10 February 2015	ITEM 13 (Decision 01104348)
Cabinet	
Treasury Management Strategy 2016/2017	
Portfolio Holder: Councillor John Kent, Portfolio Holder for Finance and Strategy	
Wards and communities affected: All	**Key Decision:** Yes
Accountable Head of Service: Sean Clark, Director of Finance and IT	
Accountable Director: Lyn Carpenter, Chief Executive	
This report is Public	
Purpose of Report: To recommend the Treasury Management Strategy for 2016/17, including the Prudential Indicators, to Council.	

EXECUTIVE SUMMARY

The CIPFA Code of Practice for Treasury Management in Public Services and the Prudential Code requires local authorities to determine the Treasury Management Strategy and Prudential Indicators on an annual basis. The annual strategy also includes the Annual Investment Strategy that is a requirement of the Department for Communities and Local Government Investment Guidance.

In accordance with the above Codes, this report:

a) sets out the Treasury Management strategy for 2016/17;

b) confirms the proposed Prudential Indicators for 2016/17; and

c) sets out the Treasury Management projections for 2016/17.

1 Recommendations:

1.1 **That the Cabinet recommend the Council:**

a) **Approve the Treasury Management Strategy for 2016/17 and its application to 2015/16 including approval of the Annual Minimum Revenue Provision (MRP) Statement for 2016/17 and its application to 2015/16;**

b) **Approve the adoption of the Prudential Indicators as set out in Appendix 1;**

c) **Delegate the approval of any changes to the Prudential Indicators to Cabinet where required due to the delivery mechanism for affordable homes in the borough as outlined in paragraph 2.16; and**

d) **To note the revised 2015/16 and 2016/17 Treasury Management projections as set out in paragraph 2.34**

2 Introduction And Background:

2.1 The Treasury Management Strategy and Annual MRP Statement are prepared under the terms of the CIPFA Prudential Code for Capital Finance in Local Authorities (the Code) and approval is sought for the adoption of the Prudential Indicators that have been developed in accordance with the Code. CIPFA revised the Treasury Management Code and Guidance Notes as well as the Prudential Indicators in late 2011. The Council has had regard to these documents in compiling this report.

2.2 The report also revises the 2015/16 forecast for interest on borrowing and investment and forecasts the 2016/17 indicative interest payable and receivable.

Borrowing Activity 2015/16 and 2016/17

2.3 The underlying need to borrow for capital purposes, as measured by the Capital Financing Requirement (CFR), together with balances and reserves, are the core drivers of Treasury Management activity. The estimates, based on the current revenue budget and capital programmes are set out on the following page:

	31/3/2016 Estimate £m	**31/3/2017 Estimate £m**	**31/3/2018 Estimate £m**
General Fund Borrowing CFR	159,952	176,417	183,265
Housing Revenue Account Borrowing CFR (includes effects of Housing Finance Reform based on current available figures)	184,067	201,811	205,890
Total Borrowing CFR	**344,019**	**378,228**	**389,155**
Less: External Borrowing	339,889	339,889	369,889
Internal/(Over) Borrowing	**4,130**	**38,339**	**19,236**

Less: Useable Reserves	8,000	8,000	8,000
Borrowing Requirement	**-3,870.0**	**30,339**	**11,236**

2.4 The Council's level of physical debt and investments is calculated by reference to the Council's balance sheet. The Council's main objectives when borrowing money are to secure low interest costs and achieve cost certainty over the period for which funds are required. A further objective is to provide the flexibility to renegotiate loans should the Council's long term plans change.

2.5 Given the ongoing significant cuts to local government funding, the Council's borrowing strategy continues to balance affordability and the longer term stability of the debt portfolio. Given the availability of low short term interest rates it is more cost effective to either use internal resources, or to borrow over short term periods. The table above shows that in 2016/17 and 2017/18 it may be necessary for the Council to borrow further funds and this will be monitored on a regular basis by officers to assess the most appropriate form of borrowing.

2.6 This enables the Council to reduce borrowing costs (despite forgone investment income) and reduce the overall treasury risk. While such a strategy is most likely to be beneficial over the next 1-2 years as official interest rates remain low, it is unlikely to be sustainable in the medium-term. 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's advisors, Arlingclose, will assist the Council with this assessment and breakeven analysis. This will help inform whether the Council borrows additional sums at long term fixed rates in 2016/17 with a view to keeping future interest costs low, even if this causes additional costs in the short term.

