Havering
LONDON BOROUGH

CABINET
8 February 2017

Subject Heading:	Treasury Management Strategy Statement, Prudential Indicators and Minimum Revenue Provision Statement for 2017/18
Cabinet Member:	Cllr Clarence Barrett
CMT Lead:	Debbie Middleton
Report Author and contact details:	Stephen Wild Head of Pensions & Treasury 02033 733881
Policy context:	The Council is required to formally approve the Treasury Management Strategy Statement, Prudential Indicators and the Minimum Revenue Provision Statement following recommendation from Cabinet
Financial summary:	The Treasury Management Strategy forms part of the Council's overall budget strategy and financial management framework.
Is this a Key Decision?	No
Is this a Strategic Decision?	Yes
When should this matter be reviewed?	Annually
Reviewing OSC:	Audit Committee

The subject matter of this report deals with the following Council Objectives

Havering will be clean and its environment will be cared for	[]
People will be safe, in their homes and in the community	[]
Residents will be proud to live in Havering	[X]

SUMMARY

In February 2011 the Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Council to approve a treasury management strategy before the start of each financial year.

In addition, the Department for Communities and Local Government (CLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the Council to approve an investment strategy before the start of each financial year.

This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA code and CLG guidance

The Council is also required to receive and approve, as a minimum, three main reports each year, which incorporate a variety of policies, estimates and actuals.

Treasury Management Strategy Statement (This report) - The first, and most important report covers:

- The borrowing and investment strategies
- Treasury Management indicators
- Prudential Indicators
- a Minimum Revenue Provision Policy (The means by which capital expenditure which is financed from borrowing is paid for by council tax payers)

Mid Year Treasury Review – This will provide an update on the prudential and treasury indicators and will include information on the current treasury position.

An Annual Treasury Report – This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

RECOMMENDATIONS

1. Cabinet to approve the Treasury Management Strategy Statement (TMSS)

2. Cabinet to approve the Prudential Indicators set out in appendix B of this report

3. Cabinet to approve the Annual Minimum Revenue Provision statement for 2017/18 set out in appendix C of this report.

4. Cabinet recommend the annual TMSS and MRP statements 2017/18 to Council for approval.

REPORT DETAIL

Introduction

1.1 CIPFA defines treasury management as:

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

1.2 The Council is required to operate a balanced budget, which broadly means that cash received during the year will meet cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in low risk counterparties or instruments commensurate with the Council’s low risk appetite, providing adequate liquidity initially before considering investment return.

1.3 The second main function of the treasury management service is the funding of the Council’s capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning to ensure that the Council can meet its capital spending obligations. This management of longer term cash may involve arranging long or short term loans, or using longer term cash flow surpluses. On occasion any debt previously drawn down may be restructured to meet Council risk or cost objectives.

Local Context

2.1 At 31/12/2016 the Council had £210m of long term borrowing and £235m of investments. This is set out in further detail in Table 1 below.

Table 1 – Existing Investment & Debt Portfolio Position

	31/12/2016 **Actual Portfolio** **£m**	31/12/2016 **Average Rate** **%**
Long Term Borrowing:		
PWLB – Fixed Rate	203.2	
PWLB – Variable Rate	0	
Local Authorities	0	
LOBO Loans	7.0	
Total Long Term Borrowing	**210.2**	**3.59%**
Short Term Borrowing		
Local Authorities	10.0	
Other	0.3	
Total Short Term Borrowing	**10.3**	**0.30%**
Investments:		
Short-term investments	195.3	
Long-term investments	40.0	
Total Investments	**235.3**	**0.66%**
Net Investments	**14.8**	

2.2 The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing, subject to holding a minimum investment balance of £30m.

2.3 CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Table 2 below sets out the balance sheet summary at 31/03/2016 and based on the Council's plans, the estimated balance sheet summary for the next 4 years. The table demonstrates compliance with this requirement, with external borrowing forecast to be £256m by 31 March 2020 compared to a CFR of £342m.

