOLIO POSITION

The Council's debt position at 31 January 2017 comprised:

Table 1 – Borrowing

Debt	1 April 2017 Principal	Rate	Maturity	23.1.18 Principal	Rate
PWLB Loan 1	£7,500,000	4.80%	2033	£7,500,000	4.80%
PWLB Loan 2	£1,000,000	1.63%	2018	£0	1.63%
PWLB Loan 3 PWLB Loan 4	£2,000,000 £909,027	0.40% (*Variable) 3.78%	2019 2044	£2,000,000 £909,027	0.40% (*Variable) 3.78%
PWLB Loan 5	£1,788,235	3.78%	2044	£1,788,235	3.78%
PWLB Loan 6 (Annuity)	£272,182	1.66%	2026	£258,099	1.66%
PWLB Loan 7	£1,000,000	2.92%	2056	£1,000,000	2.92%
PWLB Loan 8	£1,000,000	3.08%	2046	£1,000,000	3.08%
PWLB Loan 9	£1,000,000	3.01%	2036	£1,000,000	3.01%
PWLB Loan 10	£1,000,000	2.30%	2026	£1,000,000	2.30%
PWLB Loan 11	£2,000,000	2.80%	2054	£2,000,000	2.80%
PWLB Loan 12	£1,000,000	2.42%	2028	£1,000,000	2.42%
PWLB Loan 13	£2,000,000	2.53%	2057	£2,000,000	2.53%
PWLB Loan 14	£2,000,000	2.50%	2059	£2,000,000	2.50%
PWLB Loan 15	£2,000,000	2.48%	2060	£2,000,000	2.48%
PWLB Loan 16 (Annuity)			2057	£7,275,000	2.53%
P|WLB Loan 17 (Annuity)			2057	£8,350,000	2.72%
Total Debt	**£26,469,444**	**3.15%**		**£41,080,361**	**2.99%**

64. The Council has loaned money to other organisations. As at 30 September 2017 three longer term loans are outstanding. Namely:

Table 2 – Loans to Other Organisations

3rd Party Organisations	Rate/ Return (%)	Start Date	End Date	Principal £	Term
Amicus /Optivo	3.78	04/09/2014	02/09/2044	1,788,235	Fixed
The Foreshore Trust	1.66	21/03/2016	20/03/2026	258,099	Annuity
The Source	2.43	17/12/2015	16/12/2024	22,763	Annuity
			Total	2,069,097	

65. Borrowing from the PWLB was taken to fund the Amicus Horizon (now Optivo) loan (£1,788,235- maturity loan) and the loan to the Foreshore Trust (£300,000 originally borrowed – annuity loan); these correspond to PWLB loans in Table 1 above.

BORROWING

66. The capital expenditure plans set out in the budget provide details of the service activity of the Council. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of appropriate borrowing facilities. This strategy covers the relevant treasury / prudential indicators, the current and projected debt positions and the annual investment strategy.

67. Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. 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.

68. As a key indicator the Council needs to ensure that its gross debt does not, except in the short term, exceed the total of the Capital Financing Requirement (CFR) in the preceding year plus the estimates of any additional CFR for 2018/19 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 or speculative purposes.

69. 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.

70. The total CFR can also be reduced by:

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

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

71. 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. Borrowing will not exceed the figures set out in the Prudential Indicators.

72. The Council is looking to be in a fully funded position. This means that the capital borrowing need (the Capital Financing Requirement), has been fully funded with loan debt. Previously cash supporting the Council's reserves, balances and flow has been used as a temporary measure to fund the Capital expenditure. This strategy has been considered prudent as borrowing costs are increasing. However there is a cost of doing this as investment returns are low and counterparty risk is still an issue that needs to be considered.

73. The Council has at the time of writing some £40.08m of PWLB debt, and could potentially borrow up to the projected level of the CFR (£41.175m).

74. The plans for income generation, which 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 remains 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.

75. In determining what is 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.

76. The recommendation last year was 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 of course needing to be shown to be viable and fully risk assessed, with due diligence checks completed.

77. 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 borrowing limit, it still remains the position 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.

78. 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 2018/19.

79. 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 advisors, 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 are still relatively cheap.

80. 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.

81. Given that rates look set to increase and given an increased borrowing requirement relating to income generation it is recommended that new borrowing is taken rather than use internal balances for long life assets.

82. The table below provides an estimate of the Council's Capital Financing Requirement (CFR) for the current and next 3 years. Please not the table below excludes the impact of leases (which have minimal impact at present <£10k).

CFR	2017/18	2018/19 (Est)	2019/20 (Est)	2020/21 (Est)
	£	£	£	£
CFR-Opening	29,783,000	41,175,000	64,033,807	69,686,196
Less MRP	785,000	1,116,000	1,406,498	1,540,217
Plus New Borrowing	12,177,000	27,160,000	7,000,000	5,500,000
CFR Closing	41,175,000	67,219,000	69,627,308	73,645,979

83. The table below highlights the Council's gross borrowing position against the CFR, which provides an indication of affordability for the Council.

