APPENDIX L

TREASURY MANAGEMENT STRATEGY STATEMENT AND ANNUAL INVESTMENT STRATEGY 2018/19

1. This strategy statement has been prepared in accordance with the Chartered Institute of Public Finance and Accountancy (CIPFA) Treasury Management in the Public Services Code of Practice (the Code). Accordingly, the Council's Treasury Management Strategy will be approved annually by the full Council and there will be quarterly reports to the Corporate Governance Committee. The Corporate Governance Committee will consider the contents of Treasury Management Strategy Statement and Annual Investment Strategy at its meeting to be held on 29th January 2018. The aim of these reporting arrangements is to ensure that those with ultimate responsibility for the treasury management function appreciate fully the implications of treasury management policies and activities, and that those implementing policies and executing transactions have properly fulfilled their responsibilities with regard to delegation and reporting.

The Council has adopted the following reporting arrangements in accordance with the requirements of the revised Code:-

Area of Responsibility	Council/Committee/Officer	Frequency
Treasury Management Policy Statement	Full Council	Annually before start of financial year
Treasury Management Strategy/Annual Investment Strategy	Full Council	Annually before start of financial year
Quarterly treasury management updates	Corporate Governance Committee	Quarterly
Updates or revisions to Treasury Management Strategy/Annual Investment Strategy during year	Cabinet (following consideration by Corporate Governance Committee, wherever practical)	Ad hoc
Annual Treasury Outturn Report	Cabinet	Annually by end of September following year end
Treasury Management Practices	Director of Finance	
Review of Treasury Management Strategy/Annual Investment Strategy	Corporate Governance Committee	Annually before start of financial year and before consideration by full Council, wherever practical
Review of Treasury Management Performance	Corporate Governance Committee	Annually by end of September following year end

Treasury Management Strategy 2018/19

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

The Act therefore requires the Council to set its treasury strategy for borrowing and to prepare an Annual Investment strategy (as required by Investment Guidance issued subsequent to the Act) and this is included as paragraphs 27 – 46 of this strategy; this sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The suggested strategy for 2018/19 in respect of the treasury management function is based upon Officers' views on interest rates, supplemented with leading market forecasts provided by the Council's treasury adviser, Link Asset Services (formerly called Capita Asset Services).

The strategy covers:

- treasury limits in force which will limit the treasury risk and activities of the Council
- the current treasury position
- the borrowing requirement
- Prudential and Treasury Indicators
- policy on borrowing in advance of need
- prospects for interest rates
- the borrowing strategy
- debt rescheduling
- the investment strategy
- creditworthiness policy
- policy on use of external service providers
- the Minimum Revenue Provision (MRP) strategy

Balanced Budget Requirement

3. It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby the increase in charges to revenue from:-

i) increase in interest charges caused by increased borrowing to finance additional capital expenditure, and
ii) any increases in running costs from new capital projects are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

Treasury Limits for 2018/19 to 2021/22

4. It is a statutory duty under Section 3 of the Act and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the “Affordable Borrowing Limit”. In England and Wales the Authorised Limit represents the legislative limit specified in the Act.

The Council must have regard to the Prudential Code when setting the Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax level is ‘acceptable’.

Whilst termed an “Affordable Borrowing Limit” the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and three successive financial years. Details of the Authorised Limit can be found in annex 2 of this report.

Current Portfolio Position

5. The Council’s treasury portfolio position at 31st December 2017 was:

		Principal £m	Average Rate %
Fixed Rate Funding	PWLB	161.10	6.773
	Market	103.50	4.374
Other Long Term Liabilities		0.00	
		264.60	5.834
Total Investments		193.70	0.670
Net debt		70.90	

The market debt relates to structures referred to as LOBOs (Lenders Option, Borrowers Option), where the lender has certain dates when they can increase the interest rate payable and, if they do, the borrower has the option of accepting the new rate or repaying the loan. All of these LOBOs have passed the first opportunity for the lender to change the rate and as a result they are all classed as fixed rate funding, even though, in theory, the rate could change in the future.

Borrowing Requirement

6. It is not currently anticipated that the Council will take out any net new borrowing in the period covered by the Medium Term Financial Strategy (i.e. 2018/19 – 2021/22), and it is also expected that maturing loans will not be replaced. In recent years the Council has moved from a position of funding a reasonable proportion of its historic capital expenditure internally (i.e. by using cash resources that would otherwise be available to lend on money markets) at a cost of the loss of interest that would otherwise have been earned, to the current

position whereby external debt is greater than the Capital Financing Requirement.

