South Lakeland District Council

Full Council

7 February2018 / 24 July 2018

2018/19 TO 2022/23 TREASURY MANAGEMENT FRAMEWORK

PORTFOLIO:	Councillor Giles Archibald - Leader and Finance Portfolio Holder
REPORT FROM:	Shelagh McGregor - Assistant Director (Resources) and Section 151 Officer
REPORT AUTHOR:	Claire Read – Financial Services Officer
WARDS:	All Wards
FORWARD PLAN:	Budget and Policy Framework Decision included in the Forward Plan as published on 22 December 2017

1.0 EXPECTED OUTCOME

1.1 It is expected that the Treasury Management Framework for 2018/19 to 2022/23, will be approved on the 27 February 2018 as part of the 2018/19 budget process.

2.0 RECOMMENDATION

2.1 It is recommended that Council approve the Treasury Management Framework and the authorised borrowing limits within the report.

3. Regulatory and legislative changes update

3.1. During the Summer/Autumn of 2017, Chartered Institute of Public Finance and Accounting (CIPFA) conducted a review of the Treasury Management Code of Practice and the Prudential Code. The review resulted in new codes being published in December.

3.2. On 2nd February 2018 the Department of Communities and Local Government (CLG) issued revised statutory guidance on local government investments and minimum revenue provision, with an implementation date of 2019/20.

3.3. Both reviews primarily focused on 'non-treasury' investments arising from the Localism Act 2011, especially the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or use of existing cash balances) to raise cash to finance such activities.

3.4. The reviews also introduce the requirement for a Capital Strategy to demonstrate that the authority takes capital expenditure and investment decisions in line with service objectives and properly takes account of stewardship, value for money, prudence, sustainability and affordability

3.5. Earlier versions of this report reflected the proposals from CLG, minor amendments have been made to this version to ensure compliance with published guidance.

3.6. As reported in the 2017/18 Framework under the Markets in Financial Instruments Directive (MiFID) II, all local authorties will be classified as ‘retail’ clients, but have the option to opt up to ‘professional’ status, subject to meeting qualitative and quantative criteria.

3.7. The council has been opting up to professional status where required to ensure it may continue its current approach to investing, as all existing investments options will be available to us as professional clients.

4. BACKGROUND AND PROPOSALS

4.1. This report sets out the Council’s Treasury Management Framework for 2018/19 – 2022/23. The framework has been updated to reflect the 2018/19 budget and capital program and includes amendments to the counterparty selection criteria.

4.2. The framework fulfils four key legislative requirements:

- CIPFA’s Prudential Code requires the Council to set a number of **Prudential Indicators** as part of the capital strategy setting out the expected capital activities and managing its capital finances.
- The Council’s **Minimum Revenue Provision (MRP) Policy**, which sets out how the Council will pay for capital assets through revenue each year.
- The **Treasury Management Strategy Statement** which sets out how the Council’s treasury service will support the capital decisions taken above, the day to day treasury management and the limitations on activity through treasury prudential indicators;
- The **Investment Strategy** which sets out the Council’s criteria for choosing investment counterparties and limiting exposure to the risk of loss.

This report reflects the budget proposals considered by Council on 19th December 2017 for consultation.

4.3. The Council is required to set a balanced annual revenue budget. The timing and nature of income and expenditure within the budget needs to be understood and managed so that cash is available when it is required. This is a key function of the treasury management operation.

4.4. The second key function is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council. This may involve arranging new or replacement loans or the planned use of cash balances.

4.5. CIPFA defines treasury management as:

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

4.6. The Council is required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of polices, estimates and actuals. These reports are required to be adequately scrutinised by committee before being recommended to the Council. These are as follows:

- **Capital Strategy and Treasury Management and Investment Strategy** (this report), setting out the expectations for a minimum of three years, linked into the Council's wider budget setting process.
- **A Mid Year Treasury Management Report** – This will update Members with the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is meeting the strategy or whether any policies require revision.This report is incorporated into the Council's quarterly corporate monitoring reports.
- **An Annual Treasury Report** – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

4.7. The appendices to this report contain the strategy for 2018/19 which covers two main areas:

Capital Issues (appendices 1 and 2)

- The Capital Stratergy;
- the Minimum Revenue Provision statement.

Treasury management Issues (appendices 3, 4 and 5)

- the current treasury position;
- treasury indicators which will limit the treasury risk and activities of the Council;
- prospects for interest rates;
- the borrowing strategy including rescheduling;
- policy on borrowing in advance of need;
- the investment strategy including creditworthiness policy;
- policy on use of external service providers;
- high level Treasury Management Policy statement.
- Indicative lending list based on the proposed investment strategy

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

4.9. It is important to note that the key controls around placing investments focus on counterparty security, liquidity and then yield, in that order, in line with the CIPFA Code.

4.10. The council carried out a competitive tender for the Treasury Management advice service. The service was retained by Link Asset Services (formally Capita Asset Services) for the next three to five years.

