INTEGRATED PLAN

PART D - THE PRUDENTIAL CODE FOR CAPITAL FINANCE AND TREASURY MANAGEMENT STRATEGY

Contents

1 Background

1.1 Under the Local Government Act 2003, local authorities must have regard to statutory proper practices in their treasury management and borrowing activities. These are set out in the following:

- CIPFA's Treasury Management in the Public Services: Code of Practice 2011 [The CIPFA Code] which requires the Council to approve a treasury management strategy before the start of each financial year;
- CLG Guidance on Local Authority Investments, 2010 [CLG Guidance] which requires the Council to approve an investment strategy before the start of each financial year; and
- CIPFA Prudential Code for Capital Finance in Local Authorities 2011 (as amended in 2012) [The Prudential Code] which requires the Council to have regard to the Prudential Code when determining how much money it can afford to borrow.

1.2 The Council adopted the 2011 CIPFA Code on 21 February 2012 and approved the Council's Treasury Management Policy Statement which is set out as Appendix 1 to this report.

1.3 This report proposes the 2017/18 Treasury Management and Borrowing Strategy and Prudential Code indicators that will be set and monitored throughout 2017/18.

1.4 This report demonstrates that the Council has fulfilled its legal obligation under the Local Government Act 2003 to have regard to the CIPFA Code, CLG Guidance and the Prudential Code in determining the 2017/18 Treasury Management and Borrowing Strategy.

1.5 In accordance with the CLG Guidance, the Council will be asked to approve a revised Treasury Management Strategy Statement, should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, or in the Council's capital programme or in the level of its investment balance.

1.6 As at January 2017 the Financial Conduct Authority is consulting on its third phase of implementing the Markets in Financial Instruments Directive (MiFID) II. MiFID II is a package of EU legislation introduced in 2014 to regulate both retail and wholesale investment business. The draft proposals may significantly affect the ability for local authorities to carry out their treasury management activities in their current form, and may require the Treasury Management Strategy to be revised.

2 Capital Expenditure and the Capital Financing Requirement

2.1 Capital expenditure plans will be partially financed by resources such as capital receipts and capital grants. The remaining element which cannot be immediately financed from other sources will impact on the Council's underlying need to finance (the Capital Financing Requirement, or CFR). A summary of capital expenditure and financing for financial year 2017/18 together with estimates for 2018/19 to 2020/21 is shown in Table 1. This forms one of the required prudential indicators which are discussed in section 6 to this report.

2.2 There are two main limiting factors on the Council's ability to undertake financing for capital expenditure:

- Whether revenue resource is available to fully support the implications of capital expenditure including borrowing and running costs.
- Any limits on borrowing exercised by the government as a consequence of national economic policies which may assess that local plans are unaffordable for a specific council and, therefore, implement a control to limit its capital expenditure plans. There are no such requirements for the financial year 2017/18.

2.3 A key risk of the plan is that some of the estimates for other sources of funding, particularly grants and capital receipts, may be subject to change over time.

2.4 Taking this key risk into consideration, the Council is asked to approve the capital expenditure projections in Table 1 that reflect the recommended capital programme and financing.

Table 1: Proposed Capital Expenditure and Capital Financing

	2015/16 Actual £000s	**2016/17 Revised £000s**	**2017/18 Estimated £000s**	**2018/19 Estimated £000s**	**2019/20 Estimated £000s**
Total Expenditure	**163,047**	**183,496**	**219,287**	**215,542**	**177,115**
Grants	(111,986)	(100,185)	(94,966)	(74,219)	(60,555)
Contributions (including S106 and from the LEP*)	(9,004)	(31,036)	(36,037)	(58,860)	(43,594)
Reserves	(20,095)	(7,747)	(2,836)	(1,000)	(1,750)
Revenue	(16,434)	(1,039)	-	-	-
Capital Receipts / Investment Reserve	(5,461)	(21,786)	(10,000)	(10,000)	(10,000)
Borrowing Requirement	**67**	**21,703**	**75,448**	**71,463**	**61,216**

* LEP – Local Enterprise Partnership

** PFI – Private Finance Initiatives

2.5 Any increase in the Councils CFR, underlying need to finance its capital programme, will need to be done through either borrowing, finance leases or PFI contracts. There are no plans to enter into additional finance leases or PFI contracts.

2.6 The Council is asked to approve the borrowing requirement projections in Table 2 (overleaf) that support the recommended capital programme.

Table 2: Capital Borrowing Requirement Breakdown

	2015/16 Actual £000s	2016/17 Revised £000s	2017/18 Estimated £000s	2018/19 Estimated £000s	2019/20 Estimated £000s
Borrowing – General	67	21,703	60,313	61,546	61,216
Borrowing – Croxley	-	-	15,135	9,917	-
Total Movement	**67**	**21,703**	**75,448**	**71,463**	**61,216**

Change in MRP Policy

2.7 Where the Council finances capital expenditure by borrowing, it must set aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as the Minimum Revenue Provision (MRP).

2.8 The statutory regulations governing MRP allow a range of approaches for calculating this charge. The Council's policy in recent years has followed guidance issued by DCLG in 2008, and along with many other authorities adopted the "regulatory option". This linked the MRP charge for pre 2008 borrowing to the provision for capital financing within Revenue Support Grant, calculating it as a 4% reducing balance.

2.9 With the loss of RSG, the Council (like several others) has reviewed this policy and a prudent approach sought, that accurately reflects the expected life of the assets to which the borrowing relates whilst remaining affordable within the Council's overall revenue budget. Officers have worked with the Council's external auditors to agree a revised basis of calculation, and a change of policy is now proposed.

2.10 There are two elements of MRP, and the proposed changes to each are:

a) **Relating to pre 2008 spend**: currently charged on a 4% reducing balance, as above. It is proposed to change to repayment over 50 years from 2008, which reflects the life of the assets and gives an earlier provision for completing repayment of this debt. The repayments would be calculated on an annuity basis, linked to the 2008 PWLB borrowing rate, to reflect the time value of money. This reduces the charge in the early years of the repayment profile. The change in policy will be backdated to 2008, and the backdated savings spread across the remaining years, reducing the charge for future taxpayers across the life of the assets.

b) **Relating to spend from 2008**: this would continue to be charged across the expected life of the assets. However, it is proposed that the charge be calculated on an annuity basis (using PWLB rates effective at the time the spend was incurred). Discounting using the annuity reduces the charge in the short term. Future MRP annual charges can also be reduced by using borrowing to fund assets with the longest lives, so spreading repayment over a longer period. It is therefore proposed that capital receipts, reserves and other funding sources are applied to shorter life assets to the extent that they are available.

