INTEGRATED PLAN

PART C - 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 2018/19 Treasury Management and Borrowing Strategy and Prudential Code indicators that will be set and monitored throughout 2018/19.

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 2018/19 Treasury Management and Borrowing Strategy.

1.5 This report was prepared in December 2017 in compliance with the prevailing regulations. Subsequent changes to those regulations will, if applied during 2018/19, prompt a review of this document. Expected regulatory changes are noted in 1.7 and 1.8, below, and further detail can be found in Appendix 5.

1.6 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.

1.7 Towards the end of 2017 CIPFA consulted on changes to the Code of Practice for Treasury Management, and stated that it intends to publish an updated code for implementation from April 2018. The new code being unpublished, this document has been prepared in accordance with the existing code and any changes that are required in order to comply with the new code will be brought to Full Council alongside the mid-year Treasury Management report. See Appendix 5 for more detail of the proposed changes.

1.8 Further to the CIPFA Code changes, changes to DCLG Investment Guidance are also subject to consultation at the time of writing. Revised guidance is expected to be introduced for application from April 2018, alongside the Code changes, and any consequent changes will be adopted in the same revision, referred to in 1.7, and brought back to Council for approval. See Appendix for more detail of the proposed changes.

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 2018/19 together with estimates for 2019/20 to 2021/22 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 2018/19.

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

	2016/17 Actual £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Total Expenditure	**179,857**	**175,621**	**244,024**	**264,420**	**186,570**	**124,869**
Grants	104,735	98,858	81,649	81,040	56,502	60,595
Contributions (including S106 and from the LEP*)	13,822	11,592	48,148	72,029	36,132	1,890
Reserves	7,463	1,283	2,761	2,075	1,125	375
Revenue	11,678	2,705	0	0	0	0
Capital Receipts / Investment Reserve	6,160	17,122	10,000	10,000	10,000	10,000
Borrowing Requirement	**35,999**	**44,060**	**101,466**	**99,276**	**82,811**	**52,009**

* LEP – Local Enterprise Partnership

2.5 Any increase in the Councils CFR, the underlying need to finance the capital programme, will need to be funded 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 that support the recommended capital programme.

Table 2: Capital Financing Requirement Breakdown

	2016/17 Actual £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Borrowing – General	35,999	44,060	101,466	81,504	68,384	52,009
Borrowing – Croxley	0	0	0	17,772	14,427	0
Total Movement	**35,999**	**44,060**	**101,466**	**99,276**	**82,811**	**52,009**

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, whilst meeting the broad aim that the charge should be paid over the useful life of the assets, or in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant. The Council changed its policy in 2017/18, to better link the charge to the asset lives to which the borrowing relates whilst remaining affordable within the Council's overall revenue budget.

2.9 The Council's MRP policy is as follows:

a) **Relating to pre 2008 spend**: Repayment charged over 50 years from 2008, reflecting the average life of the assets. The repayments are calculated on an annuity basis, linked to the 2008 PWLB borrowing rate, to reflect the time value of money.

b) **Relating to spend from 2008**: Repayments charged across the expected lives of assets. These charges are also calculated on an annuity basis (using PWLB rates effective at the time the expenditure was incurred).

c) **For assets acquired by finance leases or Private Finance Initiative**, MRP will be determined as being equal to the element of the rent or charge that goes to write down the balance sheet liability.

Prior to 2017/18, the repayment for pre-2008 expenditure was calculated on a 4% reducing balance: the new policy has been backdated and the resulting savings spread across the remaining years, reducing the charge for future taxpayers across the life of the assets. The annuity method for spend from 2008 onwards has also been backdated, releasing £19m savings. These will be released over the next three years. As agreed in the 2017/18 IP, these will be 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.

2.10 The Council's external borrowing is significantly lower than the level of borrowing assumed by MRP (the Capital Financing Requirement was £531.0m as at end 2016/17, compared with long term borrowing of £260.8m). MRP does not therefore currently relate to actual borrowing costs.

2.11 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.

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

2.13 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. For significant assets, MRP may be delayed until the asset is available for service use, as permitted under the Code.