7. There are a number of reasons that the Council is in an ‘overborrowed’ position but among them are the relatively small size of the capital programme in recent years and the lack of unsupported borrowing within it, a move by Central Government to switch capital approvals (which required external debt to be raised) to grants and the meaningful levels of voluntary Minimum Revenue Provision (MRP) that have been applied in recent years..

8. The table below shows how the Capital Financing Requirement is expected to change over the period of the MTFS, and how this compares to the expected level of external debt. Although the level of actual debt exceeds the Capital Financing Requirement and will increase further in future years it is currently prohibitively expensive to prematurely repay existing debt. If there are cost-effective opportunities to avoid, or reduce, an overborrowed position they will be considered as long as they are in the best long-term financial interests of the Council. This will probably require both short and long-term borrowing rates to increase meaningfully from their current level.

	2018/19 £000	2019/20 £000	2020/21 £000	2021/22 £000
Opening Capital Financing Requirement	**256,920**	**246,534**	**236,543**	**230,069**
New Borrowing	0	0	0	0
Statutory Minimum Revenue Provision (MRP)	(10,386)	(9,991)	(6,474)	(6,476)
Voluntary MRP	0	0	0	0
Closing Capital Financing Requirement	**246,534**	**236,543**	**230,069**	**223,593**
Opening external debt	**264,600**	**264,100**	**263,600**	**263,100**
Loans maturing	(500)	(500)	(500)	(500)
Closing external debt	**264,100**	**263,600**	**263,100**	**262,600**
Overborrowed/(borrowing requirement)	**17,566**	**27,057**	**33,031**	**39,007**

It should be noted that from the 2020/21 financial year it is proposed to amend the method of calculating the MRP amount, which is part of the proposals for savings within the budget. Further detail on the change can be found in Annex 1 to this report.

<u>Prudential and Treasury Indicators for 2018/19 – 2021/22</u>

9. Prudential and Treasury Indicators (as set out in the tables in Annex 2 to this report) are relevant for the purpose of setting an integrated treasury management strategy.

The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management, and this was adopted in February 2010.

Prospects for Interest Rates

10. The Bank of England raised interest rates to 0.5% from an all-time low of 0.25% in November 2017, which was the first increase in over 10 years. The Bank of England is very keen to give clear guidance to markets about the likely timing and extent of future base rate movements and there is currently an expectation of one further 0.25% increase in both 2018 and 2019.

11. Global economic growth has been relatively strong and, for the first time in many years, synchronised. The UK, whilst continuing to grow, is currently something of a laggard from a growth perspective and is likely to remain so whilst the significant Brexit-related doubts persist. It is likely that Central Banks will be returning monetary policy to more 'normal' operations in the near future – for some this will mean the withdrawal of quantitative easing and other forms of support before it feeds through into base rate rises. Given that the biggest risk to global growth is probably a policy error by Central Banks, it seems likely that they will be cautious in taking action and will wait for clear evidence of the need for it before any changes are made.

12. The range of forecasts produced by economists in respect of UK base rate rises is relatively narrow, with very few predicting meaningful increases in bank base rates over the next 2 – 3 years. There is, of course, a possibility that the negotiations over Brexit may prove easier or more difficult than is currently assumed, so there is the prospect of these expectations changing. It is, however, very difficult to foresee circumstances that do not involve base rates staying very low for the next few years.

Borrowing Strategy

13. The outlook for borrowing rates - which are linked to Government bond (gilt) yields – is difficult to predict. Gilt yields have risen steadily from the multi-generational lows reached in the wake of the Brexit vote, but they are still very low by historic standards. UK Gilts will react not only to the UK economic situation, but also to movements in global bond markets, and Governments/Central Banks are very wary of sharply rising bond yields because of the knock-on effect this is likely to have on to other investment markets and potentially the economy. Whilst most investors expect bond yields to continue to trend upwards at a controlled pace, any setback in economic growth (not just in the UK, but also globally) may cause bond yields to fall.

14. The biggest external factor that is likely to influence gilt yields is the likely expansion of government spending within the US. President Trump has so far been frustrated in many of his attempts to raise spending (particularly on infrastructure), but may ultimately be able to push his policies through. Increased infrastructure spend would lead to an increase in the supply of US Treasury Bonds, and potentially to an excess of supply over demand, which would place upward pressure onto yields and have a potential knock-on impact to government bond yields elsewhere. Bond yields react to numerous other factors, however, and movements in them often defy any supposition about how they will react to events.