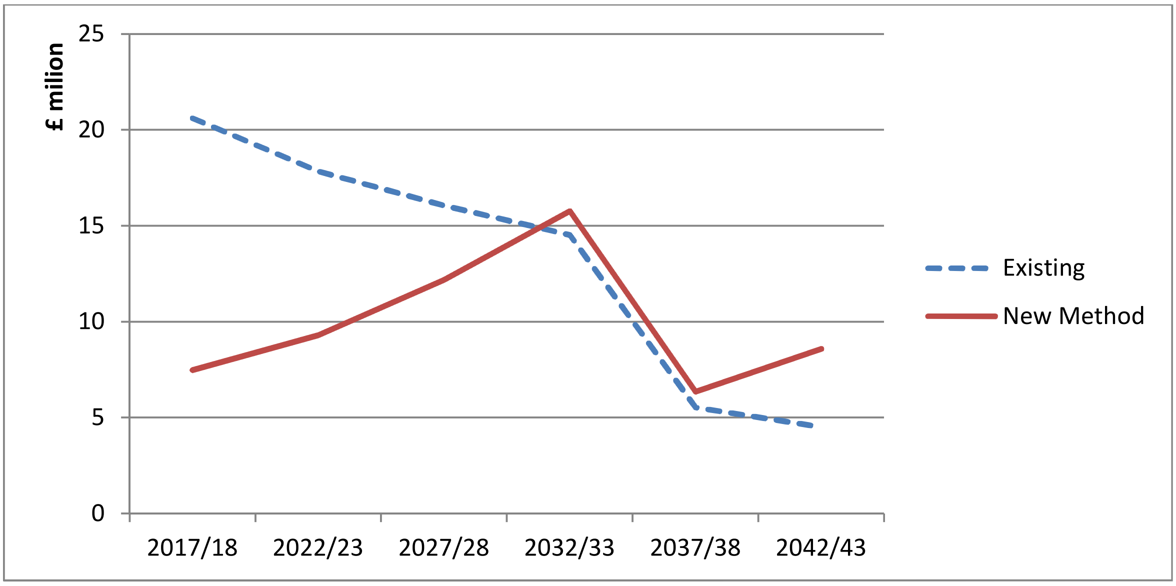
Backdating the annuity method to 2008 will release savings estimated at £19m (subject to confirmation of annuity rates and the outturn position for 2016/17), which can be released over the next three years. It is suggested that these are set aside in an Investment Reserve to be used for capital financing or related investment, which will reduce the need for future borrowing and hence MRP, and give some flexibility on capital funding.

2.11 The key benefits of the proposed policy can therefore be summarised as:

- Charge more closely matches useful life of assets financed
- Charge for pre-2008 debt is repaid sooner
- Use of annuity gives a more consistent present value of charge across asset lives
- Savings released across the short to medium term
- Policy change is backdated, releasing savings to mitigate future increases, either by apportioning across future year's MRP or using to finance capital in lieu of additional borrowing

2.12 The graph below compares charges under the new policy with the existing method. This demonstrates the delivery of savings in the short to medium term over the existing method.

Graph 1: MRP Charges under proposed policy, and existing method



2.13 Beyond 2037/38 charges under the new method will be higher, as the pre-2008 debt charges increase under the annuity method, as compared to the reducing balance. However, the real value of these charges will have been decreased by inflation (and the potential to earn interest on any savings made). This is a long term position and there is the potential for the statutory requirements for MRP to change, for example to align the charges more closely to actual borrowing. The Council's external borrowing is significantly lower than the level of borrowing assumed by MRP (the Capital Financing Requirement was £518.3m as at end 2015/16, compared with borrowing of £258.8m). MRP does not therefore relate currently to actual borrowing costs.

2.14 Financing the capital programme using borrowing or finance leases (including PFIs) increases the CFR which ultimately affects the amount the Council must put aside for debt repayment (MRP). MRP on general borrowing is charged centrally to revenue and included within the capital financing figure in the Integrated Plan. MRP on PFI contracts and finance lease liabilities are charged to the relevant service.

2.15 The annual MRP charge decreases the capital financing requirement. Borrowing and finance leases (including PFI contracts) increase the CFR.

2.16 Capital expenditure financed by borrowing will not incur an MRP charge until the year after the capital expenditure occurs. Therefore, the 2017/18 borrowing requirement will lead to additional MRP in 2018/19.

Table 3: Movement in the Estimated Capital Financing Requirement

	2015/16 Actual £000s	2016/17 Revised £000s	2017/18 Estimated £000s	2018/19 Estimated £000s	2019/20 Estimated £000s
Opening CFR	541,421	518,299	517,211	580,443	637,621
Net movement in CFR	(23,122)	(1,088)	63,232	57,177	45,065
Closing CFR	518,299	517,211	580,443	637,621	682,686
Net Movement in CFR comprises:					
MRP Borrowing	(21,765)	(21,122)	(10,720)	(12,579)	(14,283)
MRP on Finance Leases	(30)	(31)	(33)	(35)	-
MRP on PFI contracts	(1,394)	(1,638)	(1,463)	(1,672)	(1,868)
Additional Borrowing	67	21,703	75,448	71,463	61,216
Total Movement	**(23,122)**	**(1,088)**	**63,232**	**57,177**	**45,065**

2.17 The Prudential Code requires the Council to assess the affordability of its capital spending plans. This is achieved by setting and monitoring two prudential indicators. These provide an indication of the impact of the capital spending plans on the overall finances for the Council. The Council is asked to approve the following indicators:

Actual and Estimates of the ratio of financing costs to net revenue stream

The indicator set out in Table 4 identifies the trend in the cost of capital (borrowing costs net of lending income) against the net revenue stream. The estimates of financing costs include current commitments and the proposals in this report.

Table 4: Ratio of financing costs to net revenue stream

	2015/16 Actual	2016/17 Comparator	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate
Ratio	1.32%	1.33%	1.47%	1.65%	1.75%

2017/18 Context
Assuming no increase in income or reduction in expenditure from improved service delivery, an increase of 0.10% in this ratio is equivalent to an additional interest cost of approximately £775k. This equates to borrowing approximately £29m at 2.67%.

Estimates of the Incremental Impact of Capital Spending decisions on Council Tax

This indicator identifies the trend in the cost of proposed changes in the three year capital programme recommended in this budget report compared to the Council's existing commitments and current plans. The forward projections are based on the assumptions included in the budget, but will invariably include some areas, such as the level of government support, which is not published over a three year period.

Table 5 shows the incremental impact on Band D Council Tax of additional capital spending interest costs for the financial years 2017/18 to 2019/20. This relates to spending over and above the levels included in the capital programme agreed in February 2016 for financial years 2017/18 to 2019/20.

Table 5: Incremental Impact of Capital Spending Decisions on Band D Council Tax

	2017/18 Forward Projection	2018/19 Forward Projection	2019/20 Forward Projection
Council Tax Impact - Band D	£0.91	£2.76	£2.07

3 Context for the Treasury Management Strategy

3.1 Economic Background

The major external influence on the Authority's treasury management strategy for 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union.

Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the European Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

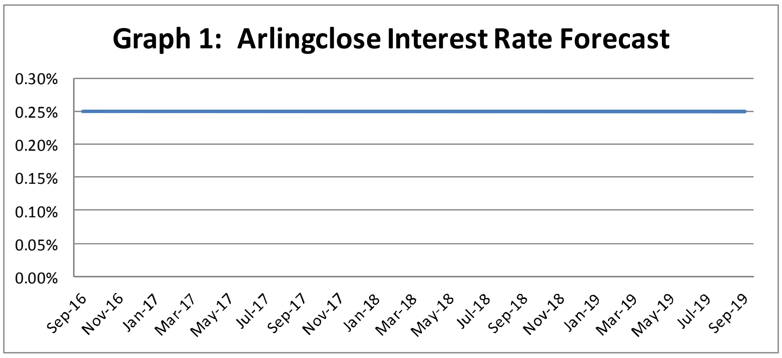
Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

3.2 Interest Rate Forecast

The Council's treasury advisor, expects that UK Bank Rate will remain at 0.25% during 2017/18, and the Bank of England has highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view, and the current inflation outlook, further falls in the Bank Rate look less likely than was thought in autumn 2016.



For the purposes of setting the budget it has been assumed that new investments will be made at an average rate of 0.35%, and new long term borrowing will be borrowed at an average rate of 2.67%

3.3 Credit Outlook

Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

3.4 Current Treasury Position for Borrowing

Table 6 shows the borrowing position at 31 March 2016 and the estimated position at 31 March 2017. No additional long term borrowing has been undertaken in 2016/17 since cash balances have been used to fund capital expenditure.