Table 3 Internal Borrowing	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Capital Financing Requirement	41,175,000	67,219,000	69,627,308	73,645,979
External Borrowing	41,080,000	65,629,000	69,500,000	73,600,000
Net Internal Borrowing	95,000	1,590,000	127,308	45,979

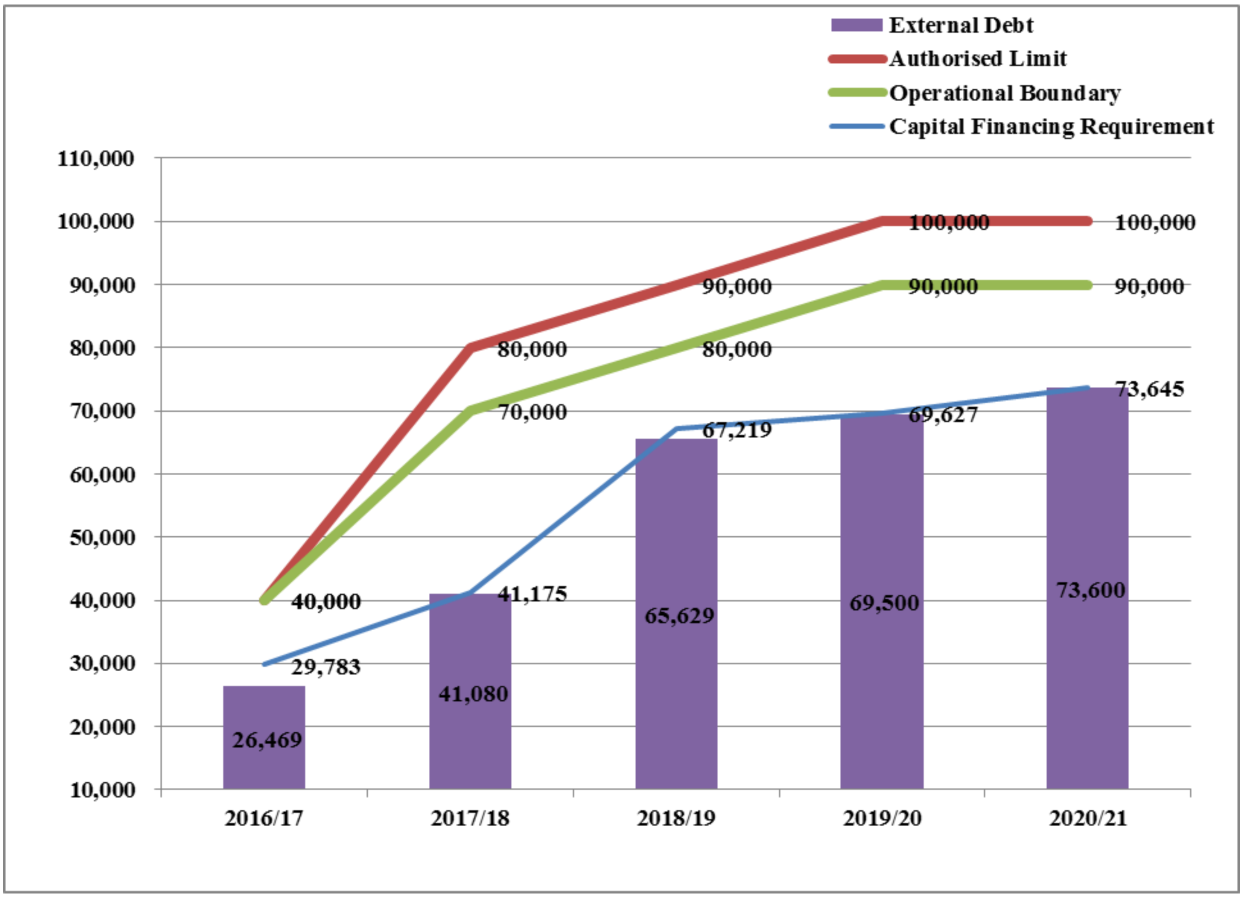
84. Borrowing activity is constrained by prudential indicators particularly the CFR, and by the authorised limit. The Council's long term borrowing must only be for a capital purpose. This essentially means that the Council is not borrowing to support revenue expenditure.

85. The Council is now maintaining a very small under-borrowed position as identified above. This means that the capital borrowing need (the Capital Financing Requirement), is nearly fully funded with loan debt as against cash supporting the Council's reserves, balances and cash flow being used as a temporary measure. This strategy is seen as prudent when interest rates are forecast to increase. However there is a cost, given that investment returns are low and counterparty risk has been relatively high. New borrowing will continue to be taken if good rates are available in the absence of any meaningful Capital receipts being available to fund Capital expenditure.

86. The Council now has some £41.08m of PWLB debt, and could potentially borrow up to a level of £41.175m (current CFR). This figure does not take account of any new capital spending in the remainder of this year which could potentially be funded by new borrowing.

87. It should be noted that a £1m PWLB loan is due to be repaid in March 2018. This loan was taken out to fund the second tranche of the Local Authority Mortgage scheme and is matched with a deposit of £1m with Lloyds Bank at an interest rate of 1.9% (which should be repaid to the Council in 2018).

88. **Table: External Debt, Authorised limits and CFR Projections**



Summary

89. New borrowing has been taken over the last 18 months, to not only take advantage of the historically low rates, but to ensure that the Council's own reserves are cash backed should restrictions be placed on the amount and levels of borrowing that authorities can undertake (particularly from the PWLB) and a balanced view will continue to be taken.

90. The plans for income generation, 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 funds, there has been a much stronger case for reducing the level of internal funding in order to ensure a lower level of borrowing risk in the future.

91. 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 has been given to weighing the short term advantage of internal

borrowing against the potential increase in long term costs as rates rise. As such additional new borrowing will be taken.

92. 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.

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

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

Policy on borrowing in advance of need

95. 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.

96. 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

97. 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.