15. Although borrowing from the Public Works Loans Board (PWLB) is still generally the most attractive external option available to the authority, the current overborrowed position makes the use of external borrowing unlikely. Even if the outlook for an overborrowed position changes, which is only likely if significant repayments of existing debt happens, the use of internal borrowing via available cash flows and balances (at a cost of the interest which would otherwise have been gained by lending the money to acceptable counterparties) is a more likely option.

16. Borrowing rates very rarely move in one direction without there being periods of volatility, and it is sensible to maintain a flexible and proactive stance towards when borrowing should be carried out (if, indeed, any borrowing is taken). Likewise it is sensible to retain flexibility over whether short, medium or long-term funding will be taken and whether some element of variable rate funding might be attractive. Any borrowing carried out will take into account the medium term costs and risks and will not be based on minimising short term costs if this is felt to compromise the medium term financial position of the Council.

External v Internal Borrowing

17. The Council currently has significant cash balances invested, and at the end of December 2017 these stood at £193.7m. These balances relate to a number of different items – earmarked funds, provisions, grants received in advance of expenditure, money invested on behalf of schools and simple cash flow are some of them. A growing source of cash balances relates to the overborrowed position outlined in paragraph 8. Without a significant increase in interest rates the overborrowing is forecast to grow to £160m by 2047. To avoid the value of this cash asset being eroded by inflation opportunities will be sought to improve the return received whilst keeping the risk to capital at a low level. Depending upon the investment approach chosen this could give rise to a requirement for internal borrowing. Therefore the Capital Financing Requirement indicator in Annex 2 is set at a level higher than the forecast requirement in paragraph 8, to provide capacity for internal borrowing.

18. The Council has, since January 2009, repaid almost £95m more of external loans than has been borrowed. There has also been no new borrowing to finance the capital programme over this period, and there is no longer any internal funding of the historic capital programme using other cash resources – in fact, the Council has more external borrowing than is required to fund the historic capital programme. In an ideal world action would be taken to ensure that an overborrowed position does not occur, but the reality is that this could only happen by the premature repayment of existing debt and this is currently not a cost-effective option. If an opportunity to repay debt occurs that is sensible from a financial perspective, it will be taken.

19. The balance between internal and external borrowing will be managed proactively, with the intention of minimising long-term financing costs. Short-term savings which involve undue risk in respect of long-term costs will not be considered.

Policy on borrowing in advance of need

20. The Council will not borrow in advance of need simply to benefit from earning more interest on investing the cash than is being paid on the loan. If value for money can be demonstrated by borrowing in advance this option may be taken, but only if it is felt that the money can be invested securely until the cash is required.

21 In determining whether borrowing will be taken in advance of the need the Council will;

- ensure that there is a clear link between the capital programme and maturity profile of existing debt which supports taking financing in advance of need
- ensure that the revenue implications of the borrowing, and the impact on future plans and budgets have been considered
- evaluate the economic and market factors which might influence the manner and timing of any decision to borrow
- consider the merits (or otherwise) of other forms of funding
- consider a range of periods and repayment profiles for the borrowing.

22. The current position in respect of the level of actual borrowing in comparison to the Capital Financing Requirement, and a move by Central Government to replace borrowing approvals for capital projects with grants, makes it extremely unlikely that borrowing in advance of need will be used in the foreseeable future.

Debt Rescheduling/Premature Debt Repayment

23. Debt rescheduling usually involves the premature repayment of debt and its replacement with debt for a different period, to take advantage of differences in the interest rate yield curve. The repayment and replacement does not necessarily have to happen simultaneously, but would be expected to have occurred within a relatively short period of time.

24. If medium and long-term loan rates rise substantially in the coming years, there may be opportunities to adjust the portfolio to take advantage of lower rates in shorter periods. It is important that the debt portfolio is not managed to maximise short-term interest savings if this is felt to be overly risky, and a maturity profile that is overly focussed into a single year will be avoided. Changes in recent years to the way that PWLB rates are set, and the introduction of a significant gap between new borrowing costs and the rate used in calculating premia/discounts for premature debt repayments, significantly reduces the probability of debt rescheduling being attractive in the future.