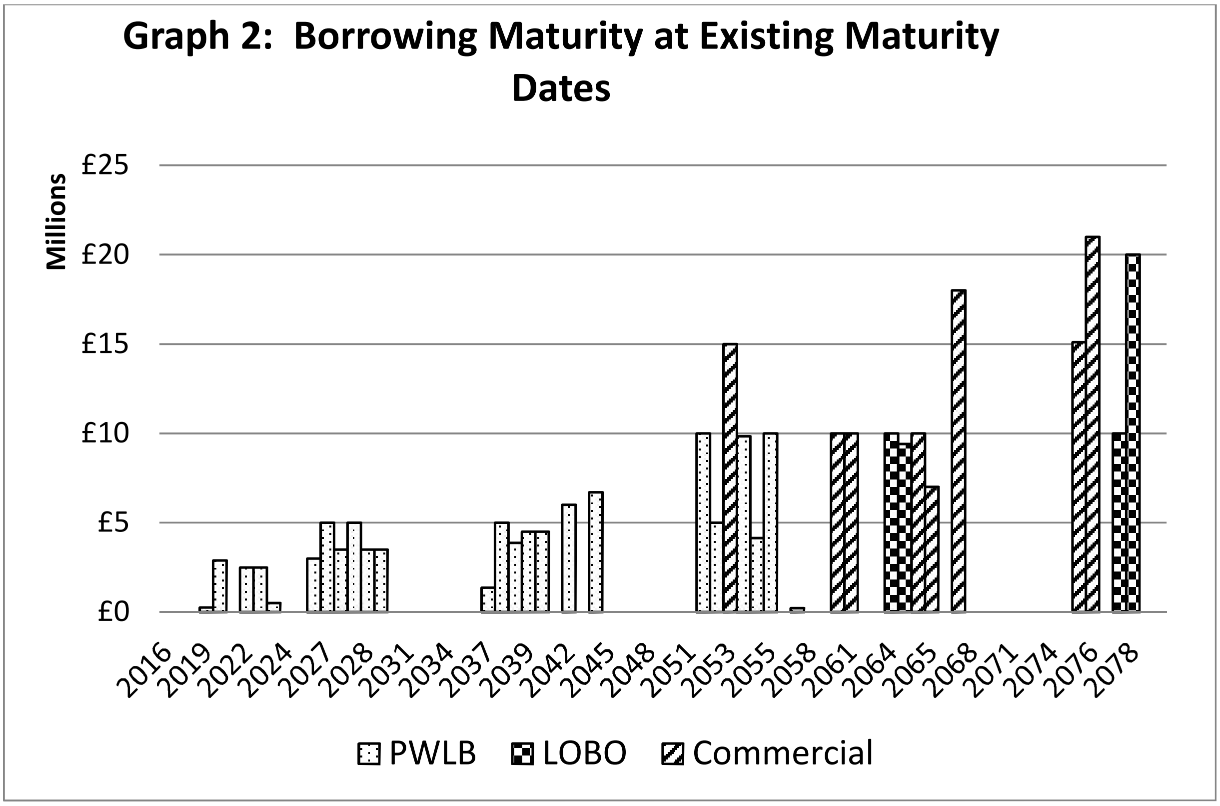
Table 6 shows the sources of borrowing and the maturity structure of the loans. Borrowing is sourced from the government's Public Works and Loans Board [PWLB] and commercial banks. Commercial bank loans are a mixture of fixed term borrowing and Lender's Option, Borrower's Option [LOBO] loans which may be called for early repayment in advance of the existing terms. PWLB loans have a fixed maturity date.

During 16/17 LOBO loans that we hold with Barclays Bank were converted to fixed term loans when the bank elected to permanently waive its future options on all of these instruments. A final Range LOBO with Barclays was also converted to a fixed rate loan following a negotiation and reduction of the interest rate payable. These fixed rate loans with Barclays are now classified as 'Commercial' in Table 6, below.

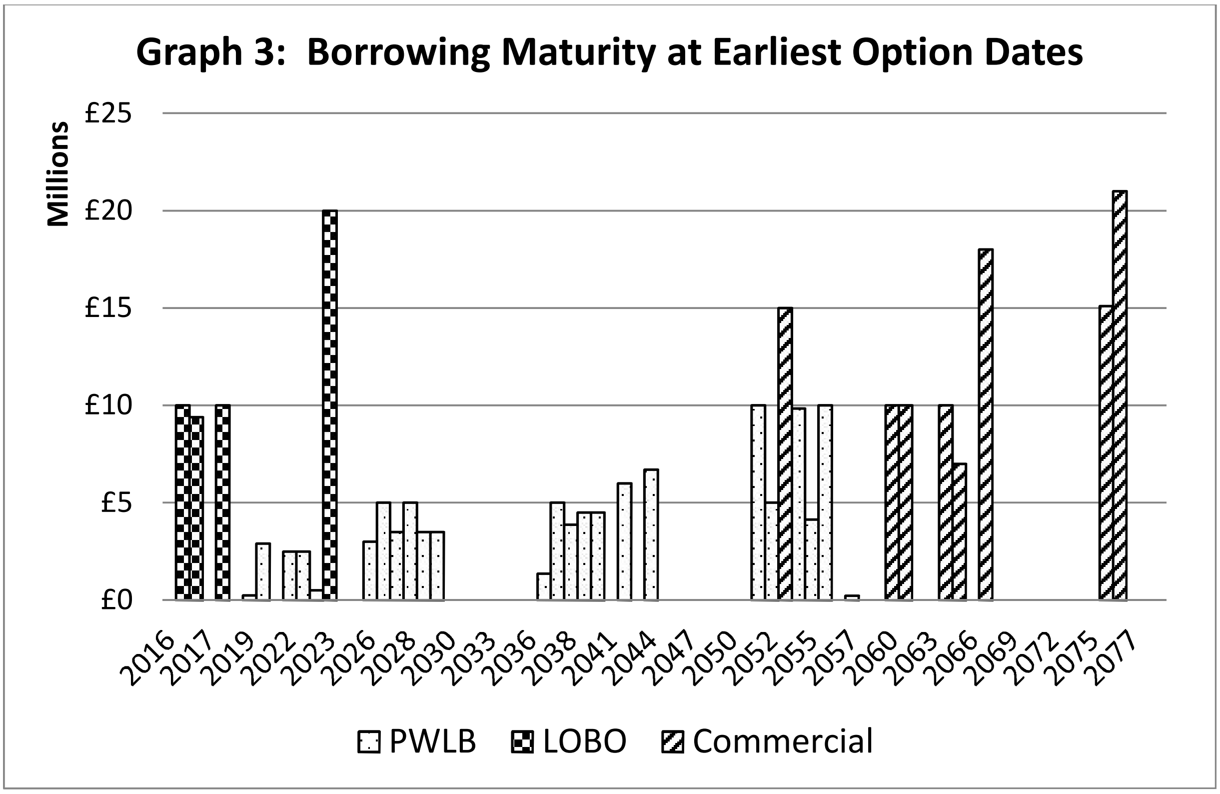
Table 6: Treasury Position for Borrowing

	2015/16 Actual	Sources of Borrowing		2016/17 Estimated	Sources of Borrowing		
	£000s	PWLB	LOBO	£000s	PWLB	Commer-cial	LOBO
Borrowing at 31 March	**258,779**	**103,279**	**137,500**	**258,779**	**103,279**	**106,100**	**49,400**
Analysed as:							
Maturing in under 2 years	-	-	-	-	-	-	-
Maturing in 2 to 10 years	8,645	8,645	-	11,645	11,645	-	-
Maturing in 10 to 30 years	55,433	55,433	-	52,433	52,433	-	-
Maturing in 30 years or later	194,701	39,201	137,500	194,701	39,201	106,100	49,400

Graph 2 below shows the existing maturity dates for PWLB, LOBO and commercial loans.