98. 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 on the 27 September 2017 the early repayment cost of the £7.5m PWLB loan, maturing in 2033, would amount to £3,177,343. No debt rescheduling is being contemplated at present.

99. 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)

100. 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.

101. 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. Where an annuity loan is taken, the Council’s policy (Appendix 1) was amended last year to reflect the matching, as far as possible, of the MRP with the actual principal repaid (within each debt repayment).

102. The MRP for 2018/19 is estimated at £1,116,000 (the statutory charge to revenue that remains within the accounts).

ANNUAL INVESTMENT STRATEGY

Investment Policy

103. The Council’s investment policy has regard to the CLG’s Guidance on Local Government Investments (“the Guidance”) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes 2017 (“the CIPFA TM Code”). The Council’s investment priorities will be security first, portfolio liquidity second, and then return.

104. In accordance with the above guidance from the MHCLG and CIPFA, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of highly creditworthy counterparties which

also enables diversification and thus avoidance of concentration risk. The key ratings used to monitor counterparties are the Short Term and Long Term ratings.

105. Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To achieve this consideration the Council will engage with its advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of the credit ratings.

Other information sources used will include the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

106. Investment instruments identified for use in the financial year are listed in an attached Appendix under the 'specified' and 'non-specified' investments categories. Counterparty limits will be as set through the Council's treasury management practices – schedules.

107. 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.

108. In accordance with guidance from the MHCLG 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.

Creditworthiness Policy

109. This Council uses the creditworthiness service provided by Link Asset Services - the potential counterparty ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications. 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

110. 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. This is a service which the Council would not be able to replicate using in house resources.

111. The selection of counterparties with a high level of creditworthiness will be achieved by selection of institutions down to a minimum durational band within Link Asset service'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 and Property Funds)
- Blue 1 year (only applies to nationalised or semi nationalised UK Banks)
- Orange 1 year
- Red 6 months
- Green 100days
- No Colour not to be used

112. The Link Asset Services' creditworthiness service uses a wider array of information other than just primary ratings. Furthermore, by using a risk weighted scoring system, it does not give undue preponderance to just one agency's ratings.

113. Typically the minimum credit ratings criteria the Council use will be a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-. There may be occasions when the counterparty ratings from one rating agency are marginally lower than these ratings but may still be used. In these instances consideration will be given to the whole range of ratings available, or other topical market information, to support their use.

114. 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 Link 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.

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

116. 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.

117. 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.

118. 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.

119. The Council awarded its banking contract 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.

Investment Strategy

120. The table below provides a snapshot of the investments and deposits held mid year (on 30 September 2017). The level of investments can fluctuate significantly on a day to day basis, given the level of funding received, precept payments, grants payable and receivable, salaries and wages, etc.

Table 4 – Investments and deposits

Counterparty	Rate/ Return	Start Date	End Date	Principal	Term
NATWEST	0.01%	15/06/2011		£77,191	Call
Lloyds - LAMS	1.97%	26/03/2013	26/03/2018	£1,000,000	Fixed
NATWEST 95 Day Notice	0.10%	21/08/2013		£5,000,021	Call 95 day
Lloyds TSB Bank plc	0.55%	16/05/2017	16/11/2017	£5,000,000	Fixed
Heleba Landesbank Hessen-Thuerin	0.28%	05/06/2017	05/12/2017	£5,000,000	Fixed
Sumitomo Mitsui Bank	0.22%	07/09/2017	09/10/2017	£3,000,000	Fixed
Barclays Corporate	0.40%	25/04/2012		£1,891,864	Call
Santander	0.00%	01/04/2011		£5	Call
Santander	0.10%	15/04/2010		£500	Call
			Total	**£20,969,581**	

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

122. The Council has various limits depending upon the credit rating e.g. £5m with any one institution with a minimum short term rating of F+, 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 25% 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.

123. 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.

124. The net interest on the deposits in respect of the LAM scheme for the year is 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

125. It was agreed in February 2017 that the option for diversification of some of the investments into a property fund be undertaken with CCLA in the sum of £2m. The investment being 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. The £2m was invested in April 2017 and the first dividend was paid in July 2017. The performance is detailed below:

End of	Dec-17	Nov-17	Oct-17	Sep-17	Aug-17	Jul-17	Jun-17	May-17	Apr-17
Offer Price p	319.44	315.83	315.20	314.48	312.74	310.87	310.22	308.64	307.19
Net Asset Value p	299.24	295.86	295.27	294.60	292.96	291.21	290.60	289.13	287.77
Bid Price p	294.60	291.27	290.69	290.03	288.42	286.70	286.10	284.64	283.31
Dividend* on XD Date p	3.38			3.77			3.34		
Dividend* - Last 12 Months p	13.71	13.56	13.56	13.56	13.07	13.07	13.07	13.19	13.19
Dividend Yield on NAV %	4.58	4.58	4.59	4.60	4.46	4.49	4.50	4.56	4.58
Fund Size £m	930.8	883.6	863.0	836.2	813.6	776.9	764.7	747.8	710.2

126. In terms of the income from the four dividends expected in respect of 2017/18 this is expected to be in the region of £29,000. The Net asset values of the units purchased have increased by some £71,000 since the purchase of the units in April 2017. As forewarned the value of the units when purchased was some 6% less than the purchase cost (equivalent to stamp duty land tax when purchasing property ourselves).

127. It is important that this is viewed as a longer term investment if the original Capital value is to be recovered. The performance to date remains encouraging and if repeated in 2018/19 should more than see the original investment value recovered.