2.7 In addition, the Council may use short term loans (normally up to one month) to manage the Council's cash flow.

2.8 In conjunction with advice from its treasury advisor, the Council will keep under review the following sources for long term and short term borrowing:

- Public Works Loan Board (PWLB) loans and its successor body;
- UK Local Authorities;
- Any institution approved for investments;
- Any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK;
- UK public and private sector pension funds;
- Capital market bond investors;
- UK Municipal Bonds Agency
- Special purpose companies created to enable joint local authority bond issues;

- Local Authority bills;
- Structured finance, such as operating/finance leases, hire purchase, Private Finance Initiative or sale and leaseback.

2.9 With regards to debt rescheduling, the PWLB allows Councils 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 repayment 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.

2.10 Borrowing and rescheduling activity will be reported to the Cabinet on a regular basis during 2016/17.

2.11 In August 2010 the Council repaid its entire PWLB portfolio of loans (£84 million) to obtain significant interest savings. The re-financing was undertaken by utilising short term funds from the money markets, mainly other Local Authorities, at substantially lower rates than taking longer term fixed debt. To the end of 2014/15 the rescheduling had saved £15.5m of interest cost and is estimated to have saved £18.8m by the end of 2015/16. Currently financing from short term money market debt is expected to continue into 2016/17. The inherent risk of this strategy is noted with potentially higher rates and increased debt costs in the future.

2.12 Borrowing can be swiftly re-fixed if required via the PWLB, either in total within a matter of days of the decision to re-fix being made or profiled against the maturity schedule of the short term debt. It is expected official rate increases will not occur until September 2016. Subsequently only gradual increases to the base rate of between 1.50% to 2.25% are anticipated by March 2018. The normalised level of the bank base rate post-crisis is expected to be between 2.50% to 3.50%.

2.13 Based on this outlook, officers will continue to borrow on a short term basis when required while monitoring interest rates to ensure borrowing is fixed if required.

2.14 The Council has £29 million of loans which are LOBO loans (Lenders Option Borrowers Option) 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. All of these loans could now be amended at the request of the lender only 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. In the event the lender exercises the option to change the rate or terms of the loan, the Council will consider the terms being provided and also repayment of the loan without penalty. The Council may utilise cash resources for repayment or may consider replacing the loan by borrowing from the PWLB or capital markets.

2.15 On 1st April 2012, the Council notionally split each of its existing long-term loans into General Fund and Housing Revenue Account (HRA) pools. New long-term loans will be assigned in their entirety to one pool or the other. Interest payable and other costs and income arising from long-term loans (e.g. premiums and discounts on early redemption) will be charged or credited to the respective revenue account. The Council will credit interest to the HRA based on the average balances of its reserves and revenue account balance at the average 7 day LIBID rate for the year.

2.16 The Council has made clear an aspiration to create new affordable homes in the borough. The delivery body of these homes is to be a wholly owned company (Gloriana) with the Council borrowing the required funding and lending it on to the company at a commercial rate. This is likely to require changes to the Council's prudential indicators and it is requested these changes be delegated to Cabinet for this purpose only to allow the development to take place. The changes would be required in terms of the Council's borrowing activity and, with a likely increase over the period of development, this would affect the Authorised and Operational Borrowing Limits and any affected Capital Indicators.

2.17 The Council is also undertaking a series of new building schemes utilising borrowing headroom within the HRA debt cap. Current indications are for new borrowing of approximately £25.0m over the next three years that would put the Council's HRA borrowing level close to its debt cap. The Council will therefore manage this programme to keep the HRA borrowing level within the debt cap by utilising other resources such as capital receipts from Council house sales, other cash backed resources, or through bidding for increases to the debt cap where considered prudent.

2.18 Finally, there are significant regeneration programmes and opportunities being considered and progressed at this time. The need to borrow for investment will be considered on a case by case basis.

Investments

2.19 The Council holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held. It is envisaged that investment balances will be approximately £15 million at the financial year end. The Council may invest its surplus funds with any of the counterparties detailed in Appendix 2.