Graph 3 (below) shows maturity dates for PWLB loans together with the next possible option for remaining LOBO loans if they were called before their maturity date.



Graph 3 highlights the inherent uncertainty around the existing terms of the remaining LOBO loans and the risk of early repayments. The Council's treasury advisor predicts that LOBOs are very unlikely to be called in the short to medium term based on current interest rate forecasts. In the event that LOBOs were to be called, then the Council would seek to replace borrowing from sources of borrowing listed in section 4.24 at the most economic rate. As a result of the conversion of £106.1m of LOBO loans to fixed term commercial loans (Table 6) the Council's exposure to this risk is now £49.4m.

3.5 **Current Treasury Position for Lending**

Table 7 shows the lending position at 31 March 2016 and the estimated position at 31 March 2017.

Table 7: Treasury Position for Lending

	2015/16 Actual £000s	2016/17 Estimated £000s
Total Lending at 31 March Analysed as:	**93,895**	**88,017**
Iceland Investments	663	643
Instant Access	30,732	24,874
60 day notice account	10,000	-
95 Day Notice Account	-	10,000
Long Term MMFs	17,500	17,5000
Fixed Term	5,000	5,000
Pooled Funds	30,000	30,000

4 Proposed Treasury Management Strategy

Lending Strategy

4.1 In developing proposals for the 2017/18 Treasury Management Strategy, risk assessments have been undertaken in conjunction with Arlingclose. Consideration has been given to the Council's risk tolerance with a primary focus on security of the Council's funds. Secondary to this is liquidity, ensuring that sufficient funds are available to meet the Council's forecasted cashflow requirements; and only once both of these matters have been taken into account will the yield be considered.

4.2 If the UK enters into a recession in 2017/18, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.3 The council will continue to pursue the strategy of a diversified investment portfolio adopted during 2015/16, in order to manage its credit risk exposure and liquidity requirements.

4.4 The use of long-term investments as part of a diversified portfolio which addresses a range of credit and counterparty risks may, when the impact of the uncertain timing of receipts and payments are considered, give rise to short-term borrowing requirements to provide required liquidity.

4.5 With due regard to this risk, £30m is deemed to be available for long-term investment and has been invested in a range of pooled funds. These funds are subject to market value fluctuations and are therefore intended to be held for the long-term to generate income and mitigate the risk of capital value variation.

Lending Policy

4.6 The lending policy seeks to address risk by setting criteria such as:

- Monetary limits on terms of investment with any one single counterparty;
- Monetary and time limits for investment with counterparty sectors or countries;
- Group limits on counterparty sectors;
- Diversifying investments across a number of different financial instruments and asset classes;
- Maximum value as a single transaction for fixed term investments; and
- Using financial data such as credit ratings to assess the creditworthiness of counterparties.

4.7 No changes are proposed to approve investment instruments for the 2016/17 Lending Policy. These are as follows:

- Call and notice accounts
- Fixed Term deposits and loans
- Treasury Bills
- Certificate of deposits
- Shares in Money Market Funds – short and long term duration
- Commercial Paper
- Other Pooled Funds (including bond, equity and property funds)
- Loan Agreements with UK Registered Providers of social housing
- Government and Corporate Bonds
- Covered Bonds
- Reverse Repurchase Agreements
- Other collateralised arrangements
- Equity shares in the Local Capital Finance Company
- Investments in small corporates via peer to peer lending through on-line portals or specialist lending vehicles.

Further information on these instruments is set out in Appendix 3.

4.8 Investment regulations require the Council to determine what specified and non-specified investments it will use. CLG guidance defines specified investments as those:

- Denominated in sterling;
- Due to be repaid within 12 months of the arrangement;
- Not defined as capital expenditure by legislation; and

- Invested with the UK government, a UK local authority, parish council or community council or an institution of "high credit quality".

The Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher (based on Fitch's credit rating criteria). For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of AAA.

4.9 Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation. This is with the exception of the Council's holding of equity shares in the LGA's Local Capital Finance Company which provides the Council with an additional source of borrowing. Limits for non-specified investments for the 2017/18 Treasury Management Strategy are set out in Table 9.

Table 9: Non-specified Investment Limits

Type of Investment	Cash limit
Total long-term investments Fixed term investments for more than 364 days from the date of arrangement and pooled funds used for longer duration investments that are not planned to mature within 364 days	£50m
Total investments without a credit rating – excluding MMFs Includes pooled funds, challenger banks, building societies and lending to corporates via peer to peer lending	£50m
Total investments without a credit rating – MMFs Money Market Funds if regulations change and these become unrated	£80m
1 Total Unsecured investments rated below A-	£10m
2 Total Secured investments rated below A-	£100m
Total equity shares in the Local Capital Finance Company	£0.5m
TOTAL NON-SPECIFIED INVESTMENT LIMIT	**£140m**

See Appendix 2, Section 1.7 for definition of unsecured investments
See Appendix 2, Section 1.8 for definition of secured investments

4.10 The Council understands that credit ratings are a good predictor of investment default but are rating agencies' expressed opinions and not a perfect indicator. Therefore, Officers will use other sources of information; including credit default swap ratings and equity prices, to determine the credit quality of an organisation. These are detailed in Appendix 2, section 4 of the proposed Lending Policy.

4.11 No investments will be made with an organisation if there are substantive doubts about its credit quality even though it may meet the Lending Policy criteria. This means the Lending Policy applied operationally may at times be more restrictive than it formally allows.

4.12 When deteriorating financial market conditions affect the creditworthiness of all organisations but these are not generally reflected in credit ratings, then the Council will restrict its investments in those organisations to maintain the required level of security. These restrictions may mean that insufficient commercial organisations of "high credit quality" are available for investment and so any cash surplus will be deposited with the government's Debt Management Office or with other local authorities. This may result in a reduction in the level of investment income earned but will protect the principal sums invested.

4.13 The proposed 2017/18 Treasury Management Strategy has considered a full range of risks and Officers will apply the strategy to ensure that security of deposits is the prime consideration. However, in agreeing the proposed strategy, Members should be aware that there is always a risk of default of counterparties other than the Debt Management Office which is guaranteed by the government.

Borrowing Strategy

4.14 The Council's objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving certainty of those costs over the period for which funds are required.

4.15 The Capital Programme for 2017/18 – 2019/20 includes a requirement for additional borrowing. As Capital Assets by nature bring benefits over multiple years, so their financing is long-term in nature.

4.16 In recent years the council followed a policy of using internal borrowing to finance unfunded elements of the capital programme. As a result the council has relatively high levels of internal borrowing, and further internal borrowing would require the liquidation of some our current investment balances. Officers will review the returns generated by those investments against interest costs of new borrowing in order to minimise the net borrowing cost to the authority.

4.17 The current low interest rate environment, as noted in section 3, is expected to continue for the foreseeable future. In this environment, where short term borrowing is available at lower cost than long term loans, it is possible to deliver value to the council by balancing the savings from low-cost short-term borrowing against the risk of future interest rate rises increasing the long-term cost of borrowing.

4.18 Accordingly it is proposed that the cost of long-term financing will be managed by meeting the council's borrowing requirement from a combination of rolling shorter term loans (0-5 years duration), combined with long term borrowing (20+ years duration).