Table 3: Movement in the Estimated Capital Financing Requirement

	2016/17 Actual £000	**2017/18 Forecast £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Opening CFR	506,478	519,686	551,460	642,159	728,330	796,275
Net movement in CFR	13,208	31,774	90,699	86,171	67,945	35,319
Closing CFR	519,686	551,460	642,159	728,330	796,275	831,594
Net Movement in CFR comprises:						
MRP Borrowing	(21,122)	(10,790)	(9,060)	(11,237)	(12,880)	(14,648)
MRP on Finance Leases	(31)	(33)	(35)			
MRP on PFI contracts	(1,638)	(1,463)	(1,672)	(1,868)	(1,986)	(2,042)
Additional Borrowing	35,999	44,060	101,466	99,276	82,811	52,009
Total Movement	**13,208**	**31,774**	**90,699**	**86,171**	**67,945**	**35,319**

2.14 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 indicators 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

	2016/17 Actual	2017/18 Forecast	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Ratio	3.89%	2.67%	2.61%	3.13%	3.56%	3.95%

<u>2018/19 Context</u>
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 financing cost of approximately £780k. This equates to the Capital Financing cost of unfunded expenditure of approximately £13m at 2.95%.

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 2018/19 to 2021/22. This relates to spending over and above the levels included in the capital programme agreed in February 2017 for financial years 2017/18 to 2019/20.

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

	2018/19	2019/20	2020/21	2021/22
Council Tax Impact - Band D	(£5.30)	(£2.27)	£4.79	£11.41

The incremental impact of capital spending decisions is negative in the first two years of the Integrated Plan as a result of savings derived from prior year MRP policy changes, and a lower forecast for interest payable due to some planned expenditure being reprogrammed into subsequent years, and higher than expected cash balances reducing the amount resulting in lower borrowing in the early years of the programme.

3 Context for the Treasury Management Strategy – Provided by Arlingclose

The Council's Treasury Advisors, Arlingclose, have provided the following information on the external context for the TMSS.

3.1 Economic Background

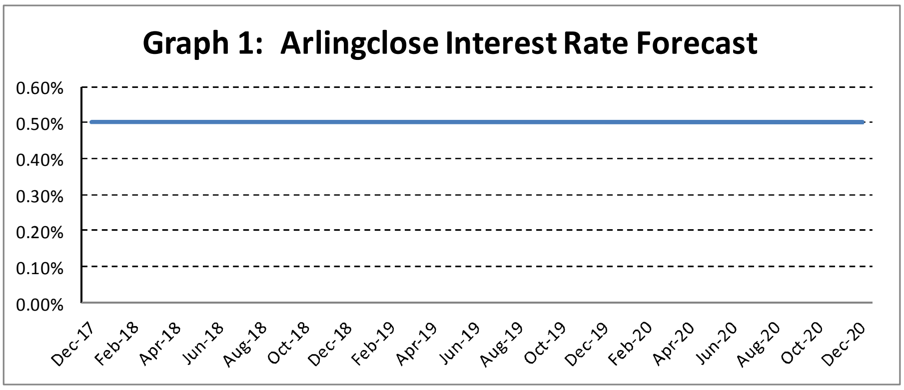
The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

3.2 Interest Rate Forecast

Graph 1, below, shows the Council's treasury adviser Arlingclose's central case for UK Bank Rate during 2018/19. Their view on this is that rates are likely to remain at 0.50%, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.



Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides.

Pressures which might lead to an increase in interest rates include sustained periods of inflation above the Bank's 2% target, especially where not linked to currency fluctuations and/or when inflation is accompanied by accelerated wage growth.

Pressures which might lead to a reduction in interest rates include weakening economic growth resulting from geopolitical uncertainty or economic shocks requiring economic stimulus measures to sustain economic activity.

The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

3.3 Credit Outlook

High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic 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. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

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 remain very low.

3.4 Current Treasury Position for Borrowing

Table 6 (below) shows the borrowing position at 31 March 2017 and the estimated position at 31 March 2018. No additional long term borrowing has been undertaken in 2017/18 since cash balances have been used to fund capital expenditure in the short-term.