25. If there is meaningful increase in medium and long-term premature repayment rates there is a possibility that premature repayment of existing debt (without any replacement) might become attractive, particularly given the current overborrowed position. This type of action would only be carried out if it was considered likely to be beneficial in the medium term.

26. All debt rescheduling or premature repayments will be reported to the Corporate Governance Committee at the earliest meeting following the action.

Annual Investment Strategy

Investment Policy

27. The Council will have regard to the DCLG's Guidance on Local Authority Investments ("the Guidance") issued in March 2004, any revisions to that guidance, the Audit Commission's report on Icelandic investments and the 2009 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). The Council's investment priorities are:-

    - the security of capital and
    - the liquidity of its investments

28. The Council will aim to achieve an optimal return on its investments that is commensurate with proper level of security and liquidity. The risk appetite of this Council is low in order to give priority to security of its investments. Borrowing money purely to invest or on-lend is unlawful and this Council will not engage in such activity.

29. The Council's policy in respect of deciding which counterparties are acceptable has always been stringent, and is one reason that the various financial organisations that have got into financial difficulties over the years (BCCI, Northern Rock, the Icelandic Banks etc.) have not been on the list of acceptable counterparties.

30. In broad terms the list of acceptable counterparties uses the list produced by Link Asset Services (the Council's treasury management advisor) but excludes any party that is included in the Link list with a maximum loan maturity period of 100 days or less. All counterparties are also restricted to a maximum loan period of one year. There are also other factors taken into account which dictate the maximum value of loans to any counterparty, together with limits on maximum exposure to all counterparties from the same country (with the exception of the UK, where there is no maximum country-level limit).

31. The combination of all these factors produces a counterparty list that comprises only very secure financial institutions, and a list that is managed pro-actively as new information is available. There are no recommended changes to the methods of compiling the counterparty list.

32. The investment instruments identified for use in the financial year are listed below. The limits for both maximum loan periods and amounts will be set in line with the criteria shown in annex 3. This list has changed from the one that was approved as part of the 2016/17 Annual Investment Strategy; the ability to invest in pooled private debt funds has been added (considered by Corporate Governance Committee and approved by Cabinet late in 2017), and the ability to invest in Money Market Funds (MMFs) has been expanded to take account of the fact that there will be changes to this sector of the market from July 2018.

33. At present the Council will only invest in MMFs that are classed as Constant Net Asset Value (CNAV); these are Funds in which the capital valuation of a unit will always be maintained at £1. From July 2018 only MMFs that maintain at least

99.5% of their assets in government backed assets will be able to classify themselves as CNAV Funds. The nature of the assets that these MMFs hold will mean that the returns available from them are unlikely to be attractive to the Council.

34. Low Volatility Net Asset Value (LVNAV) MMFs will be introduced and these Funds will be permitted to maintain the unit price at £1 as long as the net asset value does not deviate by more than 0.20% from this level – the current rules allow maintenance of a constant net asset value at a deviation of up to 0.5%. The MMFs currently utilised by the Council are unlikely to have any problem with the lower level of allowed deviation, and are expected to be reclassified as LVNAV.

35. Variable Net Asset Value (VNAV) MMFs already exist, and these Funds will value their units on the basis of the underlying value of the assets that they hold; the unit price will not necessarily always be exactly £1. Investing in this type of MMF gives the possibility of a capital gain or loss when redeeming units, although the reality is that they almost always have a unit price which is very close to £1. The upside of this type of MMF is that they are allowed greater flexibility around the periods for which they can invest, and hence they tend to produce a noticeably better level of interest for the investor; the most obvious downside is the possibility of realising a capital loss.

36. While it is not currently considered likely that VNAV MMFs will be used for Treasury Management purposes, they have been added to the list. There may be circumstances whereby the additional income yield is considered more-than-sufficient compensation for the risk of a potential (but small) loss of capital. The Council also has sufficient cash resources that it is likely to be able to retain an investment in a VNAV MMF until such time as a redemption can be made without a capital loss. In the near term a ‘watching brief’ will be kept on VNAV MMFs and no investment will be considered until such time as Officers are comfortable that the potential rewards outweigh the risks.

37. There is a requirement within the Annual Investment Strategy to state which of the approved methods of lending are specified, and which are non-specified. In broad terms a specified investment will be capable of repayment within one year and be made to a counterparty with a high credit rating; by implication non-specified investments are more risky than specified investments as they are either for longer periods of time or to lower-quality counterparties. Anything that does not meet either of these ‘tests’ is, by default, non-specified and must be highlighted as such within the Strategy. The long-term nature of the ‘LOBO-offset’ loan to Danske Bank means that it is non-specified investment, although the off-setting nature of the borrowing and the loan actually makes it low risk. Investment in pooled private debt funds is also non-specified, primarily due to the illiquid and medium-term nature of the investment.