4.11. Counterparty criteria has been changed to increase duration for UK financial instiutions and to increase monetary limits for the highest quality institutions. This will enable officers to ensure diversity in our portfolio, which is an important part of managing counterparty risk and securing our investments.

4.12. In addition to the credit rating critera, the report also details the type of investment instruments officers can use. The instruments selected are designed primarily to ensure preservation of capital and sufficent liquidity, with yield to be considered once security and liquidity are assured.

5.0 CONSULTATION

5.1 The Treasury Management Framework satisfies statutory requirements and guidance issued by CLG and CIPFA. It is a mainly technical document that also reflects the decisions made as part of the wider budget process. It has been prepared in consultation with the Council's Treasury advisor (Link Asset Services). The draft framework will be considered by Cabinet and Overview and Scrutiny Committee before the final version is presented to Council for approval on 27 February 2018.

6 ALTERNATIVE OPTIONS

6.1 No alternative options are proposed; the Treasury Management Framework is driven largely by legislation and external guidance and reflects the 2018/19 budget.

7 LINKS TO COUNCIL PRIORITIES

7.1 These arrangements enable the priorities as set out in the Council Plan to be achieved. Performance indicators are included within the report.

8 IMPLICATIONS

8.1 Financial and Resources

8.1.1 Although concerned with good financial management, the report in itself has no direct financial implications.

8.2 Human Resources

8.2.1 This report has no direct impact on the staffing of the Council.

8.3 Legal

8.3.1 This report provides a framework for treasury management in accordance with legislation. There are no other legal implications.

8.4 Health, Social, Economic and Environmental

Have you completed and Health, Social, Economic and Environmental Impact Assessment?	Yes ☐	No ☒
If you have not completed an Impact Assessment, please explain your reasons.	A HSEEIA has not been carried out as this policy does not impact individuals.	

8.5 Equality and Diversity

Have you completed an Equality Impact Analysis?	Yes ☐	No ☒
If you have not completed an Equality Impact Analysis, please explain your reasons.	An EIA has not been carried out as this policy does not impact individuals	

8.6 Risk

Risk	**Consequence**	**Controls required**
Long-term borrowing is taken at rates that are not advantageous.	Council incurs unnecessary interest costs.	Treasury advice is taken on optimum timing of borrowing
Repayment of long term borrowing at rates that are not advantageous	Council occurs unnecessary premium costs	Treasury advice is taken on optimum timing of loan repayment
Investment of principal sums with insecure counterparties.	Loss of principal due to default by borrower.	Stringent and cautious lending criteria are built into the Council's Investment Strategy.
Investment returns are volatile and may fall short of expectations.	Underperformance and underachievement of budgeted income levels.	Monitoring performance of in-house investments
Borrowing is not affordable.	Financial pressure on the General Fund.	Prudent borrowing in accordance with the Strategy and indicators. Forecast borrowing costs are factored into the 2018/19 Budget and Medium Term Financial Plan.

CONTACT OFFICERS

Claire Read, Financial Services Officer; tel 01539 793152

APPENDICES ATTACHED TO THIS REPORT

Appendix No.	Appendix name
1	Capital Strategy including - Prudential Indicators and Limits for 2018/19 to 2022/23
2	Minimum Revenue Provision Policy Statement 2018/19 to 2022/23
3	Treasury Management Policy Statement 2018/19 to 2022/23
4	Treasury Management Strategy 2018/19 to 2022/23 and Indicators
5	Example 18/19 Counterparty List

BACKGROUND DOCUMENTS AVAILABLE

Name of Background document	Where it is available
2018/19 Revenue and Capital Budget	On the same agenda

TRACKING INFORMATION

Assistant Director	**Portfolio Holder**	**Solicitor to the Council**	**SMT**	**Scrutiny Committee**
21/12/17	21/12/17	n/a	21/12/17	12/01/18
Executive (Cabinet)	**Committee**	**Council**	**Section 151 Officer**	**Monitoring Officer**
07/02/18	n/a	27/02/18	21/12/17	21/12/17
Human Resource Services Manager		**Leader**	**Ward Councillor(s)**	
n/a		n/a	n/a	

APPENDIX 1

Capital Strategy including Prudential Indicators 2018/19 – 2022/23

Introduction

1. This Capital Strategy sets out the Council's approach to meeting community and service needs through its capital investment programme. The Council's priorities, objectives and corporate outcomes are set out in its current Council Plan which was approved 22 February 2017. The Plan is supported by a set of annual service plans. The Capital Strategy describes how the deployment of capital resources will contribute to the achievement of these objectives. The Capital Strategy will continue to be reviewed with regard to its relevance in the changing context in which local government organisations work.

2. The current economic climate provides significant challenges for the Council. The demand for investment in the regeneration and renewal of infrastructure and assets continues, whilst at the same time the resources available to the Council are constrained by proposed reductions in public service expenditure following Government Spending Reviews. These reductions impact directly on the Council and on the resources available to partners.