2.20 The Council held £20m invested in the CCLA Property Fund at the end of 2014/15. The 2015/16 Treasury Management Strategy allowed for additional amounts to be added to the fund if deemed appropriate. The Director of Finance and IT, using powers delegated to him under the Treasury Policy Statement approved by Council and the associated Treasury Management Practices, increased the investment in the Fund by £10m in July 2015. A further £20m was then invested in November 2015 to bring the total invested to £50m. These increases were reported to members in the2015/16 Treasury Mid-Year Review report. The expected return net of fees in 2015/16 is estimated to be 5% with income in the region of £1.7m and assuming a similar net return of 5% in 2016/17, returns should be in the region of £2.5m.

2.21 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. The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over Authorities use of standalone financial derivatives. The CIPFA code requires authorities to clearly detail their policy on the use of derivatives in the annual strategy.

2.22 The Council will only use standalone derivatives (such as swaps, forward, futures and options) where they can be clearly demonstrated to reduce the overall level of 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, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

2.23 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. The local authority will only use derivatives after seeking expertise, a legal opinion and ensuring officers have the appropriate training for their use.

2.24 The Council complies with the provisions of s32 of the Local Government Finance Act 1992 to set a balanced budget.

2.25 The needs of the Council’s treasury management staff for training in investment management are assessed as part of the annual staff appraisal process and additionally where the responsibilities of individual members of staff change. Staff attend courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are encouraged to study for professional accountancy qualifications from appropriate bodies.

2.26 The Council has appointed Arlingclose Ltd as treasury management advisers and receives specific advice on investments, debt and capital finance issues. The quality of service is assessed by regular review meetings between Arlingclose Ltd and officers from the Council.

2.27 The Council may 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 it will be exposed to the risk of loss of the borrowed sums and the risk that investment and borrowing rates may change in the intervening period. These risks will be managed as part of the Council’s overall management of its treasury risks. The total amount borrowed by the Council will not exceed the Council’s Authorised Borrowing Limit as set in the prudential indicators. The maximum period between borrowing and expenditure is expected to be two years, although the Council is not required to link particular loans with particular items of expenditure. Any potential situation will be assessed for suitability as to the overall effect on the Council’s treasury position.

Annual Minimum Revenue Provision Statement

2.28 Local Authorities are required to prepare an Annual Statement of their policy on making MRP for each financial year. Appendix 3 outlines the assessment of the Council's Annual MRP Statement for 2016/17, which is included as item (i) in the Annual Strategy in paragraph 2.30.

2.29 Officers have reviewed the current strategy and recommend two amendments to the 2015/16 strategy and hence also impact on the 2016/17 strategy. These are to take out any reference to Investec as Fund Managers and replace it with reference to the CCLA Property Fund and to enable officers consider the use of capital receipts to pay the annual MRP charges.

2.30 Therefore, with regards to the following paragraphs on Borrowing Activity and Investments the following statement form part of the Council's Treasury Management Strategy with effect from 1 April 2016 and also apply to the 2015/16 strategy:

a) To obtain any long term borrowing requirement from the sources of finance set out in paragraph 2.8;

b) To continue to fund the ex-PWLB debt via short term funds from the money markets unless circumstances dictate moving back into long term fixed rate debt. The borrowing sources mentioned in paragraph 2.8 will then be assessed as to their suitability for use;

c) To repay market loans that require renewal by realising equivalent amounts of investments. If it is not possible to realise investments then the borrowing sources in paragraph 2.8 will be assessed as to their suitability for use as replacements;

d) To undertake short term temporary borrowing when necessary in order to manage cash flow to the Council's advantage;

e) To reschedule market and PWLB loans, if practicable, to achieve interest rate reductions, balance the volatility profile or amend the debt profile, dependent on the level of premiums payable or discounts receivable;

f) To ensure security and liquidity of the Council's investments and to then optimise investment returns commensurate to those ideals;

g) To contain the type, size and duration of investments with individual institutions within the limits specified in Appendix 2;

h) To move further funds into the CCLA Property Fund if it is felt prudent to do so; and

i) To meet the requirements of the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2016/17 shall be that the Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG. The Council will also consider the use of capital receipts to pay down any MRP incurred.

j) To ensure all borrowing and investment activities are made with due reference to any relevant Prudential Indicators

The Prudential Indicators

2.31 The prudential indicators are monitored by the Council to ensure that capital investment is affordable, prudent and sustainable. The indicators are reassessed annually to ensure their continuing relevance and appropriateness to the Council.