Table 2: Balance Sheet Summary and Forecast

	31.3.16 Actual £m	**31.3.17 Estimate £m**	**31.3.18 Estimate £m**	**31.3.19 Estimate £m**	**31.3.20 Estimate £m**
General Fund CFR	60	76	98	116	133
HRA CFR	175	175	184	194	209
Total CFR	**235**	**251**	**282**	**310**	**342**
Borrowing CFR	**235**	**251**	**282**	**310**	**342**
Less: External borrowing **	-213	-210	-210	-210	-256
Internal borrowing	**22**	**41**	**72**	**100**	**86**
Less: Usable reserves	-206	-187	-145	-115	-98
Less: Working capital	-18	-18	-18	-18	-18
Investments	**202**	**164**	**91**	**33**	**30**

2.5 Based on the above projections the Council will need to undertake additional borrowing of £46m in 2019/20 to keep forecast Investments balances at £30m.

2.6 The Council has an increasing GF CFR due to its decision in February 2016 to approve £100m of capital expenditure for regeneration and development financed by prudential borrowing. The HRA CFR is also set to increase up to its maximum borrowing headroom of £209m to finance the HRA capital programme.

Borrowing Strategy

3.1 The Council currently holds £210m of long term loans, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 2 above, shows that the Council does not expect to need to borrow externally in 2017/18 however, based on current forecasts of planned capital expenditure there will be a requirement to borrow in the region of £46m in 2019/20. A review of the medium term capital strategy during 2017 will further inform this forecast. Decisions over future external borrowing as opposed to increasing the amount of internal borrowing will be periodically assessed and will be taken dependent upon changes in market conditions and future capital plans.

3.2 The Council's primary objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term plans change is a secondary objective.

3.3 Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.

3.4 By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Whilst such a strategy is most likely to be beneficial over the next 2-3 years as interest rates remain low, it is unlikely to be sustained in the medium-term. It is therefore important that consideration is given to the development of a medium term capital programme to ensure robust financial planning through the integration of the capital investment strategy an the treasury management strategy. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise. The Council employs expert treasury management advisers Arlingclose in relation to the development and management of its treasury strategy. The advisers will support Council with this 'cost of carry' and breakeven analysis. Its output may determine whether the Council borrows additional sums at long-term fixed rates in 2017/18 with a view to keeping long term interest costs low, recognising that this may causes a short term increase in interest costs.

3.5 In addition to long term borrowing, the Council may borrow short-term loans (normally for up to three months) to cover unexpected cash flow shortages.

The approved sources of long-term and short-term borrowing are:

- Public Works Loan Board (or its successor body)
- UK local authorities
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- UK Municipal Bonds Agency plc and other special purpose companies created to enable local authority bond issues.

3.6 The Council has previously raised the majority of its long-term borrowing from the Public Works Loan Board, but it continues to investigate other sources of finance, such as local authority loans and bank loans, that may be available at more favourable rates.

3.7 The Council holds a £7m LOBO (Lender's Option Borrower's Option) loan where the lender has the option to propose an increase in the interest rate at set dates, following which the Council has the option to either accept the new rate or to repay the loan at no additional cost. The LOBO has this option again during 2017/18, and although the Council understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Council may take the option to repay LOBO loans at no cost if it has the opportunity to do so.

3.8 Short-term and variable rate loans leave the Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

3.9 Debt Rescheduling - The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. Some bank lenders may also be prepared to negotiate premature redemption terms. The Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall saving or reduction in risk.

Investment Strategy

4.1 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Council's investment balance has ranged between £202m and £255m. Forecast investment balances for 2017/18 are expected to drop from £161m to £91m .

4.2 Both the CIPFA Code and the CLG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, minimising the risk of incurring losses from defaults and the risk of receiving unsuitably low investment income.

4.3 The Council may invest its surplus funds with any counterparty meeting the criteria in table 3 below, subject to the cash and time limits shown. Any new type of investment or any investment with a new counterparty is subject to a strict scrutiny process from Senior Finance and approval from the Chief Financial Officer prior to any investments being made.