3. The Council owned property, plant and equipment, assets, investment properties and heritage assets with a total net book value of £62m at March 2017. Council assets include 43 car parks, 176 parks and open spaces, 9 cemeteries, 5 depots and 3 sports centres. The Council also owns a large number of commercial properties and agricultural land used to generate income.

Links to Other Plans and Strategies

4. This Capital strategy links to, and is consistent with, the following other plans and strategies:
    - Council Plan
    - Service Plans
    - Medium Term Financial Plan
    - Corporate Asset Strategy
    - Risk Management Strategy
    - Procurement Strategy
    - Treasury Management Strategy

5. The Council's Corporate Asset Manager and property management contractors have carried out an asset review which will be used to update the Corporate Asset Strategy in 2018.

6. The Councils Capital Strategy and expenditure plans are a key driver of treasury management activity.

Overarching Strategy

7. The Council’s capital strategy is to deliver a capital programme that:
   - Contributes to the Council Plan, and the Council’s vision, values, strategic objectives and priorities
   - Is closely aligned with the Council’s Asset Management Plan
   - Supports service-specific and other plans and strategies
   - Is affordable, financially prudent and sustainable, contributes to better value for money

8. The capital strategy will be delivered through:
   - Effective political and corporate leadership
   - Adequate and effective performance management arrangements
   - Clearly defined processes for building and monitoring the capital programme
   - Clear policies on financing capital expenditure
   - Effective risk management arrangements
   - A clear procurement protocol

9. In prioritising the Capital Programme, particular emphasis will be given to schemes that:
   - Achieve the Council’s priorities
   - Improve performance against national and local targets
   - Improve efficiency and effectiveness in service delivery, including through partnership working
   - Generate or increase income streams
   - Promote effective Asset Management, including DDA and Health & Safety issues

Prudential Indicators

10. The CIPFA Prudential Code for Capital Finance in Local Authorities (the Prudential Code) was introduced through regulation by the Local Government Act 2003. It sets out the concepts of affordability, sustainability and prudence as they apply to capital expenditure.

    A key objective of the Prudential Code is to ensure that the capital investment plans of the local authority are prudent, sustainable and affordable. It sets out the prudential indicators that must be used, and the factors that must be taken into account. These are designed to support and record local decision-making in a manner that is publicly accountable.

15. Table 3 confirms that the Council expects to be compliant with this indicator and should remain under-borrowed across the period. The increase in borrowing reflects the prudent assumption that the unfinanced element of the capital programme would be funded through external debt. The revenue budget for interest cost has been prepared on this basis to ensure that these investment plans are affordable. However, the actual cash need may be met from reduced investment balances.

16. The table below shows that gross borrowing will not exceed the CFR over the next three years:

Table 3: Gross debt and the CFR

Borrowing	2017/18 Estimate £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000	2022/23 Estimate £000
CFR at 31 March	18,373.40	18,557.70	19,495.50	19,077.90	18,526.80	18,097.90
Borrowing at 31 March	12,800.00	12,800.00	19,495.50	19,077.90	18,526.80	18,097.90
(Under)/over borrowing	(5,573.40)	(5,757.70)	0.00	0.00	0.00	0.00
Investments at 31 March	(17,657.50)	(19,031.42)	(25,486.12)	(24,254.12)	(25,612.02)	(27,138.42)

17. **Affordability**
The fundamental objective in determining the affordability of the authority's capital plans is to ensure that the total capital investment remains within sustainable limits. This includes considering the impact on Council Tax.

18. 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. The estimates are presented in the table below:

Table 3: Ratio of financing costs to net revenue stream

2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate	2022/23 Estimate
6.81%	9.40%	10.88%	12.58%	12.72%	13.06%

19. This shows that the amount of revenue budget spent financing debt is rising over the MTFP period. There are two main reasons for this trend.
    a. MRP is rising to the level required to sustain the vehicle and plant programme. Older vehicles were grant funded whereas replacement vehicles are financed through borrowing.
    b. The net revenue stream (Council Tax, retained rates and non-service grant) is forecast to reduce over the period although reductions in grant are partially offset by increases to income from local taxation.

Estimates of the incremental impact of capital investment decisions on council tax

20. This indicator identifies the revenue costs associated with proposed changes to the capital programme compared to the Council's existing approved commitments and current plans. This reflects interest income foregone on the use of reserves and additional costs where schemes are funded by external borrowing.

Table 4: Incremental impact of capital investment

Council tax	**2017/18 Estimate**	**2018/19 Estimate**	**2019/20 Estimate**	**2020/21 Estimate**	**2021/22 Estimate**	**2022/23 Estimate**
Council tax - band D	£0.53	£7.32	£2.59	£7.51	£3.71	£4.56

21. The increase in 2018/19 is reflective of the revised timescales for existing projects and new capital schemes, along with their anticipated use of reserves and potential borrowing requirements. This also shows the impact of rising MRP as discussed in 19 above

Programme Approval

22. **Prioritising projects**

All bids for inclusion in the following years programme are considered according to a set of objective criteria to assist with the prioritisation of schemes and the allocation of funds. This ensures that, in a context of limited resources, the community vision and strategy and the Council's vision, values, objectives and priorities form the framework for decisions about investment priorities, and that capital allocations are made using clear impartial criteria.