4.19 It will ultimately be necessary to fund this requirement using long-term loans, and officers will monitor interest rates in conjunction with its treasury advisor to ensure that an efficient balance of risk and cost is achieved.

4.20 The exception to this is that long-term PWLB funding at the Local Enterprise Partnership project rate has been secured to support the Croxley project, and it is anticipated that this will be borrowed in 2017/18.

4.21 This strategy meets the primary aim of security by limiting the value of surplus cash available for deposits.

Borrowing Policy

4.22 Borrowing will be undertaken only for a capital purpose and when it is necessary to manage short term cashflow requirements. The Chief Financial Officer, in consultation with the Council's treasury management advisers, will take the most appropriate form of borrowing depending on prevailing interest rates. The maturity profile of the borrowing portfolio will also be taken into consideration when deciding the duration of borrowing to ensure an even spread of loans. This will minimise the size of loans requiring refinancing during any given period thereby reducing the risk posed by periods of high interest rates.

4.23 The borrowing portfolio will be continually monitored in consultation with the Council's treasury management advisers to identify rescheduling opportunities which could reduce interest costs. The potential refinancing and interest rate risks arising from rescheduling would be considered at the same time to determine whether it is appropriate.

4.24 The approved sources of long term and short term borrowing will be:

- Public Works Loan Board (PWLB)
- Any institution approved for investments in the Lending Policy
- Any other bank or building society authorised to operate in the UK
- Other Local Authorities
- Capital market bond investors
- Local Capital Finance Company and other special purpose companies created to enable local authority bond issues
- UK public and private sector pension funds (except for Hertfordshire Pension Fund)

In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Operating and finance leases
- Private Finance Initiatives
- Hire purchase
- Sale and leaseback

5 Policy on Use of Financial Derivatives

5.1 The CIPFA Code requires local authorities to clearly detail their policy on the use of derivatives in the annual strategy.

5.2 Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans).

5.3 The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) to manage specific risks such as currency risk or where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, through entering into such contracts, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Officers will seek professional advice and opinion from the Treasury advisers and legal services on proposals to use any form of derivative contracts.

5.4 Financial derivative transactions that are arranged will only be with organisations that meets the Council's approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

6 Prudential and Treasury Management Indicators and Reporting

6.1 The Prudential Code requires the Council to set and monitor a range of prudential indicators relating to borrowing. The objectives of the Prudential Code are to ensure, within a clear framework, that capital investment plans for local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice.

6.2 This report and prudential indicators set out in Tables 1, 3, 4, 5, 10 and 11 demonstrates that the Council has fulfilled the Prudential Code objectives.

6.3 Table 10 is a key indicator of prudence to ensure that over the medium term debt will only be for a capital purpose. The Council needs to ensure that gross debt does not, except in the short term, exceed the total of the CFR in the preceding year plus the estimates of any additional CFR for 2017/18 and the next two financial years.

Table 10: Gross Debt and the Capital Financing Requirement

	2015/16 Comparator £000s	2016/17 Estimate £000s	2017/18 Estimate £000s	2018/19 Estimate £000s	2019/20 Estimate £000s
Gross Debt	258,799	258,799	334,247	405,710	466,926
CFR	518,299	517,211	580,443	637,621	682,686

6.4 The Council complied with the prudential indicator requirement to keep net borrowing below the relevant CFR in 2015/16, and no difficulties are envisaged for the current or future years. This reflects the borrowing strategy set out in section 4 and an allowance for potential short term borrowing to cover temporary cashflow requirements.

6.5 Table 11 sets out proposed limits for the following two prudential indicators which aim to control the overall level of borrowing. The limits are based on gross debt shown in Table 10. These are:

The Authorised Limit
This 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, but is not sustainable. It is the expected maximum borrowing need with some headroom for unexpected cash movements. This is the statutory limit determined under the Local Government Act 2003.

The Operational Boundary
This indicator is based on the probable external debt during the course of the year; it is not a limit and actual borrowing could vary around this boundary for short times during the year. It should act as an indicator to ensure the authorised limit is not breached.

The proposed limits reflect the capital programme and the borrowing strategy, including the potential for temporary overdraft arrangements.

Table 11: Authorised and Operational Limits

Authorised limit for external debt	**2016/17 Limit £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Borrowing	355,000	425,000	500,000	565,000
Other long term liabilities	70,000	70,000	70,000	70,000
Total	**425,000**	**495,000**	**570,000**	**635,000**
Operational boundary for external debt	**2016/17 Limit £000**	**2017/18 Estimate £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**
Borrowing	325,000	395,000	470,000	535,000
Other long term liabilities	70,000	70,000	70,000	70,000
Total	**395,000**	**465,000**	**540,000**	**605,000**

6.6 The Council measures and manages its exposure to treasury management risks using a range of indicators related to interest rate exposure, refinancing risks and liquidity risk. In addition, treasury activity is measured against a range of performance indicators related to security, liquidity and yield.

6.7 Table 12 sets out the proposed limit to control the Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures are expressed as the amount of net principal borrowed.

Table 12: Fixed and Variable Rate Exposure

	2016/17 Upper £000s	**2017/18 Upper £000s**	**2018/19 Upper £000s**	**2019/20 Upper £000s**
Limits on fixed interest rates	325,000	395,000	470,000	535,000
Limits on variable interest rates	97,500	118,500	141,000	160,500

Fixed rate investments and borrowings are those where the rate of interest is fixed for the whole financial year. Instruments that mature during the financial year are classed as variable rate.

6.8 Table 13 (overleaf) proposes the gross limits set to reduce the Council's exposure to large fixed rate sums falling due for refinancing in the same period. This is known as maturity risk. The indicators are set relatively high to provide sufficient flexibility to respond to opportunities to repay or reschedule debt during the financial year, while remaining within the parameters set by the indicators.

Table 13: Maturity Structure of Fixed Interest Rate Borrowing

	2016/17 onwards	
	Lower	**Upper**
Under 12 months	0%	50%
12 months to 2 years	0%	50%
2 years to 5 years	0%	60%
5 years to 10 years	0%	80%
10 years to 20 years	0%	85%
20 years to 30 years	0%	90%
30 years and above	0%	100%

6.9 The next indicator is the total principal funds invested for greater than 364 days. The indicators proposed in Table 14 reflects the deposits already placed, which mature more than 364 days after 31 March 2015, including those at risk in Iceland, and potential new long term investments.

Table 14: Investments Greater than 364 days

	2017/18 £000s	2018/19 £000s	2019/20 £000s
Maximum principal sums invested > 364 days	50,000	50,000	50,000

6.10 The CIPFA Code requires the Council to set performance indicators to assess the treasury function over the year. The proposed indicators that will be measured are:

Security, Liquidity and Yield Indicators

- Weighted average long term credit rating of the portfolio
- Weighted average maturity of the portfolio
- Return on lending compared to the 7 day LIBID rate
- Average rate payable on the borrowing portfolio

Operational Indicators

- Any breaches of the Lending Policy
- Types of financial instruments used

Treasury Management Reporting

6.11 Officers report to Cabinet on a quarterly basis on treasury management as part of the revenue budget monitoring process. The County Council and the Audit Committee will receive a mid-year report and a report at the end of the financial year on treasury management activities and performance. A summary statement of the prudential indicators and treasury management performance indicators that are reported is provided as Appendix 4.

6.12 The Treasury Management Strategy set out in this report is expected to be relevant throughout 2017/18. However, there may be a need to review it during the year where there are significant changes to the economic background, interest rate or changes to government guidance or best practice. If required, proposed revisions will be reported to full Council for Members' consideration in accordance with the CIFPA Code.