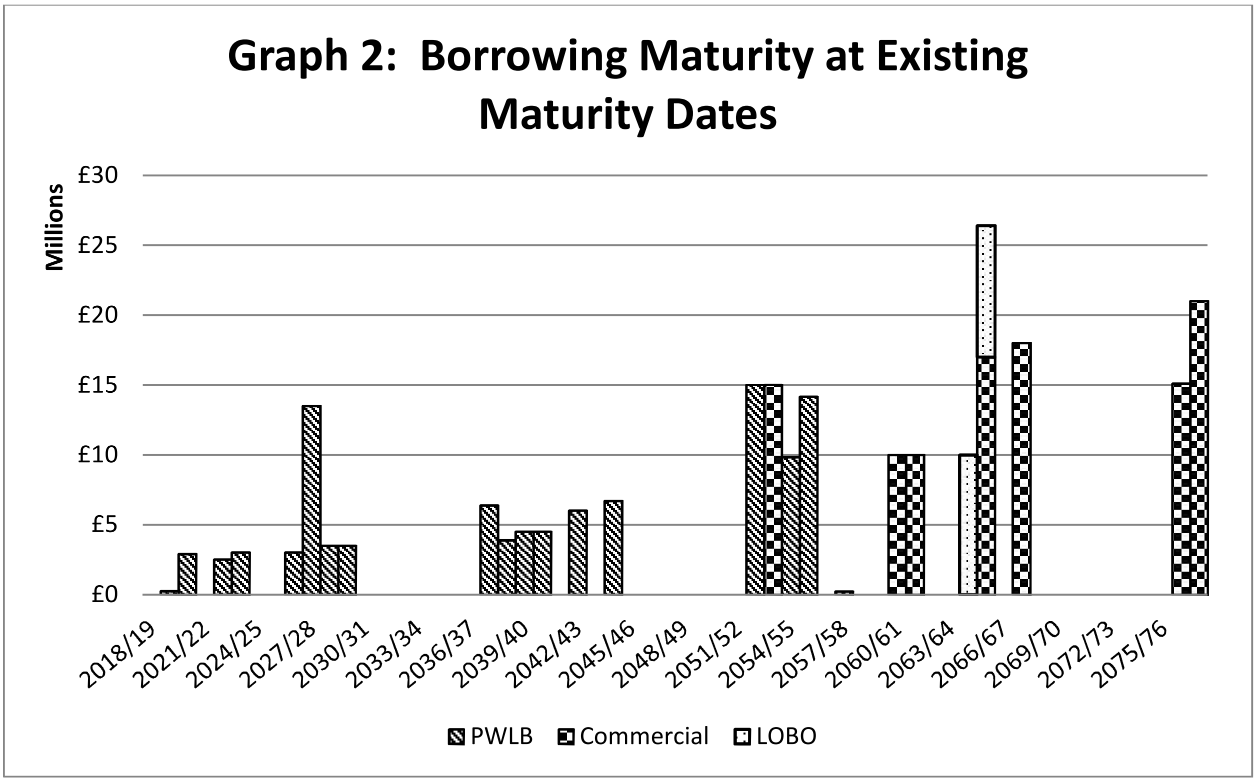
Table 6 also shows the sources of borrowing and the maturity structure of the loans. Borrowing is sourced from the government's Public Works and Loans Board [PWLB] and commercial banks. Commercial bank loans are a mixture of fixed term borrowing and Lender's Option, Borrower's Option [LOBO] loans which 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 the Council held 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 classified as 'Commercial' in Table 6, overleaf.