128. There are no plans currently to invest further in the fund given the uncertainties around claims against the Council and the existing Capital expenditure plans.

Investment Strategy – View on Interest Rates

129. Investment returns are likely to remain low during 2018/19 but to be on a gently rising trend over the next few years.

130. Investment returns expectations.

Bank Rate is forecast to stay flat at 0.50% until quarter 4 2018 and not to rise above 1.25% by quarter 1 2021. Bank Rate forecasts, by Link Asset Services, for financial year ends (March) are:

- 2017/18 0.50%
- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

131. The Council will look to report on the actual return achieved on its cash investments, both in terms of percentage and actual cash. It will look to report separately on different categories of cash investments e.g. Property Fund. It will use the London Interbank Bid Rate (3 month rate) as a comparator.

Investment Strategy – Income Generation

132. The income generation proposals that the Council is looking at 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 have been revised e.g. establishment of Income Generation Board.

133. The additional risks that the Council is taking on 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.

134. The income generation proposals require revenue loans to be provided to Council owned companies. Such funding is not be available from the Public Works Loan Board, and is therefore from existing Council reserves and balances. The rates of interest that are charged to the company (s) are determined at the time of the advance and need to comply with state aid rules where thresholds are exceeded – a market rate being payable. Given the start-up nature of the company (s) 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.

Capital Strategy

135. In the light of the increasing commercialisation within local government in particular, in December 2017, CIPFA issued revised Prudential and Treasury Management Codes.

136. The codes require all local authorities to produce detailed Capital Strategies, though CIPFA accepts that authorities may not be able to implement this in the 2018-19 budget cycle. It will be a requirement for 2019/20.

137. The Capital Strategy is intended to give a high-level overview of how capital expenditure, capital financing and treasury management activity contribute to the provision of services along with an overview of how associated risk is managed and the implications for future financial sustainability.

138. The development of a Capital Strategy allows flexibility to engage with full council to ensure that the overall strategy, governance procedures and risk appetite are fully understood by all elected members.

139. The Capital Strategy should be tailored to the authority's individual circumstances but should include capital expenditure, investments and liabilities and treasury management. The Capital Strategy should include sufficient detail to allow all members to understand how stewardship, value for money, prudence, sustainability and affordability will be secured and to meet legislative requirements on reporting.

140. The Capital strategy being a high level document that summarises in appropriate detail the requirements for specific investment appraisals. As a minimum such requirements being:

- the capital schemes that are proposed and their objectives
- The legal power to undertake a particular scheme
- The key aspects of the financial appraisal, including any significant risks that have been identified
- Qualitative criteria that have underpinned the recommendation for a scheme to proceed e.g. links to Corporate plan, economic growth, job retention, etc.
- Likely source of funding
- Long term implications
- Risks and affordability

141. In assessing new income generating proposals the Council does already consider the above list of issues as part of the due diligence checklist and decisions are fully documented.

Accounting Implications

142. International Financial reporting Standard Number 9 (IFRS 9) – This is an important consideration when assessing any investments now and will encompass the 2018/19 Accounting Code of Practice proposals for financial assets.

143. Expected Credit Loss Model – Whilst this should not be material for normal treasury investments, longer dated service investments, loans to third parties or loans to subsidiaries may be more problematic;

144. As the code is currently structured, equity related to the “commercialism” agenda, property funds, equity funds and similar, are likely to be classified as Fair Value through the Profit and Loss (FVPL). It is understood some funds are suggesting the election to Fair Value through Comprehensive Income (FVCI) applies to property funds as it would be deemed to be an equity investment. It is unclear at the date of writing this strategy whether the final Code will allow a statutory override to FVPL for these types of investment.

End of year investment report

145. 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

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

147. **Training**

The CIPFA Code requires the responsible officer (Chief Financial Officer) to ensure that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Training has been undertaken by members on an annual basis to date and further training will be arranged following the May 2018 elections.

The training needs of treasury management officers are periodically reviewed.

148. **MiFID II (Markets in Financial Instruments Directive)**

In brief, this directive requires the Council to distinguish itself as either a retail or professional client. In order to qualify for professional status the Council is required to show that it has more than £10m in investments, invests regularly (more than 10 times a quarter), as well as having appropriately trained and experienced staff.

149. To date only two counterparties have required us to complete the forms in order to maintain the existing professional status. The directive became law on 1 January 2018.

150. The two parties to date are Link Asset Services and CCLA. A schedule of such counterparties will be maintained, as per the requirements of the Code, should the list expand further.

Scheme of Delegation

151. Please see Appendix 9.

Role of the Section 151 Officer

152. Please see Appendix 10.

RISK MANAGEMENT

153. 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 five years as and when these have been further developed by its advisers.

154. 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.

155. 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. Further training sessions for all members will be arranged after the May 2018 elections and prior to the consideration of the future Mid-year review by the Audit Committee and Cabinet.

156. The training needs of treasury management officers will also be reviewed in the light of the Code's requirements and experience of new staff.

157. The additional risks that the Council is taking on with commercial property, housing and energy investments 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.

158. The Council spreads its risk on investments by limiting the amount of monies with any one institution or group and limiting the timeframe of the exposure. In determining the level of the investment and period the Council considers formal credit ratings (Fitch) along with its own advisers (Link Asset Services) ratings advice.

159. The security of the principal sum remains of paramount importance to the Council.

ECONOMIC/FINANCIAL IMPLICATIONS

160. 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 between £41m and £44m by the end of March 2018. 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

161. The Cabinet is responsible for the development and review of the Treasury Management Strategy, Minimum Revenue Provision (MRP) Policy, Investment Strategy and the future Capital 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 and will be responsible for the new Capital Strategy.