7 Financial Implications and Sensitivity to Interest Rates

7.1 The financial implications of treasury management activity are included in the Capital Financing and Interest on Balances budget which is part of the Council's overall budget being considered elsewhere on this agenda. This section highlights the financial implications of the Treasury Management Strategy described in section 4.

7.2 Table 15 shows forecasts of interest payable on borrowing split between existing commitments and a forecast of additional interest expected to be paid as a result of the proposed new borrowing requirement set out in section 2.

Table 15: Forecasts of interest payable on borrowing

	2016/17 Comparator £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's
Cumulative Additional borrowing	-	75,448	146,911	208,127
Funded by:				
Long-term Borrowing	-	75,448	146,911	208,127
Short-term Borrowing	-	-	-	-
Reduction in Investment Balance (see Table 15 for impact)	-	-	-	-
Interest Cost of Borrowing:				
Interest committed as at 31/3/2016	12,352	12,352	12,352	12,352
Estimated interest from additional long-term borrowing	-	396	1,607	2,522
Estimated interest from additional short-term borrowing	82	-	-	-
Total Estimated Interest Payable	**12,434**	**12,748**	**13,959**	**14,874**

7.3 Table 16 shows the interest the Council expects to earn on investments in the forthcoming three financial years. The Council will continue to diversify the risk of managing an investment portfolio by maintaining low investment balances. Cashflow will be maintained on a short term basis to meet known cash outflows in the next month, plus a contingency to cover unexpected cashflows over the same period.

Table 16: Forecasts of Interest on Investments

	2016/17 Comparator £000's	2017/18 Estimate £000's	2018/19 Estimate £000's	2019/20 Estimate £000's
Forecast Average Balance	124,000	90,000	70,000	70,000
Forecast Interest Rate Short-term	0.51%	0.35%	0.35%	0.35%
Forecast Interest Rate Long-term	3.27%	4.00%	4.00%	4.00%
Short-term interest earned	479	210	140	140
Long-term interest earned	1,281	1,200	1,200	1,200
Total Interest earned forecast	**1,760**	**1,410**	**1,340**	**1,340**

7.4 Changes to interest rates have an impact on treasury management activity. Table 17 demonstrates the impact of a 1% rise or fall in interest rates.

Table 17: Sensitivity to a 1% Increase/Decrease in Interest Rates

	2017/18 Estimated +1% Impact Cost / (Saving) £000s	2017/18 Estimated -1% Impact Cost / (Saving) £000s
Interest on borrowing	348	(252)
Investment income	(900)	420
Total impact on treasury	**(552)**	**168**

7.5 The Council seeks to minimise the interest rate risk by agreeing fixed rates for new long term borrowing in the majority of cases, however in the current financial climate, as outlined in section 4.5, there are opportunities for cost savings by taking advantage of lower rates on short term borrowing. In setting the budget for short term interest earned or paid the Council takes advice about the likely pattern of interest rates over the coming financial year and models the impact of a change in rates as shown in Table 17 to illustrate the risk.

8 Treasury Management Training and Advice

8.1 CLG investment guidance requires the Council to note the following matters each year as part of the annual strategy:

Treasury management advisers

The Council contracts with Arlingclose to provide advice and information relating to its investment and borrowing activities. This contract is due to expire in February 2017, and a tender process is underway to replace it. Therefore it is possible that the provider may change when the current contract ends.

The services provided are reviewed through quarterly meetings and include:

- Advice and guidance on relevant policies, strategies and reports
- Advice on investment decisions
- Notification of credit ratings and changes
- Other information on credit quality
- Advice on debt management decisions
- Technical accounting advice
- Reports on treasury performance
- Forecasts of interest rates; and
- Training courses.

Investment training

Training on treasury management will be provided in 2017/18 by the Council's treasury advisors and other professional bodies. Training will be provided to induct new members and to ensure that Members continuing in their roles in relation to treasury management keep their knowledge and skills up to date.

8.2 All treasury management Officers are required to attend an introductory course run by the treasury advisors before they are able to transact. Officers new to treasury management are shadowed by more experienced Officers until they are judged to be competent to undertake transactions themselves and demonstrate a good understanding of the Council's treasury policies. To keep Officers' knowledge up to date, the Council is a member of the CIPFA Treasury Management Forum which provides information and training to its members. In addition the Council's advisers provide continuous guidance, updates and training and Officers will attend conferences and courses related to the treasury function.

9 Treasury Management for Other Organisations

9.1 HCC currently provides treasury management services for three organisations, the Hertfordshire Pension Fund, the Hertfordshire Police and Crime Commissioner (PCC) and the Hertfordshire Local Enterprise Partnership (LEP).

9.2 Hertfordshire PCC and the Pension Fund cash balances are held in separate bank accounts and separate investments are maintained for each in accordance with their respective cashflows. These investments are made in accordance with their own Treasury Management Strategies which are maintained separately and agreed by the PCC and the Pensions Committee respectively. Reporting arrangements are similar to the Council's with a mid-year and end of year report being provided on activity within the year in addition to the Strategy.

9.3 The Hertfordshire LEP is not a separate legal entity and HCC is the Accountable body. Therefore its balances are held with the Council's and invested as part of the wider pool. Separate information is maintained on LEP cashflows, and appropriate interest is paid over to the LEP annually. Any specific investments made on behalf of the LEP are therefore covered by the HCC Treasury Management Strategy. The proposed change to the Treasury Management Strategy in 2016/17 is to enable investments in instruments linked to economic growth but which do this in such a way to manage risk.

APPENDIX 1 TREASURY MANAGEMENT POLICY STATEMENT

The Council's financial regulations require it to create and maintain a Treasury Management Policy statement, stating the policies, objectives and approach to risk management of its treasury activities, as a cornerstone for effective treasury management.

1 Definition

The Council defines its treasury management activities as the:

- Management of the Council's investments and cashflows, its banking, money market and capital market transactions
- Effective control of the risks associated with those activities
- Pursuit of optimum performance consistent with those risks

2 Risk management

The Council regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation, and any financial instruments entered into to manage these risks.

3 Value for money

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.

4 Borrowing policy

The Council values revenue budget stability and will therefore borrow the majority of its long term funding needs at long term fixed rates of interest. Short term and variable rate loans will only be borrowed to the extent that they either offset short term and variable rate investments or can be shown to produce revenue savings.

The Council will set an affordable borrowing limit each year in compliance with the Local Government Act 2003, and will have regard to the CIPFA Prudential Code for Capital Finance in Local Authorities when setting that limit. It will also set limits on its exposure to changes in interest rates and limits on the maturity structure of its borrowing in the Treasury Management Strategy report each year.

5 Investment Policy

The Council's primary objectives for the investment of its surplus funds are to protect the principal sums invested from loss, and to ensure adequate liquidity so that funds are available for expenditure when needed. The generation of investment income to support the provision of local authority services is an important, but secondary, objective.

The Council will have regard to the Communities and Local Government Guidance on Local Government Investments and will approve an investment strategy each year as part of the Treasury Management Strategy. The strategy will set criteria to determine suitable organisations with which cash may be invested, limits on the maximum duration of such investments and limits on the amount of cash that may be invested with any one organisation.

APPENDIX 2 2016/17 LENDING POLICY

1 Approved Counterparties and Limits

1.1 The Council may invest in any of the counterparty types in Table A, subject to the cash limits (per counterparty) and the time limits shown. The credit rating criteria in Table A is based on Fitch's long term credit ratings.

Table A must be read in conjunction with the notes to section 1.