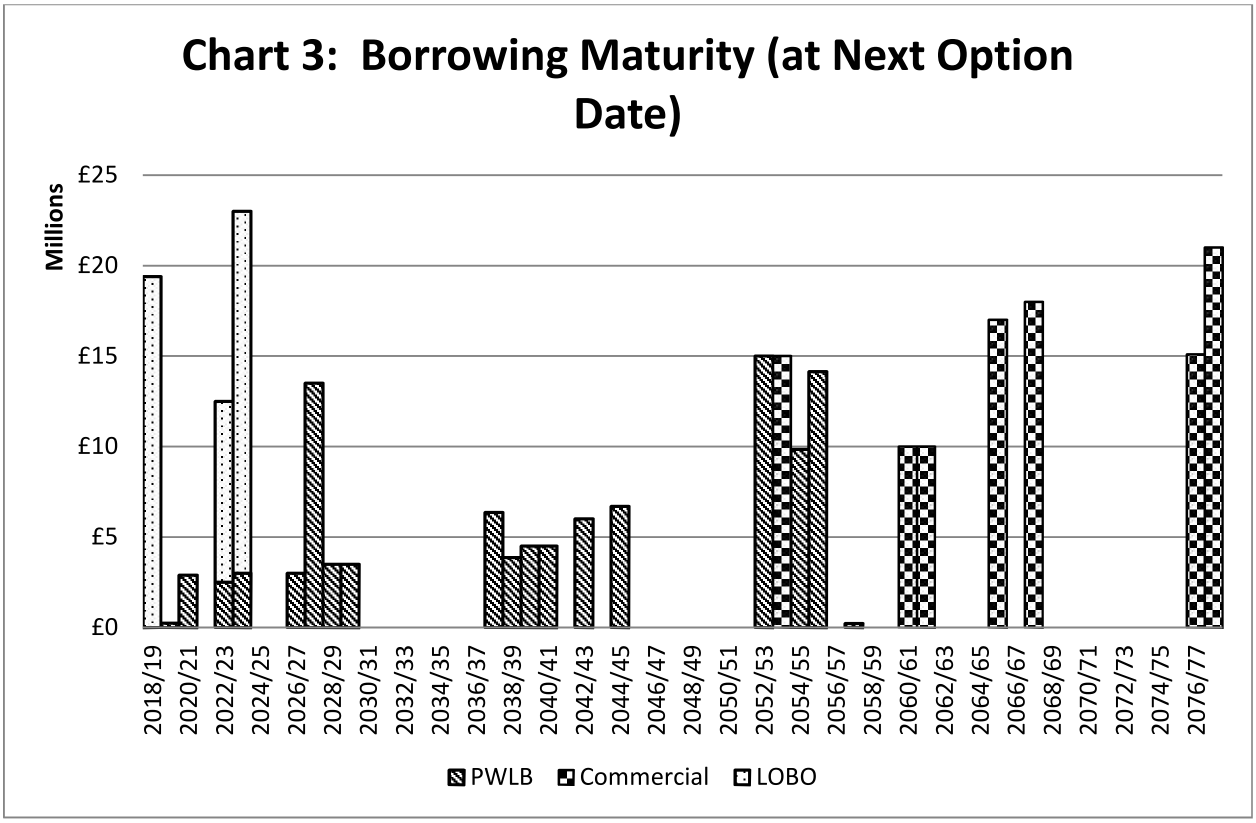
Table 6: Treasury Position for Borrowing

	2016/17 Sources of Borrowing					2017/18 Sources of Borrowing				
	Actual	PWLB	LOBO	Commercial	Other Local Authority	Estimated	PWLB	LOBO	Commercial	Other Local Authority
	£m	£m	£m	£m	£m	£m	£m	£m	£m	£m
31 March Total:	**288.78**	**103.28**	**49.40**	**106.10**	**30.00**	**302.84**	**103.28**	**49.40**	**106.10**	**44.06**
Maturity Analysis:										
Under 2 years	**30.00**	-	-	-	30	44.31	0.25	0	0	44.06
2 to 10 years	**8.65**	11.65	-	-	**-**	24.90	24.90	0	0	0
10 to 30 years	**55.43**	52.43	-	-	**-**	38.93	38.93	0	0	0
30 years or later	**194.7**	39.2	49.4	106.1	**-**	194.70	39.20	49.4	106.1	0

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



Graph 3 (overleaf) 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, 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 2017 and the estimated position at 31 March 2018.