Table 3: Approved Investment Counterparties

Credit Rating	Banks Unsecured*	Banks Secured*	Government	Corporates	Registered Providers
UK Govt	n/a	n/a	Unlimited 50 years	n/a	n/a
AAA	£25m 5 years	£25m 20 years	£25m 50 years	£15m 20 years	£15m 20 years
AA+	£25m 5 years	£25m 10 years	£25m 25 years	£15m 10 years	£15m 10 years
AA	£25m 4 years	£25m 5 years	£25 15 years	£15m 5 years	£15m 10 years
AA-	£25m 3 years	£25m 4 years	£25m 10 years	£15m 4 years	£15m 10 years
A+	£25m 2 years	£25m 3 years	£15m 5 years	£15m 3 years	£15m 5 years
A	£25m 13 months	£25m 2 years	£15m 5 years	£15m 2 years	£15m 5 years
A-	£25m 6 months	£25m 13 months	N/A	£15m 13 months	£15m 5 years
BBB+	£15m 100 days	£15m 6 months	N/A	£10m 6 months	£10m 2 years
BBB or BBB-	£15m next day only	£15m 100 days	N/A	N/A	N/A
None	£1m 6 months	N/A	N/A	£50,000 5 years	£10m 5 years
Pooled funds	£25m per fund				

This table must be read in conjunction with the notes below

*The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

Credit Rating: 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 is used, otherwise the counterparty credit rating is used.

Banks Unsecured: 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.

Banks Secured: 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.

Government: 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. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: 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.

Registered Providers: 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.

Pooled Funds: Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility 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.

Bond, equity and property 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.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council’s treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,

- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as “rating watch negative” or “credit watch negative”) so that it may fall below the approved rating criteria, then only investments that can be withdrawn [on the next working day] will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Other Information on the Security of Investments: The Council understands that credit ratings are good, but not perfect, predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.

When deteriorating financial market conditions affect the creditworthiness of all organisations, as happened in 2008 and 2011, this is not generally reflected in credit ratings, but can be seen in other market measures. In these circumstances, the Council will restrict its investments to those organisations of higher credit quality and reduce the maximum duration of its investments to maintain the required level of security. The extent of these restrictions will be in line with prevailing financial market conditions. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the Council’s cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

All eligible counterparties and new types of investments will be discussed prior to their use by the Lead Member, Chief Financial Officer and other senior finance officers where the appropriateness and security of the investment will be assessed. Any counterparties or investments that fail to meet to approval of the group will not be used despite meeting the investment strategy criteria.

4.4 Specified Investments: The CLG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council,
  - a body or investment scheme of “high credit quality”.

The Council defines “high credit quality” organisations and securities as those having a credit rating of BBB+ or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of A- or higher.

4.5 Non-specified Investments: Any investment not meeting the definition of a specified investment is classed as non-specified. The Council does not intend to make any investments denominated in foreign currencies, nor any that are defined as capital expenditure by legislation, such as company shares. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 4: Non-Specified Investment Limits

	Cash limit £m
Total long-term investments	75
Total investments without credit ratings or rated below [BBB+]	20
Total investments (except pooled funds) with institutions domiciled in foreign countries rated below [AA+]	15
Total non-specified investments	**110**

4.6 In addition to the limits already set out in Tables 3 and 4, the limits set out in table 5 below are also proposed to further protect the security of the Council's investments

Table 5: Additional Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£25m
UK Central Government	Unlimited
Any group of organisations under the same ownership	£25m
Any group of pooled funds under the same management	£25m per manager
Financial instruments held in a broker's nominee account	£50m per broker
Foreign countries	£25m per country
Registered Providers	£25m in total
Unsecured investments with Building Societies	£50m in total
Loans to unrated corporates	£25m in total
Money Market Funds	£50m in total

4.7 Liquidity Management: The Council maintains a detailed cash flow forecast to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Council's medium term financial plan and cash flow forecast.

4.8 Current Account Bank: Following a competitive tender exercise held in 2012, the Council's current accounts are held with the Royal Bank of Scotland group. Should the credit ratings fall below BBB+, for liquidity purposes the Council may continue to deposit surplus cash with the group providing that investments can be withdrawn on the next working day. Balances will be reviewed on a daily basis to assess their appropriateness.