Table A: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured		Banks Secured		Government / Sovereign		Corporates		Registered Providers	
	Value	Time	Value	Time	Value	Time	Value	Time	Value	Time
UK Govt	N/A	N/A	N/A	N/A	Unlimited	10 years	N/A	N/A	N/A	N/A
UK Local Authorities	N/A	N/A	N/A	N/A	£10m	10 years	N/A	N/A	N/A	N/A
AAA	£10m	5 years	£15m	10 years	£10m	10 years	£10m	10 years	£10m	10 years
AA+	£10m	5 years	£15m	5 years	£10m	10 years	£10m	10 years	£10m	10 years
AA	£10m	4 years	£15m	5 years	£10m	10 years	£10m	5 years	£10m	10 years
AA-	£10m	3 years	£15m	4 years	£10m	5 years	£10m	4 years	£10m	10 years
A+	£10m	2 years	£15m	3 years	£5m	5 years	£10m	3 years	£10m	5 years
A	£10m	13 months	£15m	2 years	£5m	5 years	£10m	2 years	£10m	5 years
A-	£10m	6 months	£15m	13 months	£5m	5 years	£10m	13 months	£10m	5 years
BBB+	£5m	100 days	£10m	6 months	N/A	N/A	£5m	6 months	£5m	2 years
None	£1m	6 months	N/A	N/A	N/A	N/A	N/A	N/A	N/A	N/A
Pooled Funds	£15m per Fund									
Peer to Peer Lending	Total for LEP and HCC - £5m									

1.2 The limits in table A are a guide and can change in periods of market stress. The council's advisers provide counterparty updates monthly, and in response to new information or changing market conditions. Where these differ from the above officers will adhere to the lower of the limits set out in the table, or according to the latest advice.

1.3 **Credit Ratings**
Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment issued, otherwise the counterparty credit rating is used. If an agency removes one of the set of ratings it issues for a bank or building society, the institution will be removed from the list.

Table B provides a comparison of long term credits ratings for all agencies.

Table B: Comparison of credit ratings for all agencies providing ratings

Fitch	Moody's	S&P	Definition
AAA	Aaa	AAA	Prime
AA+	Aa1	AA+	High Grade High Quality
AA	Aa2	AA	
AA-	Aa3	AA-	
A+	A1	A+	Upper Medium Grade
A	A2	A	
A-	A3	A-	
BBB+	Baa1	BBB+	Adequate Grade
BBB	Baa2	BBB	
BBB-	Baa3	BBB-	

1.4 The Council will continue to invest in UK institutions, e.g. banks, central government and pooled funds, even if the UK was not rated AA+.

1.5 Overseas subsidiaries of foreign banking groups will normally be assessed according to the country of domicile of the parent organisation. For the avoidance of doubt, Santander UK plc (a subsidiary of Spain's Banco Santander) will be classed as a UK bank due to its substantial UK franchises and the arms-length nature of the parent-subsidiary relationship.

1.6 Sovereign credit rating criteria will not apply to investments in multilateral development banks (e.g. the European Investment Bank and the World Bank) or other supranational organisations.

1.7 Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit.

1.8 **Banks Unsecured**

Definition: Accounts, deposits, certificates of deposit, and senior unsecured bonds with banks and building societies (other than multilateral development banks).

These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail.

Unsecured investment with banks rated BBB or BBB- are restricted to overnight deposits at the Council's bank, Barclays Bank plc.

1.9 **Banks Secured**

Definition: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies.

These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

1.10 **Government**
Definition: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks.

These investments are not subject to bail-in, and there is an insignificant risk of insolvency.

1.11 **Corporates**
Definition: Loans, bonds and commercial paper issued by companies other than banks and registered providers.

These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

1.12 **Registered Providers**
Definition: Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations.

These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed.

1.13 **Pooled Funds**
Definition: Shares in diversified investment vehicles consisting of any of the investment types above, plus equity shares and property.

These funds provide wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Money Market Funds that offer same-day liquidity and aim for a constant net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

1.14 **Bond, Equity and Property Funds**
These funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

2 Policy for determining limits for deposits

2.1 Table C and the following notes in this section set out the limits to be applied on investments in addition to the investment counterparty limits shown in Table A.

Table C: Limits on Investments

Type	Description	Limit
Fixed Term Deposits	The maximum amount as a single transaction when placing fixed term deposits. The only exceptions to this are deposits with the DMADF and movements in and out of call accounts and pooled funds.	**Unsecured** £10 m per transaction **Secured** £15 m per transaction
Banking Groups	A group limit will apply where a number of banks are owned by a single institution.	£15 m per Group
Money Market / Pooled Funds	Total investment in any one Money Market Fund or Pooled Fund	£15 m per Fund
Money Market / Pooled Funds Groups	A group limit will apply where a number of Money Market / Pooled funds are owned by a single institution.	£35 m per Group
UK Country Limit	Maximum percentage of portfolio permitted to be in UK institutions	100% investment portfolio
Non-UK Country Limit	Maximum percentage of portfolio permitted to be in non-UK institutions (excluding Money Market Funds)	30% investment portfolio
Single Non-UK Country	Maximum percentage of portfolio permitted to be in any one country, other than UK	5% investment portfolio
Sector	A sector limit applies to unsecured investments Building Societies to limit exposure to a common risk factor – in this case the property market	£30 m

3 Policy to be followed when credit ratings change

3.1 Negative Watch

Definition: A status that credit rating agencies apply while they are deciding whether to lower that organisation's credit rating.

- If an institution is on negative rating watch the Council will treat it as one credit rating lower than it is currently rated.
- If an institution is at the bottom of the Council's credit rating criteria and is placed on negative watch, the Council will stop investing and attempt to call back any money which is currently invested, depending on the economic viability of withdrawing the investment.

This policy does not apply to a negative outlook on a credit rating. In the case of a negative outlook any investment decision will be considered in line with all other information available but will not prompt immediate action to review existing investments.

3.2 **Downgrading**

- If an institution is downgraded below the minimum credit rating criteria, then it will be removed from the list with immediate effect, along with any subsidiaries, and no new investments will be made.
- If funds are on call with an institution when a downgrade happens, they will be withdrawn or the balance reduced as appropriate, at the earliest possible opportunity, which may be the following working day.
- If there are outstanding fixed term deposits with an institution which has been removed from the list, terms for repayment will be sought and, if offered, fully considered and documented by Officers.
- Downgrading and the action taken will be reported in the weekly treasury management meetings and quarterly reports to members.

4 Other matters to be considered by Officers

4.1 In applying the policy set out above, Officers will refer to the following sources of market information on a regular basis:

- Credit Default Swap Rates
- Equity Prices
- Economic data
- Financial statements
- Outlook reports from credit agencies
- Financial Times and other news sources
- Professional journals and other publications

4.2 A regular briefing will be provided for all Officers involved in the dealing function, the Head of Specialist Accounting and/or the Assistant Director of Finance. This will provide all relevant information to enable decisions to be taken about treasury activity to ensure it remains within the policy. By its very nature the information will not be definitive and Officers will do all they can to react to these sources of information with the primary objective of security. The briefings will generally be delivered by weekly meetings. If for any reason, a meeting cannot be convened, all relevant information will be circulated to Officers and the Assistant Director of Finance.

4.3 Officers maintain an overview of prevailing market rates in their regular contact with brokers. When considering fixed term deposits, Officers will consider quotes from brokers for a range of periods before making decisions.

APPENDIX 3 FINANCIAL INSTRUMENTS GLOSSARY

Call accounts
Bank account that pays a higher rate of interest than an ordinary account. These investments are subject to the risk of credit loss as a result of a bail-in should the regulator determine that the bank is failing or likely to fail.