Table 7: Treasury Position for Lending

	2016/17 Actual £000	2017/18 Estimated £000
Total Lending at 31 March	**103,141**	**55,612**
Analysed as:		
Iceland Investments	643	612
Instant Access	36,979	25,000
95 Day Notice Account	10,000	0
Long Term MMFs	17,500	0
Fixed Term	8,019	0
Pooled Funds	30,000	30,000

4 Proposed Treasury Management Strategy

Lending Strategy

4.1 In developing proposals for the 2018/19 Treasury Management Strategy, risk assessments have been undertaken in conjunction with Arlingclose. Factors considered in this assessment include credit ratings, exposure to bail-in, market conditions and the outlook for interest rates.

4.2 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 forecast cashflow requirements; and only once both of these matters have been taken into account will the yield be considered.

4.3 Whilst currently deemed unlikely, were an economic downturn to occur in 2018/19 the Bank of England could chose to set a bank rate at or below zero. This would likely feed through to negative rates on all low-risk short-term investment options In this event, security would be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

4.4 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.

4.5 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.

4.6 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. The target for these investments was to generate a yield of 4% per annum. During 2017/18 the overall return on these funds exceeded 5%. It is intended that these investments will continue to be held throughout 2018/19.

Lending Policy

4.7 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.

4.8 No additional changes are proposed to the approved list of financial instruments for investment purposes for the 2018/19 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.

4.9 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.

It is noted that AAA rated funds may have exposure to underlying investments with lower credit ratings than the overall fund rating; a fund's AAA rating is assessed based on a number of factors, including the use of asset diversification to mitigate the credit risk of individual underlying investments, and the risk tolerance and fund management policies in place.

4.10 Any investment not meeting the definition of a specified investment is classed as non-specified. Limits for non-specified investments for the 2018/19 Treasury Management Strategy are set out in Table 8.

Table 8: 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 1.9 for definition of unsecured investments
See Appendix 2, Section 1.10 for definition of secured investments

4.11 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.

4.12 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 is formally stated

4.13 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.

4.14 The proposed 2018/19 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.

Non-Treasury Investments

4.15 Although not classed as treasury management activities and therefore not covered by the CIPFA code or the DCLG guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example loans to local business, or as equity investments.

Such loans and investments will be subject to the Authority's normal approval process for revenue and capital expenditure and need not comply with this TMSS

Borrowing Strategy

4.16 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.

4.17 The Capital Programme for 2018/19 - 2021/22 includes a requirement for additional borrowing. As Capital Assets by nature bring benefits over multiple years, so their financing is long-term in nature.

4.18 In recent years the council followed a policy of using internal borrowing to finance unfunded elements of the capital programme. Internal Borrowing is the use of short-term cash surpluses (generated primarily by the council's reserves and provisions) to fund Capital Projects. This is a prudent approach which reduces the cost of interest paid on borrowing in the short term. The council has relatively high levels of internal borrowing, and further internal borrowing would require the liquidation of some its 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. In the long term, as reserves and provisions are used it will be necessary to convert this internal borrowing into long-term loans.

4.19 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.

4.20 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).

4.21 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.

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

Borrowing Policy

4.23 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 and avoid a concentration of loans maturing at the same time requiring refinancing in a high interest rate environment.

4.24 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.

4.25 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 or interest rate risk and 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, 9 and 11 demonstrates that the Council has fulfilled the Prudential Code objectives.

6.3 Table 9 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 2018/19 and the next three financial years.

Table 9: Gross Debt and the Capital Financing Requirement

	2016/17 Comparator £000	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Gross Debt	258,799	302,859	368,628	467,904	550,715	602,724
CFR	519,686	551,460	642,159	728,330	796,275	831,594

6.4 The Council complied with the prudential indicator requirement to keep net borrowing below the relevant CFR in 2016/17, 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 10 (overleaf) sets out proposed limits for the following two prudential indicators which aim to control the overall level of borrowing. The limits are based on the Capital Financing Requirement shown in Table 9. 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. In the

event that there is a risk of this limit being breached officers will report to Resources Panel and subsequently to Audit Committee in the annual reporting cycle

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. Performance against this indicator is reported in the Quarterly performance report to Resources Panel.