Treasury Management Indicators

5.1 The Council measures and manages its exposures to treasury management risks using the following indicators.

Security: The Council has adopted a voluntary measure of its exposure to credit risk by monitoring the value-weighted average credit rating of its investment portfolio. This is calculated by taking the arithmetic average, weighted by the size of each investment. Unrated investments are assigned a score based on their perceived risk.

	Target
Portfolio average credit rating	*A-*

Liquidity: The Council has adopted a voluntary measure of its exposure to liquidity risk by monitoring the amount of cash available to meet unexpected payments by the next working day and within a rolling three month period, without additional borrowing.

	Target
Total cash available by the next working day	£5m
Total cash available within 3 months	£30m

5.2 Interest Rate Exposures: This indicator is set to control the Council's exposure to interest rate risk on its debt portfolio. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of gross principal borrowed will be:

	2017/18	**2018/19**	**2019/20**
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	25%	30%	35%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, the whole financial year. Instruments that mature during the financial year are classed as variable rate.

5.3 Maturity Structure of Borrowing

This indicator is set to control the Council's exposure to refinancing risk. The upper and lower limits on the maturity structure of fixed rate borrowing will be:

	Upper	Lower
Under 12 months	40%	0%
12 months and within 24 months	40%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	75%	0%
10 years and above	100%	0%

Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment. Due to the unlikelihood of any LOBO's being called they are treated as maturing on the maturity date rather than the potential repayment date.

5.4 Principal Sums Invested for Periods Longer than 364 days

The purpose of this indicator is to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the total principal long term sums invested to final maturities beyond the period end will be:

	2017/18	2018/19	2019/20
Limit on principal invested beyond year end	£75m	£75m	£75m

Other Items

There are a number of additional items that the Council is obliged by CIPFA or CLG to include in its Treasury Management Strategy.

6.1 Policy on Use of Financial Derivatives

Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the *Localism Act 2011* removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).

The Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the overall level of risk. Embedded derivatives including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

Financial derivative transactions may be arranged with any organisation that meets the 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.

6.2 Policy on Apportioning Interest to the HRA

On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and HRA pools. In the future, new long-term loans borrowed will be assigned in their entirety to one pool or the other. Interest payable and other costs/income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged/ credited to the respective revenue account. Differences between the value of the HRA loans pool and the HRA's underlying need to borrow (adjusted for HRA balance sheet resources available for investment) will result in a notional cash balance which may be positive or negative. This balance will be measured and interest transferred between the General Fund and HRA at an appropriate rate which has been adjusted for credit risk.

6.3 Loans to Third Parties

The Council may borrow to make grants or loans to third parties for the purpose of capital expenditure, as allowable under paragraph 25 (1) (b) of the Local Authorities (Capital Financing and Accounting) (England) Regulations 2003 (Statutory Instrument No. 3146). This facility is likely to be used to support local economic regeneration and development activity but not limited to those purposes. The additional capital expenditure may be funded by external borrowing. Loans for working capital or revenue purposes are permitted as long as these are funded from the Council's internal cash balances as external borrowing is not permitted in such circumstances.

A loan of up to £10m to Havering College was agreed in principle by Cabinet on 18th January 2017 although the final decision on making the loan remains subject to due diligence.

6.4 Investment Training

The needs of the Authority's treasury management staff for training in investment management are assessed on a regular basis as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose who are the Council's treasury advisers the Chartered Institute of Public Finance and Accountancy (CIPFA). Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

6.5 Investment Advisers

The Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon our investment advisers.

6.6 Investment of Money Borrowed in Advance of Need

The Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

Financial Implications

7.1 The budget for investment income in 2017/18 is £0.765m. This is based on an average investment portfolio of £127.5m at an interest rate of 0.60%. There is also an additional net income target of £0.3m as a result of investment in the new housing company established.

7.2 The budget for debt interest paid in 2017/18 is £7.5m. This is based on an average debt portfolio of £210m at an average interest rate of 3.6%. Of this figure, £170m is HRA debt, with a budget for debt interest paid of £5.8m.