Investment	Repayment within 12 months	Level of Security	Maximum Period	Maximum % of Portfolio or cash sum (1)
Term deposits with the Debt Management Office	Yes	Government-Backed	1 year	100
UK Government Treasury Bills	Yes	Government-Backed	1 year	100
Term deposits with credit-rated institutions with maturities up to 1 year*	Yes	Varied acceptable credit ratings, but high security	1 year	100
Term deposits that are legally capable of offset against existing LOBO borrowing that the Council has^	No	Varied, but off-setting nature of borrowing against loan gives a very low risk	20 years	25
Money Market Funds: Constant NAV Low Volatility NAV	Yes	At least as high as acceptable credit – rated banks	Daily, same-day redemptions and subscriptions	£125m (includes any investment in variable NAV MMFs)
Variable NAV Money Market Funds	Yes	At least as high as acceptable credit – rated banks	Same day subscriptions, 2 – 3 day redemption period	£125m (includes any investment in other MMFs)
Pooled private debt funds^	No	Diversification within pooled fund and historic loss rate suggests high security	Varies across funds – likely to be at least a three year investment period, followed by a further three years to redeem all loans	£40m
Term Deposits with UK Local Authorities up to 1 year	Yes	LA's do not have credit ratings, but high security	1 year	50
Certificates of Deposit with credit-rated institutions with maturities of up to 1 year	Yes	Varied acceptable credit ratings, but high security	1 year	100

(1) As the value of the investment portfolio is variable, limit applies at time of agreeing investment. Subsequent changes in the level of the portfolio will not be classed as a breach of any limits.

^ Non-specified investment

* For the sake of clarity, if a forward deal (one where the start of the investment is at some future date) is agreed, the maximum period commences on the first date of investment.

Local Authority Mortgage Scheme
Under this scheme the Council has a current investment of £5m (@ 31/12/17), for a period of up to 5 years. This is classified as being a service investment, rather than a treasury management investment.

Leicestershire Local Enterprise Fund
Up to £1m has been made available for loans to small and medium-sized Leicestershire businesses via this Fund, which is administered by Funding Circle. This is classified as being a service investment, rather than a treasury management investment. This Fund is in the process of being wound-down as there is no longer evidence of financial support from the Council being required

Pooled property fund investment
As at the end of December 2017 £20m had been invested. A further £5m has been agreed for investment but transactions had not been entered into to action this. This is classified as a service investment, rather than a treasury management investment.

Creditworthiness policy

38. The Council adopts the suggested counterparty list as produced by Link Asset Services, subject to a maximum one year loan period and the exclusion of any counterparty with a suggested maximum loan period of 100 days or less. Link's methodology includes the use of credit ratings from S & P, Fitch and Moody's, factors such as credit outlook reports from the credit rating agencies, the rating of the sovereign government in which the counterparty is domiciled and the level of Credit Default Swap spreads within the market (effectively the market cost of insuring against default). The general economic climate is also considered and will, on occasions, have an impact onto the list of suggested counterparties.

39. Link Asset Services issue very timely information in respect of changes to credit ratings or outlooks, and changes to their suggested counterparty list are also issued. These reports are monitored within a short time of receipt and any relevant changes to the counterparty list are actioned as quickly as is practical. A weekly summary of the credit ratings etc. of counterparties is also issued and this gives an opportunity to ensure that no important information has been missed.

Country Limits

40. The Capita criteria includes a requirement for the country of domicile of any counterparty to be very highly rated. This is a requirement on the basis that it will probably be the national government which will offer financial support to a failing bank, but the country must itself be financially able to afford the support. The Council's list of acceptable counterparties will include a limit on the maximum amount that can be invested in all counterparties domiciled in a single country (except for the UK) in order to mitigate sovereign risk.

Investment Strategy

41. The investment strategy shall be to only invest in those institutions and/or asset types that are included in the counterparty list, and only to lend up to the limit set for each counterparty. Periods for which loans are placed will take into account the outlook for interest rates and, to a lesser extent, the need to retain cash flows. There may be occasions when it is necessary to borrow to fund short-term cashflow issues, but there will generally be no deliberate intention to make regular borrowing necessary.