The prioritisation process is linked directly to the information given on the completed project appraisals, with weighting given to schemes that strongly support the Council's objectives and priorities, and those that fulfil an urgent legal or statutory requirement.

In summary, each bid can be rated on the extent to which the project contributes:

- The Council's objectives and priorities
- Legal commitments or statutory duties, including DDA & Health & Safety issues
- Equalities
- Improvements in performance indicators
- Efficiency savings
- Value for money
- The delivery of service objectives
- Effective Asset Management
- Extent of ring fenced or specific funding
- Levels of financial risk involved
- Impact on the revenue budget and income generation

Prioritisation of the bids enables officers to put forward a recommended programme that is within available resources. The weighting within the scoring framework will be reviewed on an annual basis as part of a policy of continuous improvement and to take into account any relevant factors. Bids for work required to meet a statutory or legal obligation will be given a high priority.

The prioritised programme is for guidance only. Members are responsible for agreeing the capital programme and have the discretion to include or exclude schemes as they deem appropriate.

23. **Project Appraisals**

All bids for inclusion in the capital programme are supported by a project appraisal, the preparation of which is the responsibility of the budget holder or project manager. The project manager signs the appraisal to confirm that their Assistant Director, Director and Portfolio Holder are aware of and support the scheme.

The appraisal pro-forma has been designed to ensure that the information gathered is sufficient in order to make decisions based on the criteria set out above. Project appraisals must consider carefully the deliverability of projects to avoid slippage of the capital programme.

The de-minimus level set by the authority for capital expenditure is £10,000. Individual schemes must therefore be £10,000 and above to be included in the authorities capital programme. The only exception is where the funding for the project is external and requires the scheme to be capital.

Programme Monitoring

24. Project managers are responsible for the proper and effective control and monitoring of their projects, including financial monitoring.

This includes ensuring that:

- Only capital expenditure is charged to the capital project;
- Proper procurement processes are followed, in accordance with the Contract Procedure Rules;
- Only expenditure properly attributable to the scheme is coded to the scheme;
- The scheme expenditure is contained within the agreed budget, and that any ‘unavoidable’ variations are dealt with appropriately;
- Realistic expenditure profiles are determined;
- A realistic forecast outturn for the financial year and the project as a whole are calculated and kept under regular review;
- Any slippage of expenditure from current to future years is identified;
- Any grants or third party funding is applied for and all grant conditions met
- The source of any revenue funding is identified.

Project managers are also responsible for carrying out project reviews following scheme completion.

25. The finance team is responsible for providing support and advice to assist project managers in managing and monitoring their capital budgets. It also has a key role in consolidating and co-ordinating the monitoring information that is required for reporting purposes. This involves reporting to Senior Management Team, Cabinet and Council.

The capital programme position is reported to Senior Management Team, Cabinet and Council as part of Corporate Financial Monitoring report and covers the latest programme and any amendments to be notified or approved, expenditure to date, and the forecast outturn. It also outlines the financing position and any steps needed to deal with potential financing difficulties.

At year-end, an outturn report and carry-forward requests are taken to Cabinet and Council. These will include an analysis of programme slippage to the following year, including the reasons for that slippage and how it is to be financed.

26. The programme for the coming year is set and agreed by Council prior to 1st April (at the February Council as part of the Budget process), but it is essential to also have a process that then allows for changes during the year.

Changes may be required as a result of proposed additions to the programme, amendments to existing schemes or deletions from the programme. For example tenders may come in above or below estimate; difficulties may be encountered in implementation, which require a change of approach; funding may need to be released to support another more urgent priority.

27. The need to add a scheme to the programme usually arises from either access to additional funding, such as a grant or third party contribution, or as a response to an unforeseen urgent issue (often related to legal or health and safety concerns).

In order to bid for an addition to the programme, a project appraisal must be completed and signed off in the usual way. The funding for the project must be identified at this stage. Where there is no additional funding to support the bid, resources must be identified from within the existing programme. The prioritisation of the proposed addition will need to be considered with reference to any reserve list of projects, as well as projects already in the programme but not yet complete.

The request for the addition will either be incorporated into the regular Corporate Quarterly Financial Monitoring report to Cabinet or Council, or approved by Cabinet and Council.

28. If the proposed amendment is one of substance, which results in a scheme materially different from the original project appraisal, then the original project must be withdrawn, and a new project appraisal completed to support the new bid. If, however, the substance of the scheme remains the same, then the change can be dealt with through the Corporate Quarterly Financial Monitoring process.

Formal variations to budgets for existing projects must be completed and authorised in the following circumstances:

- Forecast total scheme outturn is materially in excess of budget
- Additional funding has become available to support a scheme
- A forecast overspend is to be funded by a forecast underspend in another project
- Funding is released due to a forecast underspend on a scheme
- A scheme is to be withdrawn from the programme

Treasury Management

29. It is also prudent to carry out treasury management activities in accordance with good practice, and the Prudential Code sets a number of indicators to address this.