7.3 If actual levels of investments and borrowing or actual interest rates differ from those forecast, performance against budget will be correspondingly different. Variance from budget will be reported on a quarterly basis to the Audit Committee and on a bi annual basis to full Council.

Markets in Financial Instruments Directive

8.1 The Council's treasury management activities may be impacted by the implementation of the Markets in Financial Instruments Directive (MiFID II) from January 2018. This directive currently proposes that the Council would be classified as a retail investor and might, therefore, earn lower rates on its deposits. This could simply depend on the nature of the potential investment the Council might make but there could be other factors that also play a role. The Council will continue to monitor the potential impact of this Directive throughout 2017/18.

REASONS AND OPTIONS

Reasons for the decision:

The statutory Codes set out that the Council ought to approve a Treasury Management Strategy Statement, the MRP Strategy and the Prudential Indicators.

Other options considered:

The CLG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer, having consulted with the Cabinet Member for Financial Management believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties	Interest income will vary depending on the counterparties used	Lower chance of losses from credit related defaults, but any such losses will be greater
Invest in a wider range of counterparties	Interest will again vary depending on the counterparties used.	Increased risk of losses from credit related defaults, but any such losses will be smaller
Invest in deposits with a longer duration	Interest income will be higher	Increased risk of losses from credit related defaults and a reduction in liquidity
Invest in deposits with a shorter duration	Interest income will be lower	Decreased risk of losses from credit related defaults and an increase in liquidity
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs will be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long term costs will be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs will be less certain and there may be additional costs occurred from restructuring

IMPLICATIONS AND RISKS

Financial implications and risks:

The Treasury Management Strategy Statement is a key part of the overall budget strategy and financial management framework and governs the strategic and operational treasury management activities throughout each financial year in order to manage the Council's financial risks associated with cash management via borrowing and investments.

Legal implications and risks:

The Council must comply with its duty under section 3 Local Government Act 2003 to keep under review the amount of money the Authority can afford to borrow. The Local Authorities (Capital Finance and Accounting) (England) Regulations 2003/3146 require the Authority to have regard to the code of practice entitled the "Prudential Code for Capital Finance in Local Authorities" published by CIPFA when considering its duty under section 3. Appendix B provides further detail on the content of that Code.

The Council has fiduciary duties toward its tax payers to act in good faith in the interests of those tax payers with the considerable sums of money at their disposal. The Strategies being proposed for approval seek to discharge those duties in a reasonable and prudent fashion and therefore there is a low risk of successful challenge.

Otherwise there are no apparent legal implications arising as a result of this Report."

Human Resources implications and risks:

There are no direct Human Resources implications arising as a result of this report

Equalities implications and risks:

There are no equalities implications within this report

BACKGROUND PAPERS

There are no background papers associated with this report

Appendix A - Prudential Indicators 2017/18

The Local Government Act 2003 requires the Council to have regard to the Chartered Institute of Public Finance and Accountancy's *Prudential Code for Capital Finance in Local Authorities* (the Prudential Code) when determining how much money it can afford to borrow. The objectives of the Prudential Code are to ensure, within a clear framework, that the capital investment plans of local authorities are affordable, prudent and sustainable, and that treasury management decisions are taken in accordance with good professional practice. To demonstrate that the Council has fulfilled these objectives, the Prudential Code sets out the following indicators that must be set and monitored each year.

Estimates of Capital Expenditure: The Council's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
General Fund	66.3	102.1	61.8	53.8
HRA	17.2	60.5	39.9	33.4
Total Expenditure	**83.5**	**162.6**	**101.7**	**87.2**
Capital Receipts	16.3	26.8	16.2	13.5
Government Grants	33.0	52.8	25.9	20.6
Reserves	0	26.1	7.1	3.0
Revenue	16.9	24.1	22.5	16.1
Borrowing	17.3	32.8	30.0	34.0
Leasing and PFI	0	0	0	0
Total Financing	**83.5**	**162.6**	**101.7**	**87.2**

Estimates of Capital Financing Requirement: The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose.