162. 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.

163. There are new responsibilities placed on the Council and the Chief Finance officer from the new Codes of Practice which relate to governance arrangements, ensuring robustness of business cases, and risk management. The risk management requirements relate to asset related properties which the Council has borrowed to finance, and assessments of overall risk. There are specific requirements to maintain schedules of counterparties and of any guarantees that the Council may give or have given in the past in order to fully assess the potential risks that the Council may be exposed to when making investment decisions.

Timetable of Next Steps

Action	Key milestone	Due date (provisional)	Responsible
Update Treasury Management Practices, produce necessary schedules for full compliance with Codes of Practice	Mid-Year Review (2018) 30 September 2018	Full implementation by 2019/20	Chief Finance Officer
Produce Capital Strategy, Revise Treasury Management Strategy	Budget Cabinet and Council – February 2019	Full implementation by 2019/20	Chief Finance Officer
Arrange Training for members/ officers		Before Mid-Year review(2018)	Chief Finance Officer

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 (2017)
CIPFA - The Prudential Code (2017)

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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 2018/19

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2008/9 , and will assess the MRP for 2018/19 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 2018/19 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 2018 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 – subject to the limitations of the government's investment requirements (2018). 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. The LAMS scheme should be ending in early 2018, but it is possible if there is outstanding debt that it extends into 2018/19 and hence this paragraph is retained within the policy.

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 Optivo (previously Amicus Horizon) in respect of the Coastal Space scheme. Optivo will meet the costs of the loan (Principal and Interest). Likewise for any loan to the Foreshore Trust - 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 element of the actual loan repayments (rather than accruals). The interest rate to be calculated at the outset being determined by the Chief Finance Officer.

APPENDIX 2 Interest Rate Forecasts

The data below shows Sectors forecast

Link Asset Services Interest rate forecast – Dec 2017 – March 2021

	Dec-17	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%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB Rate	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB View	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB View	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB Rate	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

APPENDIX 3 Economic Review (Link Asset Services)

GLOBAL OUTLOOK. World growth looks to be on an encouraging trend of stronger performance, rising earnings and falling levels of unemployment. In October, the IMF upgraded its forecast for world growth from 3.2% to 3.6% for 2017 and 3.7% for 2018.

In addition, inflation prospects are generally muted and it is particularly notable that wage inflation has been subdued despite unemployment falling to historically very low levels in the UK and US. This has led to many comments by economists that there appears to have been a fundamental shift downwards in the Phillips curve (this plots the correlation between levels of unemployment and inflation e.g. if the former is low the latter tends to be high). In turn, this raises the question of what has caused this? The likely answers probably lay in a combination of a shift towards flexible working, self-employment, falling union membership and a consequent reduction in union power and influence in the economy, and increasing globalisation and specialisation of individual countries, which has meant that labour in one country is in competition with labour in other countries which may be offering lower wage rates, increased productivity or a combination of the two. In addition, technology is probably also exerting downward pressure on wage rates and this is likely to grow with an accelerating movement towards automation, robots and artificial intelligence, leading to many repetitive tasks being taken over by machines or computers. Indeed, this is now being labelled as being the start of the fourth industrial revolution.

KEY RISKS - central bank monetary policy measures
Looking back on nearly ten years since the financial crash of 2008 when liquidity suddenly dried up in financial markets, it can be assessed that central banks' monetary policy measures to counter the sharp world recession were successful. The key monetary policy measures they used were a combination of lowering central interest rates and flooding financial markets with liquidity, particularly through unconventional means such as Quantitative Easing (QE), where central banks bought large amounts of central government debt and smaller sums of other debt.

The key issue now is that that period of stimulating economic recovery and warding off the threat of deflation is coming towards its close and a new period has already started in the US, and more recently in the UK, on reversing those measures i.e. by raising central rates and (for the US) reducing central banks' holdings of government and other debt. These measures are now required in order to stop the trend of an on-going reduction in spare capacity in the economy, and of unemployment falling to such low levels that the re-emergence of inflation is viewed as a major risk. It is, therefore, crucial that central banks get their timing right and do not cause shocks to market expectations that could destabilise financial markets. In particular, a key risk is that because QE-driven purchases of bonds drove up the price of government debt, and therefore caused a sharp drop in income yields, this then also encouraged investors into a search for yield and into investing in riskier assets such as equities. This resulted in bond markets and equity market prices both rising to historically high valuation levels simultaneously. This, therefore, makes both asset categories vulnerable to a sharp correction. It is important, therefore, that central banks only gradually unwind their holdings of bonds in order to prevent destabilising the financial markets. It is also likely that the timeframe for central banks unwinding their holdings of QE debt purchases will be over several years. They need to balance their timing to neither squash economic recovery by taking too rapid and too strong action, or, alternatively, let inflation run away by taking action that was too slow and/or too weak. The potential for central banks to get this timing and strength of action wrong are now key risks.

There is also a potential key question over whether economic growth has become too dependent on strong central bank stimulus and whether it will maintain its momentum against a backdrop of rising interest rates and the reversal of QE. In the UK, a key vulnerability is the low level of productivity growth, which may be the main driver for increases in wages; and decreasing consumer disposable income, which is important in the context of consumer expenditure primarily underpinning UK GDP growth.