30. The Council has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross Sectorial Guidance Notes.

31. Other treasury indicators can be found in the treasury strategy in Appendix 3

Non-Treasury Investments

32. Investments taken out for non-treasury management purposes, which are held primarily or partially to generate a profit. Examples of this include investment properties and loans supporting service outcomes.

33. The Council has 21 Investment properties including retails units and industrial sites. Which at 31st March 2017 had a value of £4.3 million and after expenses earned the council £0.325 million in income, creating a return on investment of 7.5% overall. This will vary year on year depending on maintenance required.

34. As part of the changes to the Treasury and Prudential Codes of Practice and the CLG guidance a list of non-treasury investments is being compiled and will be kept up-to-date.

35. In the future such investments will have to go through a robust procedure to ensure that they fit in with the council's plans, are affordable and sustainable. The principles of the procedure are:

    a. Ensuring the investment meets the councils risk profile
    b. Ensuring the portfolio of assets is prudently balanced to minimise risk of income fluctuations and loss of capital value.
    c. Ensuring the rate of return exceeds that which could be achieved through traditional sources of investments
    d. Establishing a comprehensive due diligence process to minimise risks including use of specialist external advice where appropriate
    e. Establishing appropriate governance arrangements to ensure decisions are made in a streamlined and efficient way.

APPENDIX 2

The purpose of this Appendix is to set out the Council's Policy on making Minimum Revenue Provision (MRP) for Capital Expenditure Financed by borrowing or Credit Arrangements.

MRP Policy Statement

1. The Council is required to pay off an element of the accumulated General Fund capital spend each year (the CFR) through a revenue charge (the minimum revenue provision - MRP).
2. CLG Regulations have been issued which require the full Council to approve **an MRP Statement** in advance of each year. A variety of options are provided to councils, so long as there is a prudent provision. The Council is recommended to approve the following MRP Statement.
3. For capital expenditure incurred before 1 April 2008 or which in the future will be Supported Capital Expenditure, the MRP policy will be:
   - **Previous practice -** MRP will follow the practice outlined in former CLG regulations (option 1); this option provides for an approximate 4% reduction in the borrowing need (CFR) each year on eligible debt.
4. From 1 April 2008 for all unsupported borrowing (including Private Finance Initiative and finance leases) the MRP policy will be
   - **Asset Life Method** – MRP will be based on the estimated life of the assets, in accordance with the proposed regulations (this option must be applied for any expenditure capitalised under a Capitalisation Direction). This option provides for a reduction in the borrowing need over approximately the asset's life.

     This method allows for annual payment to be calculated as equal instalments or set as an annuity (increasing payments) over the life of the asset. The exact repayment calculation will be determined on a case by case basis.
   - **For Finance leases,** the MRP will be calculated to match the capital repayment identified within the annual lease payments.

APPENDIX 3

The purpose of this appendix is to set out the Council’s Treasury Management policy.

TREASURY MANAGEMENT POLICY STATEMENT

1. This organisation defines its treasury management activities as:

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

2. This organisation 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.

3. This organisation 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 4

The purpose of this appendix is to set out the Council's Treasury Management Strategy for 2018/19 including the Treasury Indicators.

TREASURY MANAGEMENT STRATEGY

1. The capital expenditure plans set out in **Appendix 1** provide details of the service activity of the Council.

2. 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 service activity. This will involve both the organisation of the cash flow and, where capital plans require, the organisation of approporiate borrowing facilities.

3. The strategy covers the relevant Treasury/Prudential Indicators, the current and projected debt positions and the Annual Investment Strategy.

Economic background and prospects for interest rates (provided by Link Asset Services)

4. The Council has appointed Link Asset Services as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.

5. It is important to note that interest rate projections are estimates at a point in time and are subject to constant revision. However, in terms of managing interest rate risk, it is important to be aware of expert opinion around the magnitude, timings and direction of travel on rates. Link Asset Services' view on rates is presented in the table below:

Table 1: Interest rates (Provided by Link Asset Services)

	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%

6. As expected, the Monetary Policy Committee (MPC) delivered a 0.25% increase in Bank Rate at its meeting on 2 November 2017. 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%. This is reflected in table 1.

7. UK growth in 2017 has been week compared to strong growth in 2016, with the latest results at the end of quarter 3 being 1.5% year on year. 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.

8. Inflation is expected to peak at just over 3% before falling back to around 2%, as the increase in rates due to the referendum drops out of the calculation.

9. There is still much uncertainty surrounding Brexit negotiations, coupled with poor consumer and business confidence, it is far too early to be confident about how the next two to three years will actually pan out

Current Portfolio Position

10. The Council currently distinguishes between operational and core cash balances. The operational balances relate to short term cash management whereas the core cash balances reflect longer term strategic resources (such as the General Fund balance and usable capital receipts).