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

Table 10: Authorised and Operational Limits

Authorised limit for external debt	**2017/18 Limit £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Borrowing	425,000	475,000	574,500	657,500	710,000
Other long term liabilities	70,000	70,000	70,000	70,000	70,000
Total	**495,000**	**545,000**	**644,500**	**727,500**	**780,000**
Operational boundary for external debt	**2017/18 Limit £000**	**2018/19 Estimate £000**	**2019/20 Estimate £000**	**2020/21 Estimate £000**	**2021/22 Estimate £000**
Borrowing	395,000	445,000	544,500	627,500	680,000
Other long term liabilities	70,000	70,000	70,000	70,000	70,000
Total	**465,000**	**515,000**	**614,500**	**697,500**	**750,000**

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 11 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 11: Fixed and Variable Rate Exposure

	2017/18 Upper £000	**2018/19 Upper £000**	**2019/20 Upper £000**	**2020/21 Upper £000**	**2021/22 Upper £000**
Net Limits on fixed interest rates	395,000	445,000	547,500	633,500	689,000
Net Limits on variable interest rates	118,500	133,500	188,000	222,500	234,500

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months after the start of the financial year, or the start date of the investment if later. Instruments that mature during the financial year, or within 12 months of the start-date if later are classed as variable rate.

6.8 Table 12 (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 12: Maturity Structure of Fixed Interest Rate Borrowing

	2018/19 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 13 reflects the deposits already placed, which mature more than 364 days after 31 March 2018, including those at risk in Iceland, and potential new long term investments.

Table 13: Investments Greater than 364 days

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Maximum principal sums invested > 364 days	50,000	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 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 be reviewed during the year as significant changes are proposed to the CIPFA Prudential Code for Capital Finance, the Treasury Management Code, and DCLG's regulatory investment guidance. At the time of preparing this document the changes had not been published but it was the stated intention of both CIPFA and DCLG for their proposed changes to apply from April 2018. Any changes that are required to be made to this Strategy as a result of these publications will be brought to Council for approval during 2018/19.

6.13 In addition to the changes to statutory guidance detailed above, if there are significant changes to the economic background, interest rate or changes to government guidance or best practice the TMSS will be reviewed.

6.14 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 14 (overleaf) 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 14: Forecasts of interest payable on borrowing

	2017/18 Forecast £000	2018/19 Estimate £000	2019/20 Estimate £000	2020/21 Estimate £000	2021/22 Estimate £000
Cumulative Additional borrowing	44,060	109,829	209,105	291,916	343,925
Funded by:					
Long-term Borrowing	0	15,282	54,915	104,553	145,958
Short-term Borrowing	44,060	94,548	154,191	187,364	197,967
Interest Cost of Borrowing:					
Interest committed as at 31/3/2017	12,352	12,352	12,352	12,352	12,352
From additional long-term borrowing	0	387	1,449	2,854	4,087
From additional short-term borrowing	20	303	847	1,468	2,062
Total Estimated Interest Payable	**12,372**	**13,041**	**14,648**	**16,674**	**18,502**

7.3 Table 15 shows the interest the Council expects to earn on investments in the forthcoming four 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 15: Forecasts of Interest on Investments

	2017/18 Forecast £000's	2018/19 Estimate £000's	2019/20 Estimate £000's	2020/21 Estimate £000's	2021/22 Estimate £000's
Forecast Average Balance	137,000	60,500	60,500	60,500	60,500
Forecast Interest Rate Short-term	0.34%	0.34%	0.45%	0.57%	0.57%
Forecast Interest Rate Long-term	5.19%	4.25%	4.25%	4.25%	4.25%
Short-term interest earned	362	104	137	174	174
Long-term interest earned	1,557	1,275	1,275	1,275	1,275
Total Interest earned forecast	**1,919**	**1,379**	**1,412**	**1,449**	**1,449**

7.4 Changes to interest rates have an impact on treasury management activity. Table 16 demonstrates the impact of a 1% rise or fall in interest rates.