A further question that has come to the fore is whether an inflation target for central banks of 2%, is now realistic given the shift down in inflation pressures from internally generated inflation, (i.e. wage inflation feeding through into the national economy), given the above mentioned shift down in the Phillips curve.

- Some economists favour a shift to a lower inflation target of 1% to emphasise the need to keep the lid on inflation. Alternatively, it is possible that a central bank could simply ‘look through’ tepid wage inflation, (i.e. ignore the overall 2% inflation target), in order to take action in raising rates sooner than might otherwise be expected.
- However, other economists would argue for a shift *UP* in the inflation target to 3% in order to ensure that central banks place the emphasis on maintaining economic growth through adopting a slower pace of withdrawal of stimulus.
- In addition, there is a strong argument that central banks should target financial market stability. As mentioned previously, bond markets and equity markets could be vulnerable to a sharp correction. There has been much commentary, that since 2008, QE has caused massive distortions, imbalances and bubbles in asset prices, both financial and non-financial. Consequently, there are widespread concerns at the potential for such bubbles to be burst by exuberant central bank action. On the other hand, too slow or weak action would allow these imbalances and distortions to continue or to even inflate them further.
- Consumer debt levels are also at historically high levels due to the prolonged period of low cost of borrowing since the financial crash. In turn, this cheap borrowing has meant that other non-financial asset prices, particularly house prices, have been driven up to very high levels, especially compared to income levels. Any sharp downturn in the availability of credit, or increase in the cost of credit, could potentially destabilise the housing market and generate a sharp downturn in house prices. This could then have a destabilising effect on consumer confidence, consumer expenditure and GDP growth. However, no central bank would accept that it ought to have responsibility for specifically targeting house prices.

UK. After the UK surprised on the upside with strong economic growth in 2016, growth in 2017 has been disappointingly weak; quarter 1 came in at only +0.3% (+1.8% y/y), quarter 2 was +0.3% (+1.5% y/y) and quarter 3 was +0.4% (+1.5% y/y). The main reason for this has been the sharp increase in inflation, caused by the devaluation of sterling after the EU referendum, feeding increases in the cost of imports into the economy. This has caused, in turn, a reduction in consumer disposable income and spending power and so the services sector of the economy, accounting for around 80% of GDP, has seen weak growth as consumers cut back on their expenditure. However, more recently there have been encouraging statistics from the manufacturing sector which is seeing strong growth, particularly as a result of increased demand for exports. It has helped that growth in the EU, our main trading partner, has improved significantly over the last year while robust world growth has also been supportive. However, this sector only accounts for around 10% of GDP so expansion in this sector will have a much more muted effect on the overall GDP growth figure for the UK economy as a whole.

While the Bank of England is expected to give forward guidance to prepare financial markets for gradual changes in policy, the Monetary Policy Committee, (MPC), meeting of 14 September 2017 managed to shock financial markets and forecasters by suddenly switching to a much more aggressive tone in terms of its words around warning that Bank Rate will need to rise soon. The Bank of England Inflation Reports during 2017 have clearly flagged up that it expected CPI inflation to peak at just under 3% in 2017, before falling back to near to its target rate of 2% in two years' time. The Bank revised its forecast for the peak to just over 3% at the 14 September meeting. (Inflation actually came in at 3.1% in November so that may prove now to be the peak.) This marginal revision in the Bank's forecast can hardly justify why the MPC became so aggressive with its wording; rather, the focus was on an emerging view that with unemployment having already fallen to only 4.3%, the lowest level since 1975, and improvements in productivity being so weak, that the amount of spare capacity in the economy was significantly diminishing towards a point at which they now needed to take action. In addition, the MPC took a more tolerant view of low wage inflation as this now looks like a common factor in nearly all western economies as a result of automation and globalisation. However, the Bank was also concerned that the withdrawal of the UK from the EU would effectively lead to a *decrease* in such globalisation pressures in the UK, and so this would cause additional inflationary pressure over the next few years.

At Its 2 November meeting, the MPC duly delivered a 0.25% increase in Bank Rate. It also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This is, therefore, not quite the 'one and done' scenario but is, nevertheless, a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

However, some forecasters are flagging up that they expect growth to accelerate significantly towards the end of 2017 and then into 2018. This view is based primarily on the coming fall in inflation, (as the effect of the effective devaluation of sterling after the EU referendum drops out of the CPI statistics), which will bring to an end the negative impact on consumer spending power. In addition, a strong export performance will compensate for weak services sector growth. If this scenario was indeed to materialise, then the MPC would be likely to accelerate its pace of increases in Bank Rate during 2018 and onwards.

It is also worth noting the contradiction within the Bank of England between action in 2016 and in 2017 by two of its committees. After the shock result of the EU referendum, the Monetary Policy Committee (MPC) voted in August 2016 for emergency action to cut Bank Rate from 0.50% to 0.25%, restarting £70bn of QE purchases, and also providing UK banks with £100bn of cheap financing. The aim of this was to lower borrowing costs, stimulate demand for borrowing and thereby increase expenditure and demand in the economy. The MPC felt this was necessary in order to ward off their expectation that there would be a sharp slowdown in economic growth. Instead, the economy grew robustly, although the Governor of the Bank of England strongly maintained that this was *because* the MPC took that action. However, other commentators regard this emergency action by the MPC as being proven by events to be a mistake. Then in 2017, we had the Financial Policy Committee (FPC) of the Bank of England taking action in June and September over its concerns that cheap borrowing rates, and easy availability of consumer credit, had resulted in too rapid a rate of growth in consumer borrowing and in the size of total borrowing, especially of unsecured borrowing. It, therefore, took punitive action to clamp down on the ability of the main banks to extend such credit! Indeed, a PWC report in October 2017 warned that credit card, car and personal loans and student debt will hit the equivalent of an average of £12,500 per household by 2020. However, averages belie wide variations in levels of debt with much higher exposure being biased towards younger people, especially the 25 -34 year old band, reflecting their lower levels of real income and asset ownership.