Certificates of Deposit (CDs)
CDs are negotiable term deposits made with a bank or a building society. They are bearer instruments which can be issued at a discount and without a coupon (interest payment), however, more typically they pay either a fixed or a variable coupon; with variable rates of interest being fixed semi-annually against a reference rate such as LIBOR. The coupon is closely related to the current market deposit rate from the same counterparty for a corresponding maturity. Large issues will typically be issued at par and are actively traded on a secondary market meaning that they can be acquired and sold on a daily basis. CDs are a money market instrument and therefore the credit ratings will be the same as those for term deposits. CDs offer the same credit quality as term deposits, but due to their liquidity there is an active secondary market and therefore the rate of interest paid is typically slightly lower than the rate earned on a term deposits of the same duration.

Commercial papers
An unsecured, short-term debt instrument issued by a corporation, typically for the financing of accounts receivable, inventories and meeting short-term liabilities. Maturities on commercial paper rarely range any longer than 270 days. The debt is usually issued at a discount, reflecting prevailing market interest rates.

Corporate bonds
These are issued by companies that are looking to raise capital and are seen as riskier than gilts, as companies are likelier to default on debt than governments. You generally get a higher rate of interest for taking on this risk. A corporate bond is a loan made to a company for a fixed period by an investor, for which they receive a defined return. Investors usually receive annual payments for their cash (which are normally expressed as a percentage) as well receiving the principal sum back at the end of the term. Investment grade corporate bonds are usually issued by established companies which are deemed less likely to default on their obligations. Corporate bonds can be traded on a secondary market.

Covered Bonds, Reverse Repurchase Agreements and other Collateralised Agreements
These investments are secured on a bank or building societies’ assets, which limits the potential losses in the event of insolvency which means that they are exempt from bail in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Fixed Term Deposits
A deposit held at a financial institution that has a fixed term. These are generally short-term with maturities ranging anywhere from a month to a few years. When a term deposit

is purchased, the lender (the customer) understands that the money can only be withdrawn after the term has ended or by giving a predetermined number of days' notice. These investments are subject to the risk of credit loss as a result of a fail-in should the regulator determine that the bank is failing or likely to fail.

Government Bonds (Gilts)
This type of fixed interest security is issued by the British government if it wants to raise money and is generally seen as very low risk. This is because it is highly unlikely that the British government would go bankrupt and therefore be unable to pay the interest due or repay the loan in full. Government bonds are traded on a secondary market and therefore seen to be very liquid.

Index linked gilts pay interest linked to the Retail Price Index (RPI) so their value rises with inflation.

Loans to Local Authorities or Companies
This type of investment is an arrangement under which an amount is lent for a fixed period of time to a counterparty for which a rate of interest is receivable either at intervals during the loan or on maturity.

Local Capital Finance Company (LCFC) Equity
LCFC was established in 2014 by the Local Government Association (LGA) Municipal Bond Agency. Its aim is to provide local authorities with an alternative form of borrowing to supplement current lenders such as the PWLB and banks. The LCFC plans to issue bonds on the capital markets and lend proceeds to local authorities. The LGA is seeking to raise equity of £10m from local authorities and in September 2014 the LGA had raised £4.5m from 38 councils. A mid-year change to the 2014/15 Treasury Management Strategy was agreed by Council on 25 November 2014 to enable investment in the LCFC.

Local Government Bonds
A loan raised by a local authority in the form of a fixed-interest bond, repayable at a specific date. Local Government Bonds are tradable but the market is less establish as with other bond markets.

Money Market Funds
A Money Market Fund is an open-ended mutual fund that invests in a diversified pool of securities short-term debt securities such as Treasury bills and commercial paper. Money Market Funds are widely regarded as being as safe as bank deposits yet providing a higher yield.

Notice accounts
Accounts on which the account holder is required to give a notice of withdrawal a specified number of days before making the withdrawal to avoid penalties. These investments are subject to the risk of credit loss as a result of a bail-in should the regulator determine that the bank is failing or likely to fail.

Peer to Peer Lending
Peer to peer lending (P2PL) is a method of lending money to unrelated individuals, or "peers", without going through a traditional financial intermediary such as a bank or other financial institution. Typically these investment vehicles offer higher rates of return commensurate with the underlying risk of unsecured investments. In addition, this form of investment may provide a means of stimulating economic development within a corporate

rather than financial risk profile and may be particularly suitable for the Local Enterprise Partnership

Pooled Funds
Pooled funds include pooled bond, equity and property funds. They provide enhanced returns over the longer period, but are, potentially, more volatile in the shorter term. These funds would enable the Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Council's investment objectives will be monitored regularly.

Registered Providers of Social Housing
Formerly known as Housing Associations, Registered Providers for social housing are tightly regulated by the Homes and Communities Agency. They retain a high likelihood of receiving government support if needed. The Council will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

Supranational Bonds
A supranational entity is formed by two or more central governments with the purpose of promoting economic development for the member countries. Supranational institutions finance their activities by issuing debt, such as supranational bonds. Examples of supranational institutions include the European Investment Bank and the World Bank.

Similarly to the government bonds, the bonds issued by these institutions are considered very safe and have a high credit rating.

Treasury Bills (T-Bills)
Treasury Bills are short term Government debt instruments. They are issued by the Debt Management Office and are an eligible sovereign instrument, meaning they have an AAA rating. T-Bills are issued on a zero-coupon, i.e. they are issued at a discount to their par nominal value whereupon maturity the par value redemption will be higher than the purchase price reflecting an income return alongside the return of the initial capital outlay. T-Bills are actively traded on a secondary market meaning that they can be acquired and sold on a daily basis.

APPENDIX 4 PRUDENTIAL AND TREASURY MANAGEMENT INDICATORS SUMMARY

The following table sets out the Prudential and Treasury Management Indicators that will be monitored and reported on during the financial year.

Table		**2017/18 £'000**	**2018/19 £'000**	**2019/20 £'000**
Prudential Indicators				
Section 1.2	Adoption of CIPFA Treasury Management in the Public Service: Code of Practice 2011 edition	✓	✓	✓
1	Capital Expenditure	219,287	215,542	177,115
3	Capital Financing Requirement (CFR)	580,443	637,621	682,686
4	Ratio of financing costs to net revenue stream	1.47%	1.65%	1.75%
5	Incremental impact of capital investment decisions on Band D Council Tax	£0.91	£2.76	£2.07
9	Gross Borrowing	328,347	402,503	467,025
	Net Borrowing less than CFR	Y	Y	Y
10	Authorised Limit for external debt	495,000	570,000	635,000
	Operational Boundary for external debt	465,000	540,000	605,000
Treasury Management Operational and Performance Indicators				
11	Limit on Fixed Interest Rates	395,000	470,000	535,000
	Limits on Variable Interest Rates	118,500	141,000	160,500
12	Maturity Structure of fixed rate borrowing (against max position)			
	Under 12 months	50%	50%	50%
	12 months to 2 years	50%	50%	50%
	2 years to 5 years	60%	60%	60%
	5 years to 10 years	80%	80%	80%
	10 years to 20 years	85%	85%	85%
	20 years to 30 years	90%	90%	90%
	30 years and above	100%	100%	100%
13	Investments greater than 364 days (Maximum Limit)	50,000	50,000	50,000
Treasury Management Security Liquidity and Yield Performance Indicators				
	Weighted average long term credit rating of the investment portfolio			
	Weighted average maturity of the investment portfolio			
	Return on lending compared to 7 day LIBID rate			
	Average rate payable on the borrowing portfolio			
	Any breaches of the Lending Policy			
	Types of financial instruments used			