Capital Financing Requirement	**31.03.16 Actual £m**	**31.03.17 Revised £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
General Fund	60.5	76.5	97.7	115.7	133.3
HRA	174.7	174.7	184.7	194.7	208.7
Total CFR	**235.2**	**251.2**	**282.4**	**310.4**	**342.0**

The CFR is forecast to rise by £106.8m over the next 4 years as capital expenditure financed by debt outweighs resources set aside for debt repayment. Of the £106.8m, £34.0m is in relation to the HRA and £72.8m is in relation to the GF.

Gross Debt and the Capital Financing Requirement: In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that debt 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. This is a key indicator of prudence.

Debt	**31.03.16 Revised £m**	**31.03.17 Estimate £m**	**31.03.18 Estimate £m**	**31.03.19 Estimate £m**	**31.03.20 Estimate £m**
Borrowing	213.2	210.2	210.2	210.2	256.2

Total debt is expected to remain below the CFR during the forecast period.

Operational Boundary for External Debt: The operational boundary is based on the Council's estimate of most likely, i.e. prudent, but not worst case scenario for external debt. It links directly to the Council's estimates of capital expenditure, the capital financing requirement and cash flow requirements, and is a key management tool for in-year monitoring. Other long-term liabilities comprise finance lease, Private Finance Initiative and other liabilities that are not borrowing but form part of the Council's debt.

Operational Boundary	**2016/17 Revised £m**	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**
Borrowing	258.7	276.3	310.6	341.4
Other long-term liabilities	2.0	2.0	2.0	2.0
Total Debt	**260.7**	**278.3**	**312.6**	**343.4**

Authorised Limit for External Debt: The authorised limit is the affordable borrowing limit determined in compliance with the Local Government Act 2003. It is the maximum amount of debt that the Council can legally owe. The authorised limit provides headroom over and above the operational boundary for unusual cash movements.

Authorised Limit	2016/17 Revised £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Borrowing	284.6	303.9	341.7	375.5
Other long-term liabilities	2.0	2.0	2.0	2.0
Total Debt	**286.6**	**305.9**	**343.7**	**377.5**

Ratio of Financing Costs to Net Revenue Stream: This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %
General Fund	2.02	2.29	2.65	2.95
HRA	5.56	5.48	5.41	5.33

Incremental Impact of Capital Investment Decisions: This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and housing rent levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the new capital programme.

Incremental Impact of Capital Investment Decisions	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £
General Fund - increase in annual band D Council Tax	£9.03p	£6.99p	£6.80p
HRA - increase in average weekly rents	£1.44p	£1.19p	£1.39p

Adoption of the CIPFA Treasury Management Code: The Authority has adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition*.

Appendix B – Annual Minimum Revenue Provision Statement 2017/18

Where the Council's finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum provision since 2008. The Local Government Act 2003 requires the Authority to have regard to the Department for Communities and Local Government's *Guidance on Minimum Revenue Provision* issued in 2012.

The broad aim of the CLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, 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 CLG Guidance requires the Council to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement only incorporates options recommended in the Guidance.

> For capital expenditure incurred before 1st April 2008, MRP will be determined in accordance with the former regulations that applied on 31st March 2008, incorporating an "Adjustment A" of £2.9m on a reducing balance method
>
> For capital expenditure incurred after 31st March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant assets in equal instalments, starting in the year after the asset becomes operational. MRP on purchases of freehold land will be charged over 50 years. MRP on expenditure not related to fixed assets but which has been capitalised by regulation or direction will be charged over 20 years.
>
> For assets acquired by finance leases or the 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.
>
> No MRP will be charged in respect of assets held within the Housing Revenue Account.

Third party loans – Under statutory requirements the payment of the loan will normally be treated as capital expenditure. The subsequent loan repayments, (which are treated as capital receipts under statutory requirements), will be used to reduce the long term liability and consequently the CFR. As a result MRP will not generally be charged on the loan as it is not appropriate to do so.

Capital expenditure incurred during 2016/17 will not be subject to a MRP charge until 2017/18

Based on the Authority's estimate of its Capital Financing Requirement on 31st March 2017, the budget for MRP has been set at £1.57m