2.32 The proposed indicators for 2016/17 are set out in Appendix 1 to this report.

Interest Projections 2015/16 Revised and 2016/17 Original

2.33 The CIPFA document Treasury Management in the Public Services: Code of Practice places a requirement on the Council to publish estimates relating to the operation of the borrowing and investment function.

2.34 The 2015/16 budget and the projected position for 2015/16 as at December 2015 and also an initial projection for 2016/17 are shown in summary format in table 2 belo

		Budget 2015/16 £000’s	Projected 2015/16 £000's	Budget 2016/17 £000's
	Interest payable on External Debt			
1.	Debt Interest		2,437.7	2,824.9
2.	Total internal interest		116.0	154.0
3.	Interest payable	2,980.0	2,553.7	2,978.9
	Investment Income			
4.	Interest on Investments	-1,055	-1,947.2	-3,364.8
5.	Net interest charged to General Fund	1,925.0	506.7	-385.9
6.	MRP- Supported/Unsupported Borrowing	5,982.0	3,696.8	4,586.6
7.	Overall charge to GF	7,907.0	4,203.5	4,200.8

2.35 It should also be noted that the figures shown above for 2016/17 are based on assumptions made about the level of balances available for investment, any anticipated new long term borrowing and the level of interest rates achievable. They may be liable to a significant degree of change during the year arising from variations in interest rates, other market and economic developments, and officers' response to those events.

2.36 In accordance with the requirements of the revised CIPFA Treasury Management Code, the Council will report on treasury management activity and the outturn against the treasury related Prudential Indicators at least twice a year, one such report will be after the financial year end.

3 Issues, Options And Analysis Of Options:

3.1 The strategy of the Council is contained within the body of the report and has been set with consideration of relevant legislation and appropriate guidance. The Prudential Indicators are governed by decisions made on the revenue and capital budgets.

3.2 There are three key areas in this report for Members to be particularly mindful of:

a) The plan to maintain temporary borrowing for the foreseeable future. Officers will continue to monitor this to react to any changes in the economy; and

b) There is a clear commitment and need for affordable housing in the borough and this could impact on the prudential indicators appended to this report through an increase in borrowing.

c) The approach taken to the minimum revenue provision.

4 Reasons For Recommendation:

4.1 There is a legal requirement for a Treasury Management Annual Strategy and the Annual Minimum Revenue Provision Statement to be ratified by Full Council. This report and appendices have been written in line with best practice and the Council's spending plans.

5 Consultation

5.1 The Council's Treasury Advisors, Arlingclose, have been consulted. As set out in section 4, the report is largely based on best practice and the Council's spending plans that have been scrutinised throughout recent months.

6 Impact On Corporate Policies, Priorities, Performance And Community Impact

6.1 Treasury Management plays a significant support role in the delivery of services to the community. Since the debt restructure in August 2010, the function has contributed savings in the region of £16m to date.

7 Implications

7.1 <u>Financial</u>

Implications verified by: **Chris Buckley**
Treasury Management Officer

The financial implications are included in the main body of the report.

7.2 <u>Legal</u>

Implications verified by: **David Lawson**
Deputy Head of Legal & Deputy Monitoring Officer

The report is in accordance with the Local Government Act 2003, related secondary legislation and other requirements including the Prudential Code.

Publication of the strategies is a statutory requirement and conforms to best practice as required by the CIPFA Code of Practice.

7.3 <u>Diversity and Equality</u>

Implications verified by: **Rebecca Price**
Community Development Officer

There are no direct diversity implications noted in this report

7.4 <u>Other implications</u> (where significant) – i.e. Section 17, Risk Assessment, Health Impact Assessment, Sustainability, IT, Environmental

- Not applicable

8 Conclusion

8.1 The report sets out the Annual Borrowing and Investment Strategy and the Annual Minimum Revenue Provision Statement. The function has again contributed towards protecting front line services and will be used to facilitate the housing development programme for the borough.

BACKGROUND PAPERS USED IN PREPARING THIS REPORT:

- Revised CIPFA Prudential Code
- Revised draft ODPM's Guidance on Local Government Investments
- Revised CIPFA's Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes
- Treasury Management Policy Statement
- 2015/16 Annual Investment Strategy
- Arlingclose's Investment Review.