One key area of risk is that consumers may have become used to cheap rates since 2008 for borrowing, especially for mortgages. It is a major concern that some consumers may have over extended their borrowing and have become complacent about interest rates going up after Bank Rate had been unchanged at 0.50% since March 2009 until falling further to 0.25% in August 2016. This is why forward guidance from the Bank of England continues to emphasise slow and gradual increases in Bank Rate in the coming years. However, consumer borrowing is a particularly vulnerable area in terms of the Monetary Policy Committee getting the pace and strength of Bank Rate increases right - without causing a sudden shock to consumer demand, confidence and thereby to the pace of economic growth.

Moreover, while there is so much uncertainty around the Brexit negotiations, consumer confidence, and business confidence to spend on investing, it is far too early to be confident about how the next two to three years will actually pan out.

EZ. 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 November inflation was 1.5%. 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.

USA. Growth in the American economy was notably erratic and volatile in 2015 and 2016. 2017 is following that path again with quarter 1 coming in at only 1.2% but quarter 2 rebounding to 3.1% and quarter 3 coming in at 3.2%. Unemployment in the US has also fallen to the lowest level for many 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 four 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.

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.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50
- March 2019: initial two-year negotiation period on the terms of exit. In her Florence speech in September 2017, the Prime Minister proposed a two year transitional period after March 2019.
- UK continues as a full EU member until March 2019 with access to the single market and tariff free trade between the EU and UK. Different sectors of the UK economy will leave the single market and tariff free trade at different times during the two year transitional period.
- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.
- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK could also exit without any such agreements in the event of a breakdown of negotiations.
- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.
- On full exit from the EU: the UK parliament would repeal the 1972 European Communities Act.
- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

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.

TREASURY MANAGEMENT PRUDENTIAL INDICATORS	2017/18*	2018/19	2019/20	2020/21	2021/22
	£'000	£'000	£'000	£'000	£'000
Authorised Limit for external debt					
Borrowing	£75,000	£85,000	£95,000	£95,000	£95,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£80,000	£90,000	£100,000	£100,000	£100,000
Operational Boundary for external debt -					
borrowing	£65,000	£75,000	£85,000	£85,000	£85,000
other long term liabilities	£5,000	£5,000	£5,000	£5,000	£5,000
TOTAL	£70,000	£80,000	£90,000	£90,000	£90,000

2017/18* - proposed revision to authorised boundary from £70m to £80m. Operational boundary unaltered.

Interest Rate Exposures	**2018/19**	**2019/20**	**2020/21**
	Upper	**Upper**	**Upper**
Limits on fixed interest rates based on **net** debt	100%	100%	100%
Limits on variable interest rates based on **net** debt	100%	100%	100%
Limits on fixed interest rates:			
· Debt only	100%	100%	100%
· Investments only	100%	100%	100%
Limits on variable interest rates			
· Debt only	30%	30%	30%
· Investments only	100%	100%	100%
Maturity Structure of fixed interest rate borrowing 2018/19			
		lower	**Upper**
Under 12 Months		0%	100%
12 months to 2 years		0%	100%
2 years to 5 years		0%	100%
5 years to 10 years		0%	100%
10 years to 20 years		0%	100%
20 years to 30 years		0%	100%
30 years to 40 years		0%	100%
40 years to 50 years		0%	100%
Maturity Structure of variable interest rate borrowing 2018/19			
		lower	**Upper**
Under 12 Months		0%	30%
12 months to 2 years		0%	30%
2 years to 5 years		0%	30%
5 years to 10 years		0%	30%
10 years to 20 years		0%	10%
20 years to 30 years		0%	10%
30 years to 40 years		0%	10%
40 years to 50 years		0%	10%

Affordability prudential indicator - Ratio of financing costs to net revenue stream

This indicator assesses the affordability of the capital investment plans. It provides an indication of the impact of the capital investment plans on the Council's overall finances 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.

Prudential Indicator: Financing Cost to Net Revenue Stream	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate
Financing Costs	£'000	£'000	£'000	£'000	£'000
1. Interest Charged to General Fund	703	1,022	1,655	2,153	2,334
2. Interest Payable under Finance Leases and any other long term liabilities	-	-	-	-	-
3. Gains and losses on the repurchase or early settlement of borrowing credited or charged to the amount met from government grants and local taxpayers	-19	-19	0	0	0
4. Interest and Investment Income	-369	-360	-465	-465	-465
5. Amounts payable or receiveable in respect of financial derivatives	-	-	-	-	-
6. MRP, VRP	505	785	1,116	1,348	1,627
6. Depreciation/Impairment that are charged to the amount to be met from government grants and local taxpayers	-	-	-	-	-
Total	820	1,428	2,306	3,036	3,496
Net Revenue Stream					
Amount to be met from government grants and local taxpayers	14,549	13,870	13,522	12,999	12,289
Ratio					
Financing Cost to Net Revenue Stream	**6%**	**10%**	**17%**	**23%**	**28%**

This prudential indicator shows that the ratio of financing costs to the net revenue stream is increasing. This is not unexpected given that the Council has an income generation strategy that has identified an additional £50m of Capital expenditure over the period 2017/18 to 2020/21. The above ratio does not currently take into account the income that will be generated from the Capital investment.