Table 16: Sensitivity to a 1% Increase/Decrease in Interest Rates

	2018/19 Estimated Impact 1% Rate Increase Cost / (Saving) £000	2018/19 Estimated Impact 1% Rate Decrease Cost / (Saving) £000
Interest on borrowing	504	(258)
Investment income	(606)	403
Total impact on treasury	**(102)**	**145**

7.5 The saving resulting from a reduction in interest rates are not equal to the cost of an increase in rates because there is a presumed minimum interest rate payable on borrowing, below which rates will not fall. At prevailing low rates a 1% increase rate reduction would result in a reduction of less than 1% in new borrowing rates.

7.6 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 16 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 began in February 2017, following a competitive tender process.

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 2018/19 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. 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 Network 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.

8.3 Treasury Officers will maintain a Continuing Professional Development records in order to allow the Council to maintain its Elective Professional Client status under MiFID II regulations (see section 9 for details).

9 Markets in Financial Instruments Directive

9.1 The UK Financial Conduct Authority [FCA] implemented regulation the EU Markets in Financial Instruments Directive (MiFID) II, with effect from 3rd January 2018. This regulation has changed the classification of Local Authorities, which were previously treated as de facto 'professional' clients of Financial Institutions [FIs], to be treated as 'retail' customers.

9.2 The change in default status creates a risk that the Council could lose access to some financial instruments and market participants where the Institutions are not authorised to transact with retail clients, or will charge increased fees for their services.

9.3 Under the regulation authorities may adopt "elective professional" status with FIs. This status is assessed by each FI on the basis of evidence provided by the applicant against criteria set by the FCA. The criteria include the size of the applicant's investment balance, and the knowledge, expertise and experience of its nominated staff.

9.4 The Council is in the process of seeking 'elective Professional status' with FIs where it is necessary to retain access to a market.

9.5 In Order to remain eligible for elective professional status the Council must:
- maintain a balance of at least £10m;
- have at least one officer responsible with at least one year of relevant experience involved in investment decision making.

9.6 The following indicators will be reported to allow the Audit Committee to monitor the ongoing eligibility of the Council for elective professional status and that meets the criteria set by the FCA to elect to be a professional investor:

Table 17 – MiFID Compliance Indicators

(a) Investment Balance at Reporting Date	
Minimum Balance Limit	£10m
Actual Balance (at reporting date)	£xm

(b) Number of Officers with at least 1 Year relevant experience	
Regulatory Requirement	1
Officers Currently Named with FIs	3

10 Treasury Management for Other Organisations

10.1 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).

10.2 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.

10.3 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 Treasury Management Strategy was amended 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 2018/19 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
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 UK Local Authorities with a credit rating will be subject to the lower of the standard Local Authority limit or the limit for Government counterparty for the relevant credit rating shown in Table A.

1.4 **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-	

1.5 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+.

1.6 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.

1.7 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.

1.8 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.

1.9 **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.

The Authority may incur operational exposures to the banking sector through, for example, current accounts, collection accounts and merchant acquiring services. These are not classed as investments, but are still subject to the risk of a bank bail-in. Officers will seek to minimise operational exposure by keeping total operational balances as close to zero as possible. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

1.10 **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.

1.11 **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.

1.12 **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.

1.13 **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.

1.14 **Pooled Funds**
Definition: Shares or units 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.

1.15 **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
Total Exposure to Money Market Funds	A limit will apply to ensure exposure to Money Market Funds is proportionate and avoid excessive concentration in these instruments	£130m total
UK Country Limit	Maximum percentage of portfolio permitted to be in UK institutions	100% investment portfolio
Non-UK Country Limit	Maximum balance permitted to be in non-UK institutions (excluding Money Market Funds)	£70m
Single Non-UK Country	Maximum balance permitted to be in any one country, other than UK	£10m
Sector	A sector limit applies to unsecured investments in Building Societies to limit exposure to a common risk factor – in this case the property market	£30m

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.
- If the Council's own bank were to be downgraded, officers would reduce balances according to the strategy. In the event of a significant downgrading of Barclays, where the bank's credit rating fell below investment grade, officers would reduce balances to minimum operational levels, but it would not be possible to eliminate all exposure to the bank.