11. A key prudential indicator is that external borrowing must not (except in the short term to support operational cash flow) exceed the underlying level of indebtedness (the CFR) and is intended to control any 'borrowing to on-lend' or borrowing to support the revenue account. As shown in Appendix 1 table 3 external debt is £12.8 million and internal borrowing is £5.7 million

The Operational Boundary

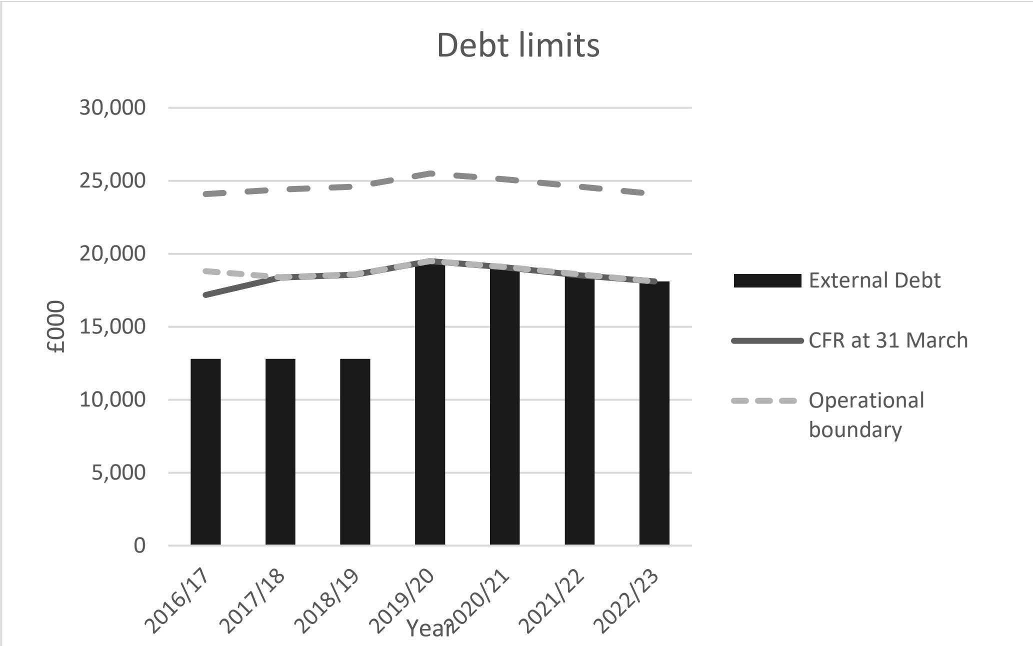
12. This is the limit beyond which external debt is not normally expected to exceed. This is set at a level consistent with the borrowing need (CFR), the anticipated level of external borrowing plus any anticipated further borrowing that may be required to manage operational cash balances. This may be required, for example, at year end when operational cash balances are at their lowest due to the timing of local taxation collection.

The Authorised Limit for external debt.

13. This reflects the level of external debt which, while not desired, could be afforded in the short term, but is not sustainable in the longer term. This is a limit on the maximum level of debt, beyond which external debt is prohibited and the limit can only be set or revised by Full Council.

Table 3: Authorised limit and operational boundary

	2017/18 Estimate £000	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**	**2022/23 Estimate £000**
CFR at 31 March	18,373.40	18,557.70	19,495.50	19,077.90	18,526.80	18,097.90
Under borrowing 31 March	(5,573.40)	(5,757.70)	0.00	0.00	0.00	0.00
Add operational cash limit	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00	6,000.00
Operational boundary	**18,400.00**	**18,600.00**	**19,500.00**	**19,100.00**	**18,600.00**	**18,100.00**
Authorised limit	**24,400.00**	**24,600.00**	**25,500.00**	**25,100.00**	**24,600.00**	**24,100.00**



Borrowing Strategy

14. The Council is currently maintaining an under-borrowed position, where borrowing is lower than the Capital Financing Requirement (CFR). This means utilising internal cash rather than taking out new borrowing to support the un-financed elements of the capital programme. This is a prudent strategy as investment returns are low and it minimises counterparty risk.

15. The policy of avoiding new borrowing and minimising cash balances has helped keep borrowing costs down. This needs to be kept under review to manage the risk of changes to the availability of internal cash and future borrowing costs. The projections include an assumption that the “underborrowing” will be reversed in 2019/20. This is to ensure that the medium term projections are prudent, it does not mean that the Council will definitely borrow (up to the CFR) in that year.

16. The Assistant Director (Resources) will continue to monitor this position through out the year and will respond to changing circumstances. As required by the Prudential Code, the MTFP relfects the cost of potential further borrowing and sufficient budget is available to ensure that, if requried, an increased borrowing requirement is affordable. Any decisions taken will be reported to members at the next available opportunity.

Policy on Borrowing in Advance of Need

17. The Council will not borrow in advance of its needs in order to on lend. Any decision to borrow will be within the approved CFR estimates, and will be considered carefully to ensure that value for money can be demonstrated, and that gross long term borrowing will not exceed the CFR.