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 up to a maximum of 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 (CNAV, LVAV,VNAV)	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	12 months
UK Government Treasury Bills	UK sovereign rating	12 months

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 be agreed as part of 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

The list is based on those countries which have sovereign ratings of AA- or higher (the lowest rating shown from Fitch, Moody's and S&P) and also, (except at the time of writing- for Hong Kong, Norway and Luxembourg), have banks operating in sterling markets which have credit ratings of green or above in the Link Asset Services credit worthiness service.

Countries that meet our criteria 1, 2, 3, 4 (at 15.1.2018)

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
   - U.K.

4. AA-
   - Belgium
   - Qatar

Examples of Countries that do not meet our criteria:

Japan
Kuwait
Greece
Spain

APPENDIX 7 Treasury Management Policy Statement

The Council defines the policies and objectives of its treasury management activities as:

"The management of the organisation'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".

This 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, and any financial instruments entered into to manage these risks.

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 Key Principles and Clauses formally adopted

The Code identifies three key principles:

Key Principle 1

Public service organisations should put in place formal and comprehensive objectives, policies and practices, strategies and reporting arrangements for the effective management and control of their treasury management activities

Key Principle 2

Their policies and practices should make clear that the effective management and control of risk are the prime objectives of their treasury management activities and that responsibility for these lies clearly within their organisations. Their appetite for risk should form part of their annual strategy, including any use of financial instruments for the prudent management of those risks, and should ensure that priority is given to security and portfolio liquidity when investing treasury management funds.

Key Principle 3

They should acknowledge that the pursuit of value for money in treasury management and the use of suitable performance measures, are valid and important tools for responsible organisations to employ in support of their business and service objectives; and that within the context of effective risk management, their treasury management policies and practices should reflect this.

Clauses to be formally adopted

1. This organisation will create and maintain, as the cornerstones for effective treasury management:

- a Treasury Management Policy Statement, stating the policies, objectives and approach to risk management of its treasury management activities

- suitable Treasury Management Practices (TMPs), setting out the manner in which the organisation will seek to achieve those policies and objectives, and prescribing how it will manage and control those activities.

The content of the policy statement and TMP's will follow the recommendations contained in Sections 6 and & of the Code, subject only to amendment where necessary to reflect the particular circumstances of this organisation. Such amendments will not result in the organisation materially deviating from the Codes key principles.

2. This organisation (i.e. full board/council) will receive reports on its treasury management policies, practices and activities, including, as a minimum, an

annual strategy and plan in advance of the year, a mid- year review and an annual report after its close, in the form prescribed in its TMPs.

3. This council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury decisions to the Chief Financial Officer, who will act in accordance with the organisations policy statement and TMPs and, if he/she is a CIPFA member, CIPFA's Standard of Professional Practice on Treasury Management.

4. This Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

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 Midyear 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 midyear 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).
4. Approval of/amendments to the organisation’s adopted clauses, treasury management policy statement;
5. budget consideration and approval;
6. approval of the division of responsibilities;

(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) responsibilities

- 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.

The above list of specific responsibilities of the S151 officer in the 2017 Treasury Management Code has not changed. However, implicit in the changes in both codes, is a major extension of the functions of this role, especially in respect of non-financial investments, (which CIPFA has defined as being part of treasury management). Namely:-

1. preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management, with a long term timeframe (say 20+ years – to be determined in accordance with local priorities. Please also note that CIPFA has provided advice that it recognises that it may be too late in the current budget round for 2018/19 for many local authorities to produce a capital strategy this year.)
2. ensuring that the capital strategy is prudent, sustainable, affordable and prudent in the long term and provides value for money
3. ensuring that due diligence has been carried out on all treasury and non-financial investments and is in accordance with the risk appetite of the authority
4. ensure that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing
5. ensuring the proportionality of all investments so that the authority does not undertake a level of investing which exposes the authority to an excessive level of risk compared to its financial resources

6. ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long term liabilities

7. provision to members of a schedule of all non-treasury investments including material investments in subsidiaries, joint ventures, loans and financial guarantees .

8. ensuring that members are adequately informed and understand the risk exposures taken on by an authority

9. ensuring that the authority has adequate expertise, either in house or externally provided, to carry out the above

10. Creation of Treasury Management Practices which specifically deal with how non treasury investments will be carried out and managed, to include the following): -

   - Risk management (TMP1 and schedules), including investment and risk management criteria for any material non-treasury investment portfolios;

   - Performance measurement and management (TMP2 and schedules), including methodology and criteria for assessing the performance and success of non-treasury investments;

   - Decision making, governance and organisation (TMP5 and schedules), including a statement of the governance requirements for decision making in relation to non-treasury investments; and arrangements to ensure that appropriate professional due diligence is carried out to support decision making;

   - Reporting and management information (TMP6 and schedules), including where and how often monitoring reports are taken;

   - Training and qualifications (TMP10 and schedules), including how the relevant knowledge and skills in relation to non-treasury investments will be arranged.

At the time of writing 28 January 2018, the Governments update of investment regulations has not been released. More guidance on the detail of these changes will be included in the update of the CIPFA Publication *Treasury Management in the Public Services Guidance Notes for Local Authorities including Police and Fire Bodies*. This publication will be updated following the issue of the Statutory Guidance on Local Government Investments which was subject to consultation from November to December 2017.