Policy on the use of external service providers

42. External investment managers will not be used, except to the extent that a Money Market Fund or the managers of pooled property or private debt funds can be considered as an external manager.

43. The Council uses Link Asset Services as its external treasury management adviser, but recognises that responsibility for treasury management decisions remains with the organisation at all times. Undue reliance on our external advisers will be avoided, although the value of employing an external adviser and accessing specialist skills and resources is recognised.

Scheme of Delegation

44. (i) Full Council
- Approval of annual strategy
- Other matters where full Council approval is required under guidance or statutory requirement

(ii) Cabinet
- Approval of updates or revisions to strategy during the year
- Approval of Annual Treasury Outturn report

(iii) Corporate Governance Committee
- Mid-year treasury management updates (usually quarterly)
- Review of treasury management policy and procedures, including making recommendations to responsible body
- Scrutiny of Treasury Management Strategy/Annual Investment Strategy and Annual Treasury Outturn report.

(iv) Director of Finance
- Day-to-day management of treasury management, within agreed policy
- Appointment of external advisers, within existing Council procurement procedures

Role of Section 151 Officer

45. The Section 151 Officer is the Director of Finance, who has responsibility for the day-to-day running of the treasury management function.

Pension Fund Cash

46. This Council will comply with the requirements of The Local Government Pension Scheme (Management and Investment of Funds) Regulations 2009, which were implemented on 1st January 2010, and will not pool pension fund cash with its own cash balances for investment purposes. Any investments made by the pension fund directly with the County Council after 1st April 2010 will comply with the requirements of SI 2009 No 393.

ANNEX 1

ANNUAL STATEMENT FOR THE DETERMINATION OF THE ANNUAL MINIMUM REVENUE PROVISION (MRP)

Statutory regulations introduced in 2008 require local authorities to make prudent provision for the repayment of debt raised to finance capital expenditure. In addition a statement of the level of MRP has to be submitted to the County Council for approval before the start of the next financial year.

Prudent Provision.

The definition of what is prudent provision is determined by each local authority based on guidance rather than statutory regulation

It is proposed that provision is made on the following basis:

Government supported borrowing (through the formula grant system):

Retention of the pre 2003 arrangements whereby provision for repayment is based on 4% of outstanding debt (i.e. repayment over approximately 25 years) including an optional adjustment used in the transition to the new system in 2004 to avoid debt repayment being higher than under the previous system.

Prudential (unsupported) borrowing and expenditure capitalised by direction of the Secretary of State and certain other expenditure classified as capital incurred after 1st April 2008:

Provision to be based on the estimated life of the asset to be financed by that borrowing, with repayment by equal annual instalments.

The County Council will also look to take opportunities to use general underspends and one-off balances to make additional (voluntary) revenue provision where possible to reduce ongoing capital financing costs.

Financial Implications

MRP is a constituent of the Financing of Capital budget shown within Central Items component of the revenue budget and for 2018/19 totals £10.4m. This comprises £10m in respect of supported borrowing and £0.4m in respect of unsupported borrowing incurred since 2008/9.

The extent of unsupported borrowing required to finance the capital programme is not directly linked to any specific projects thus in determining the average life of assets an average of 25 years has been taken as proxy for the average life of assets contained within the discretionary component of the Capital Programme.

ANNEX 2

PRUDENTIAL AND TREASURY INDICATORS

In line with the requirements of the CIPFA Prudential Code for Capital Finance in local authorities, the various indicators that inform authorities whether their capital investment plans are affordable, prudent and sustainable, are set out below.

A further key objective of the code is to ensure that treasury management decisions are taken in accordance with good professional practice and in a manner that supports prudence, affordability and sustainability. The indicators for Treasury management are set out in this paper.

Compliance with the Code is required under Part I of the Local Government Act 2003.

	2016/17 Actual	2017/18 Estimate	2018/19 Estimate	2019/20 Estimate	2020/21 Estimate	2021/22 Estimate
Capital Expenditure	£99m	£83m	£122m	£119m	£68m	£59m
Capital financing requirement	£268m	£257m	£257m	£257m	£257m	£257m
Ratio of total financing costs to net revenue stream	7.19%	5.94%	5.54%	5.62%	4.75%	4.81%
Impact on Band D Council Tax of unsupported borrowing	£3.89	£3.72	£3.55	£3.42	£3.30	£2.96

The projected level of capital expenditure shown above differs from the total of the detailed four year programme presented in this report as an allowance has been provided to cover estimated additional expenditure that may occur during the course of a year, for instance projects funded by government grants, section 106 contributions and projects funded from the future developments programme. Capital expenditure for 2020/21 to 2021/22 is less than earlier years as government funding for Children and Family Services has not yet been announced.