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 financial 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 Finance – Pensions and Treasury 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		2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Prudential Indicators					
Section 1.2	Adoption of CIPFA Treasury Management in the Public Service: Code of Practice 2011 edition	✓	✓	✓	✓
1	Capital Expenditure	244,024	264,420	186,570	124,869
3	Capital Financing Requirement (CFR)	642,159	728,330	796,275	831,594
4	Ratio of financing costs to net revenue stream	2.61%	3.13%	3.56%	3.95%
5	Incremental impact of capital investment decisions on Band D Council Tax	(5.30)	(2.27)	4.79	11.41
9	Gross Borrowing	368,628	467,904	550,715	602,724
	Net Borrowing less than CFR	Y	Y	Y	Y
10	Authorised Limit for external debt	545,000	644,500	727,500	780,000
	Operational Boundary for external debt	515,000	614,500	697,500	750,000
Treasury Management Operational and Performance Indicators					
11	Net Limit on Fixed Interest Rates	445,000	544,500	627,500	680,000
	Net Limit on Variable Interest Rates	133,500	184,500	217,500	228,000
12	Maturity Structure of fixed rate borrowing	All Years			
		Lower Limit		Upper Limit	
	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%	
13	Maximum Investments greater than 364 days	50,000	50,000	50,000	50,000
Treasury Management Security Liquidity and Yield Performance Indicators					
Weighted average 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					
MiFID II Compliance Indicators					
	Minimum Investment Balance to remain eligible	£10m			
	Minimum Required Suitably Qualified Officers	1			

Appendix 5 – Regulatory Changes

1 CIPFA Prudential and Treasury Management Codes

1.1 During 2017, CIPFA consulted on proposals to amend the Prudential Code for Capital Finance and the Treasury Management Code of Practice, and that the amended codes would be effective from April 2018. It is expected that the amended codes will be published by the end of the calendar year 2017.

1.2 Underlying the changes is a desire to streamline and improve the focus and reporting, and a recognition that the existing codes need to reflect and support the increasing commercial focus of Local Government and the drive to increased property investment,

1.3 Expected changes to the Prudential Code:

- Introduction of a new "Capital Strategy" which will provide a high level report to Full Council
- Detailed Technical Information to remain in Treasury Strategy, and reporting on this delegated to a Committee
- Changes to mandatory Prudential Indicators.

1.4 Expected changes to the Treasury Code:

- Extending the scope of the code to cover non-treasury investments, such as property, which are held for financial return.
- Ability to delegate TMSS reporting to a Committee
- Changes to the Treasury Management Indicators

2 DCLG Investment Guidance

2.1 DCLG published it's consultation on Proposed Changes to MRP and Investment guidance in December 2017. DCLG expects to implement changes to these documents from April 2018.

2.2 The drivers for the proposals are similar to those underlying the changes to the CIPFA codes outlined above.

- Expected changes to the guidance include a widening of the definition of investments to include "all financial and non-financial assets" held primarily to generate income.
- Extension of the principals of Security, Liquidity and Yield to non-financial investments
- Focus on risk assessment and risk management including competition in markets, barriers to entry and exit.
- Changes to the definition of "borrowing in advance of need".
- New requirements for the training of statutory officers and members to ensure they have the skill and knowledge to make informed investment decisions.

3 Implementation

3.1 This report was prepared prior to the publication of the revised CIPFA codes and final DCLG guidance to be applied from April 2018. It has therefore been prepared on the basis of the existing codes of practice and regulatory guidance from the DCLG.

3.2 Following publication of the new regulations, officers will undertake analyses of the requirements in order to understand what changes are required in order to maintain compliance.

3.3 The late publication of these documents means that is unlikely that it will be possible to understand and incorporate any changes prior to the start of the 2018/19 financial year. As a result any revisions that are required will be brought forward during the year and applied retrospectively. Where transitional arrangements for implementation are outlined they will be observed by officers. If no such guidance is provided any changes to the TMSS will be brought forward in a revised TMSS and Capital Strategy for approval by Full Council.