APPENDICES TO THIS REPORT:

- Appendix 1 – Prudential Indicators
- Appendix 2 – Specified and Non-Specified Investments
- Appendix 3 – Annual Minimum Revenue Provision Statement

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APPENDIX 1

PRUDENTIAL INDICATORS 2016/17 TO 2018/19

The following prudential indicators are recommended to the Council.

A. Prudential indicators for Affordability

In demonstrating the affordability of its capital investment plan the Council must:

- Determine the ratio of financing costs (e.g. capital repayments, interest payments, investment income) to net revenue stream for both the Housing Revenue Account (HRA) and non-HRA services for a 3 year period.
- Determine the incremental impact on the Council tax and housing rents (in both instances the scope for increases is governed by the Government's ability to limit council tax increases and the current restriction on council rents).

Indicator A1 sets out the ratio of financing costs to net revenue stream. The estimates of financing costs include current commitments and the proposals in this budget report.

A1: Prudential indicator – Estimates of the ratio of financing costs to net revenue stream 2016/17 to 2018/19

Indicator	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Non HRA	4.04%	5.93%	7.32%
HRA	12.80%	13.0%	13.2%

Indicators A2 and A3 set out the estimated incremental impact on both the levels of council tax (Band D equivalent) and housing rents of the recommended capital investment plans and funding proposals. The impact has been calculated using the latest projections on interest rates for both borrowing and investments. The impact does not take account of government support included for new borrowing within the formula spending share and housing subsidy.

A2: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the council tax 2016/17 to 2018/19

Indicator	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Additional annual Council Tax requirement	1.88	27.81	42.62

A3: Prudential indicator – Estimates of the incremental impact of the new capital investment decisions on the average weekly housing rents 2016/17 to 2018/19

Indicator	2016/17 Estimate	2017/18 Estimate	2018/19 Estimate
Addition in average weekly housing rent	5.87	11.14	13.53

B. Prudential indicators for Prudence

B1: Prudential indicator – Gross debt and the capital financing requirement

This is a key indicator of prudence. In order to ensure that over the medium term debt will only be for a capital purpose, the local authority should ensure that debt does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus estimates of any additional capital financing requirement for the current and next two financial years.

If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement which is used for comparison with gross external debt.

The Director of Finance and IT reports that the Council had no difficulty meeting this requirement in 2015/16, nor is there any difficulties envisaged in future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

Where the gross debt is greater than the capital financing requirement the reasons for this should be clearly stated in the annual treasury management strategy.

The table below shows the projected position from 31 March 2015.

Indicator	Estimate £'000
CFR at 31/3/15	305,288
Increase in 15/16	38,731
Increase in 16/17	34,209
Increase in 17/18	10,927
Total CFR	**389,155**
Gross Debt	**339,889**

C. Prudential indicator for Capital Expenditure

Elsewhere in this report /agenda is a recommendation for the capital investment plans for the Council over the next three years. Indicator C1 summarises the recommendations within that report. Indicator C2 sets out the estimates of the capital financing requirement over the same period.

C1: Prudential indicator – Estimates of total capital expenditure 2016/17 to 2018/19

Indicator	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Total Non HRA	46,559	21,174	11,761
Total HRA	33,050	13,787	9,000
Total Programme	79,609	34,961	20,761

In considering the capital investment plan the Council had regard to a number of key issues, namely:

- affordability, e.g. implications for council tax/housing rents
- prudence and sustainability, e.g. implications for external borrowing
- value for money, e.g. option appraisal
- stewardship of assets, e.g. asset management planning
- service objectives, e.g. strategic planning for the Council
- practicality, e.g. achievability of the forward plan.

C2: Prudential indicator – Estimates of capital financing requirement 2016/17 to 2018/19

Indicator	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
HRA	201,811	205,890	205,890
Non-HRA	176,417	183,265	180,846
Total	378,228	389,155	386,736

The estimates are based on the financing options included in the recommended capital investment programme. The estimates will not commit the Council to particular methods of funding – the actual funding of capital expenditure will be determined after the end of the relevant financial year.

The Council has a number of daily cashflows, both positive and negative, and manages its treasury position in terms of its borrowings and investments in accordance with the approved treasury management strategy and practices. In day to day cash management no distinction can be made between revenue cash and capital cash. External borrowing arises as a consequence of all the financial transactions of the Council and not simply those arising from capital spending. It is possible external debt could exceed the capital financing requirement in the short term.