The capital financing requirement (CFR) measures the Authority's need to borrow for capital purposes and as such is influenced by the availability of capital receipts and income from third parties, e.g. grants and developer contributions. The estimates are higher than the amounts shown in the main Treasury Management Strategy as they include provision to potentially use part of the over borrowed position (compared with actual debt). This would provide flexibility to raise prudential borrowing (funded from internal borrowing) to fund future capital developments and the Corporate Asset Investment Fund if needed.

The prudential code includes the following as a key indicator of prudence:

'In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that net external borrowing does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years'. In the medium term this indicator will not be met due to the reduction in the capital financing requirement in recent years and the currently prohibitively expensive premiums to repay existing debt. The Council will consider options to reduce this position where they are in the long term financial interests of the Council. Further details are included in the main Treasury Management Strategy Statement and Annual Investment Strategy 2018/19.

The key indicator of affordability is the impact of capital expenditure on Council Tax. The indicator falls gradually over the periods shown reflecting the decision for no new unsupported borrowing from external loans.

In respect of external debt, it is recommended that the Council approves the limits detailed in the tables below for its total external debt for the next four financial years. These limits separately identify borrowing from other long term liabilities such as finance leases. The Council is asked to approve these limits and to delegate authority to the Director of Finance, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities. Any such changes made will be reported to the Cabinet at its next meeting following the change.

There are two limits on external debt: the 'Operational Boundary' and the 'Authorised Limit'. Both are consistent with the current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with approved treasury management policy statement and practices. They are both based on estimates of most likely, but not worst case, scenario. The key difference is that the Authorised Limit cannot be breached without prior approval of the County Council. It therefore includes more headroom to take account of eventualities such as delays in generating capital receipts, forward borrowing to take advantage of attractive interest rates, use of borrowing in place of operational leasing, "invest to save" projects, occasional short term borrowing to cover temporary revenue cash flow shortfalls as well as an assessment of risks involved in managing cash flows. The Operational Boundary is a more realistic indicator of the likely position.

Operational boundary for external debt

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Borrowing	264.6	264.1	263.6	263.1
Other long term liabilities	1.3	1.2	1.1	1.0
Total	**265.9**	**265.3**	**264.7**	**264.1**

Authorised limit for external debt

	2018/19 £m	2019/20 £m	2020/21 £m	2021/22 £m
Borrowing	274.6	274.1	273.6	273.1
Other long term liabilities	1.3	1.2	1.1	1.0
Total	**275.9**	**275.3**	**274.7**	**274.1**

In agreeing these limits, the Council is asked to note that the authorised limit determined for 2018/19 will be the statutory limit determined under Section 3(1) of the Local Government Act 2003.

Comparison of original 2017/18 indicators with the latest forecast

In February 2017 the County Council approved certain prudential limits and indicators, the latest projections of which are shown below:

	Prudential Indicator 2017/18	Latest Projection 18/01/18
Actual Capital Financing Costs as a % of Net Revenue Stream	5.95%	5.94%
Capital Expenditure	£83m	£83m
Operational Boundary for External Debt	£275.9m	£275.9m
Authorised Limit for External Debt	£285.9m	£285.9m
Interest Rate Exposure – Fixed	50-100%	100%
Interest Rate Exposure – Variable	0-50%	0%
Capital Financing Requirement	£257m	£257m

The latest forecast of external debt, £264.6m, shows that it is within both the authorised borrowing limit and the operational boundary set for 2017/18. The maturity structure of debt is within the indicators set. The latest projection for capital expenditure is in line with the indicator set.

Treasury Management Indicators
The Local Government Act 2003 requires the County Council to ensure that treasury management is carried out with good professional practice. The Prudential Code includes the following as the required indicators in respect of treasury management:

a) Upper limits on fixed interest and variable rate external borrowing.
b) Upper and lower limits for the maturity structure of borrowings.
c) Upper limit for principal sums invested for periods longer than 364 days.