18. Borrowing in advance will be made within the constraints that:

- It will be limited to no more than 50% of the expected increase in borrowing need (CFR) over the five year planning period and then only where there is sufficient certainty that expenditure will be incurred to prevent borrowing exceeding the CFR at any year end within the planning period; and

- The Council would not look to borrow more than 6 months in advance of need.

19. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reports.

Treasury Management Limits on Activity

20. There are three debt related treasury activity limits. The purpose of these is to restrain the activity of the treasury function within certain limits, thereby managing risk and reducing the impact of any adverse movement in interest rates. The indicators are:

- Upper limits on variable interest rate exposure. This identifies a maximum limit for variable interest rates based upon the debt position net of investments
- Upper limits on fixed interest rate exposure. This is similar to the previous indicator and covers a maximum limit on fixed interest rates
- Maturity structure of borrowing. These gross limits are set to reduce the Council's exposure to large fixed rate sums falling due for refinancing, and are required for upper and lower limits.

21. The table below summarises the debt limits for the next three years.

Table 4: Interest rate exposure limits

	2018/19	**2019/20**	**2020/21**	**2021/22**	**2022/23**
Interest rate Exposures					
	Upper	**Upper**	**Upper**	**Upper**	**Upper**
Limits on fixed interest rates based on net debt	Authorised limit	Authorised limit	Authorised limit	Authorised limit	Authorised limit
Limits on variable interest rates					
Investments	£20m	£20m	£20m	£20m	£20m
Borrowing	£0m	£0m	£0m	£0m	£0m
Maturity Structure of fixed interest rate borrowing 2018/19					
Time period				**Lower**	**Upper**
Under 12 months				0%	25%
12 months to 2 years				0%	25%
2 to 5 years				0%	25%
5 to 10 years				0%	100%
10 to 20 years				0%	100%
20 to 30 years				0%	100%
30 to 40 years				0%	100%
40 years and above				0%	100%

Policy on the use of external service providers

22. In November 2017 the Council ran a competative tender process for the treasury management advise contract. The current encoumbant Link Asset Services, formally Capita Asset Services, won the tender and will continue as the councils advisors for the next three to five years.

23. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our external service providers.

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

Annual Investment Strategy

25. The Council’s investment policy has regard to the DCLG’s Guidance on Local Government Investments (“the Guidance”) and the CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (“the CIPFA TM Code”).

26. The Council’s overiding policy objective is to prudently manage council funds; ensuring risks are minimised whilst maximising returns. The Councils investment priorities, in order, are:

    - Security of the invested capital
    - Liquidity of the invested capital
    - Yield (return on investment), which is in line with security and liquidity.

27. In accordance with the above, 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.

28. The Council has chosen to opt-up to professional status under MIFID II, to maintain the current level of access it enjoys to the money market.

Investment Counterparty Selection Criteria

29. The Assistant Director (Resources) will maintain a counterparty list in compliance with the following criteria and will revise the criteria and submit them to Council for approval as necessary. These criteria provide an overall pool of counterparties considered high quality which the Council may use.

30. When considering the security of investments, we also need to consider concentration risk. This is the risk of having a significant proportion of your investments in one sector of the market and that sector failing. In order to mitigate against this risk, the counterparty selection criteria has been updated.

31. This Council will apply the creditworthiness service provided by Link Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from

the three main credit rating agencies - Fitch, Moody's and Standard and Poor's. The credit ratings of counterparties are supplemented with the following overlays:

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

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 bands which indicate the relative creditworthiness of counterparties and provide a suggested duration for investments.

32. The Council will apply a duration overlay to banks selected under the credit worthiness service, such that the investment duration will be the lessor of 1 year for Uk banks or 190 days for non Uk banks and Links's suggested duration with the exception of part nationlised banks.

33. With the exception of the UK, the minimum soverign rating is AAA by 2 out 3 of the main rating agencies. The minimum counterparty credit rating criteria is a Short Term rating (Fitch or equivalents) of F1 and a Long Term rating of A-.

34. In addition the the council will also invest in;

    - Building Societies
    - Multilateral Development Banks and Supranational Organisations
    - Money Market Funds
    - Other collective investment schemes

    provided they meet the criteria laid out in Table 5 Counterparty limits.

35. Sole reliance will not be placed on the use of Link Asset Service's external service. In additon the Council will also use market information, economic data and information on any external support for banks to help support its decision making process.