After reviewing the current situation and assessing the likely position next year, the following limits are recommended:

a) An upper limit on fixed interest rate exposures for 2018/19 to 2021/22 of 100% of its net outstanding principal sums and an upper limit on its variable interest rate exposures for 2018/19 to 2021/22 of 50% of its net outstanding principal sums.

b) Upper and lower limits for the maturity structure of its borrowings as follows: Amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate:

	Upper Limit %	Lower Limit%
under 12 months	30	0
12 months and within 24 months	30	0
24 months and within 5 years	50	0
5 years and within 10 years	70	0
10 years and above	100	25

c) An upper limit for principal sums invested for periods longer than 364 days is 0% of the portfolio.

The County Council has adopted the CIPFA code of Practice for Treasury Management in the Public Services.

ANNEX 3

POLICY ON APPROVED ORGANISATIONS FOR LENDING

APPROVED ORGANISATIONS FOR LENDING

Institution	Maximum Sum Outstanding/Period of Loan
UK Clearing Banks and UK Building Societies*	£20m/6 months up to £50m/12months
UK Debt Management Office	No maximum sum outstanding/12 months
UK Government Treasury Bills	No maximum sum outstanding/12 months
Foreign Banks	£10m/6 months up to £15m/12 months
Money Market Funds	£25m limit within any AAA-rated fund. £125m maximum exposure to all Money Market Funds
UK Local Authorities	£10m/12 months

*In the event that an investment is entered into which is legally offset against borrowing in the form of a LOBO (Lender's Option, Borrower's Option) from the same counterparty, the maximum period will be 20 years and the maximum sum will be the amount of the LOBO deal against which the legal offset exists.

The list of acceptable institutions will mirror the list of suggested counterparties maintained by Capita Asset Services, except the maximum maturity period will be restricted to 1 year and no institution with a suggested maturity period of 100 days or less will be excluded.

LIMITS FOR INDIVIDUAL FINANCIAL INSTITUTIONS

UK Banks and Building Societies

Maximum Sum Outstanding	£50m	£30m	£20m
Maximum Loan Period	1 year	1 year	6 months
General description	'Special Institutions' (i.e. a significant element of UK-Government ownership) and included in Capita list for period of 1 year or more	Not 'special institutions' and included in Capita list for period of 1 year or more	Included in Capita List for period of 6 months

Overseas Banks

Maximum Sum Outstanding	£15m	£10m
Maximum Loan Period	1 year	6 months
Minimum Fitch Ratings	Included in Capita list for period of 1 year or more	Included in Capita List for period of 6 months

A maximum of £30m can be invested with all banks domiciled within a single country (note: there is no limit for total lending to UK financial institutions).

Some financial institutions have both a parent company and a subsidiary that are licensed deposit takers in the UK. Where this is the case a ‘group limit’ will apply, and this will be the limit that is given to the parent company.

In some cases the parent company will be an overseas institution and they will have UK-registered subsidiaries. Where this is the case the parent company limit will apply at a total group level, even if this limit is less than would be given to the UK subsidiary on a stand-alone basis. Any money invested with a UK subsidiary of an overseas institution will be classed as being invested in the country of domicile of the parent, if the parent is an overseas institution for country-maximum purposes.

If the credit rating of an individual financial institution decreases to a level which no longer makes them an acceptable counterparty the Director of Finance will make a decision on what action to take. Similar actions will be taken if a counterparty is downgraded to a level which allows them to remain on the list of acceptable counterparties, but where the unexpired term of any loan is longer than the maximum period for which a new loan could be placed with them.

In the event that the circumstances highlighted in the above paragraph occur, the Director of Finance will report his decision to the Cabinet and/or Corporate Governance Committee when it is deemed significant enough to do so. If there is considered to be no meaningful risk involved, relative to agreeing a new loan of the outstanding maturity period to the same counterparty, the decision will not be reported.

It should be noted that there will be no legal right to cancel a loan early, and any premature repayment can only be made with the approval of the counterparty and may include financial penalties.

ANNEX 4

TREASURY MANAGEMENT POLICY STATEMENT (TMPS)

1. This organisation defines its treasury management activities as:

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

2. This organisation regards the successful identification, monitoring and control of risk to be the prime criteria by which the effectiveness of its treasury management activities will be measured. Accordingly, the analysis and reporting of treasury management activities will focus on their risk implications for the organisation.

3. This organisation acknowledges that effective treasury management will provide support towards the achievement of its business and service objectives. It is therefore committed to the principles of achieving value for money in treasury management, and to employing suitable comprehensive performance measurement techniques, within the context of effective risk management.

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