36. The time and monetary limits for institutions on the Council's counterparty list are as follows:

Table 5: Counterparty limits

	Criteria	Money Limit	Time Limit
UK Banks	Yellow, Purple, Blue or Orange	£3m	1 year
UK Banks	Red	£3m	6 Months
UK Banks	Green	£3m	100 Days
Non UK Banks	Blue or Orange	£3m	190 Days
Non UK Banks	Red	£3m	6 Months
Non UK Banks	Green	£3m	100 Days
Banks	No colour	£0m	n/a
Building Societies	Top 5 by Asset size and assets> £2 billion	£3m	6 months
Building Societies	Top 6-10 by Asset size and assets> £2 billion	£2m	6 months
Debt Management Account Deposit Facility - DMADF	n/a	Unlimited	6 months
UK Gilts, Treasury Bills	n/a	Unlimited	5 years
Local Authorities	N/A	£5m	2 Years
Money Market Funds - LVNAV - CNAV Government Funds	AAA	£5m	Liquid
Multilateral Development Banks and Supranational Organisations	AAA	£3m	2 Years
Other Collective Investment Schemes e.g. Enhanced Money Market Funds & Bond Funds	AAA S1/V1	£2m	1 Year

37. The Council is alerted to changes to ratings of all three agencies through its use of the Link Asset Services' credit worthiness service. In addition a full review will be carried out at least monthly.

38. In the event of a downgrade resulting in a counterparty or investment scheme no longer meeting the Council's minimum criteria, its further use for new investments will be withdrawn immediately.

39. Any changes in counterparty ratings or other criteria that put the counterparty below the minimum criteria, whilst holding a deposit for the Council, will be brought to the attention of the Assistant Director (Resources) and the Portfolio Holder with responsibility for Finance. Further action will be decided on a case-by-case basis.

40. Specified investments are investments less than 1 year in duration meeting the criteria for high quality above.

41. Non specified investments are all investments with a duration of 1 year or greater and/or not meeting the definition of high credit quality. A maximum of 75% of investments can be non-specified.

42. A copy of the Council's counterparty list under the above criteria is attached as **Appendix 5**

Other considerations

43. In addition to the credit criteria, due care will be taken to consider the country, group and sector exposure of the Council's investments. In part the country selection will be chosen by the credit rating of the sovereign state in Banks 1 above.
In addition:

- no more than £3 million will be placed with counterparties from any one non-UK country at any one time up to a maximum of £9 million being held in non UK countries at any one time (excluding Money Market Funds, Multilateral Development Banks and Supranational Institutions and Collective Investment Schemes).
- limits in place above will apply to a group of companies
- sector limits will be monitored regularly for appropriateness

The value of the portfolio fluctuates significantly during the year so monetary limits have been used in favour of percentages. This is to give a clearer indication of the maximum amounts which could be invested in non UK counterparties.

44. To ensure sufficent liquidity, investments will be made with reference to the Council's cash flow requirements.

45. Funds invested for greater than 365 days are set with regard to the Council's security and liquidity requirements. They are based on the lowest expected availability of funds after each year-end (ie the core balances) within the three year plan. To allow longer term investment of the core balances, subject to satisfying security and liquidity, the Council is asked to approve the treasury indicator and limit:-

Table 6 Maximum principal sums invested for more than 364/365days

£m	2017/18	2018/19	2019/20	2020/21	2021/22
Principal sums invested > 365 days	£11m	£11m	£11m	£11m	£11m

46. When placing investments there are a number of financial instruments available for use by officers. The instruments that officers are authorised to use are;

   a. Fixed Deposits; deposits at a fixed interest rate for a fixed duration.

   b. Certificate of Deposits; similar to fixed deposits but tradeable in a secondary market

   c. Government Treasury Bills & Gilts; UK Government debt instruments

   d. Call accounts; instant access accounts with banks at a variable interest rate,

   e. Notice accounts; Savings accounts where by we have to give the bank/building society notice to withdraw our money.

   f. Money Market Funds; collective investment accounts with a Low Volatility Net Asset Value) LVNAV or constant net asset value, generally these allow investors instant access and have a variable interest rate.

   g. Other Collective Investment Schemes; similar to money market funds these are funds with a variable net asset value, which can invest in a wider range of instruments. These are generally instruments whereby the Council would invest for longer periods and receive a greater return over time, though the value of the fund can modestly fluctuate.

47. At the end of the financial year, the Council will report on its investment activity as part of its Annual Treasury Report.

Training

47. Officers will ensure that staff involved in Treasury Management receive adequate training through attendance at external workshops and internal briefing sessions.

48. Training will be made available to all Members to assist in their understanding of the treasury management framework.

Counterparty		Capita Creditworthiness Methodology suggested durations	SLDC Monetary Limit	SLDC Duration *(lower of 190 days or Capita duration)*	Building Society Rank by Asset (size)
United States (AAA,AAA,AA+)					
Banks	Bank of America N.A.	R - 6 mths	3.00 Million	6 Months	
	Bank of New York Mellon, The	P - 24 mths	3.00 Million	190 Days	
	Citibank N.A.	R - 6 mths	3.00 Million	6 Months	
	JPMorgan Chase Bank N.A.	O - 12 mths	3.00 Million	190 Days	
	Wells Fargo Bank, NA	P - 24 mths	3.00 Million	190 Days	

Key to Capita creditworthiness methodology suggested durations:

Y – Yellow, 60 months
P – Purple, 24 months
B – Blue, 12 months
O – Orange, 12 months
R – Red, 6 months
G – Green, 100 days
N/C – no colour, 0 days