D. Prudential indicators for External Debt

A number of prudential indicators are required in relation to external debt

D1: Prudential indicator – Authorised limit 2016/17 to 2018/19

Indicator	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Borrowing	482,781	482,721	463,221
Other Long Term Liabilities	1,000	800	600
Total	483,721	483,521	463,821

The authorised limit is the aggregate of gross borrowing (i.e. before investment) and other long term liabilities such as finance leases. In taking its decisions on the budget report the Council is asked to note that the authorised limit determined for 2016/17 in the above table is a statutory limit required to be determined by full Council under section 3(1) of the Local Government Act 2003.

The authorised limits are consistent with the Council's current commitments, existing plans and the proposals in the budget report for capital expenditure and financing, and with its approved treasury management policy statement and practices. The Director of Finance and IT confirms that they are based on the estimate of most likely, prudent but not worst case scenario, with in addition sufficient headroom over and above this to allow for operational management, for example unusual cash movements. Risk analysis and risk management strategies have been taken into account, as have plans for capital expenditure, estimates of the capital financing requirement and estimates of cashflow requirements for all purposes.

D2: Prudential indicator – Operational boundary 2016/17 to 2018/19

Indicator	2016/17 Estimate £'000	2017/18 Estimate £'000	2018/19 Estimate £'000
Borrowing	452,721	452,721	433,221
Other Long Term Liabilities	1,000	800	600
Total	453,721	453,521	433,821

The operational boundary is based on the authorised limit but without the additional headroom. The operational boundary represents a key management tool for in-year monitoring by the Director of Finance and IT. As with the authorised limit figures for borrowing (gross) and other long term liabilities are separately identified.

The authorised limit and operational boundary separately identify borrowing from other long-term liabilities. It is recommended that Council delegate authority to the Director of Finance and IT, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long term liabilities, in accordance with option appraisal and best value for money for the Council. Any such changes made will be reported to the Council at its next meeting following the change.

D3: Prudential indicator – HRA Limit on Indebtedness Under Self Financing

This is known as the Debt Cap and is the absolute level of debt permitted under Self Financing Regulations. The debt cap is set at £188.141m which means debt attributable to the HRA cannot exceed this figure. Agreement to increase the debt cap to borrow an additional £11.58m in 2015/16 with regards to the HRA has been received from the DCLG, giving a revised debt cap £199.721m. At 31 March 2015 the Council had total HRA borrowing of £160.9m and the figure will be the same as at 31 March 2016.

E. Prudential indicators for Treasury Management

A number of prudential indicators are required in respect of treasury management. The indicators are based on the Council's treasury management strategy and take into account the pre-existing structure of the Council's borrowing and investment portfolios.

E1: Prudential indicator – the Council has adopted the "CIPFA Code of Practice for Treasury Management in the Public Services" within its Financial Standing Orders.

The Council has adopted the code within the financial standing orders and monitors the treasury management function to ensure it continues to meet the specified requirements.

E2: Prudential indicators – Upper limits on interest rate exposure 2016/17 to 2018/19

Indicator	2016/17	2017/18	2018/19
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

This indicator specifies the limits on the proportion on the Council net outstanding principal sums (i.e. net of investments) with fixed interest payments and variable interest payments.

The upper limit of 100% is a consequence of the Council maintaining an investment portfolio. Indicator E2a exemplifies the indicator over borrowing and investment.

E2a: Prudential indicators (supplemental) – Upper limits on interest rate exposure 2016/17 to 2018/19

Indicator	2016/17	2017/18	2018/19
Upper limit on borrowing – fixed rate exposure	100%	100%	100%
Upper limit on borrowing – variable rate exposure	50%	50%	50%
Upper limit on investments – fixed rate exposure	100%	100%	100%
Upper limit on investments – variable rate exposure	50%	50%	50%

Indicator E2a is supplemental to Indicator E2 and shows separately the maximum limits for both borrowing and investments. The indicator is not a requirement of the prudential code but it does show more clearly the interest rate exposure limits within which borrowing and investments will be managed.

E3`; Prudential indicator – Upper and lower limits on the maturity structure of borrowing 2016/17

	Upper Limit	Lower Limit
under 12 months	100%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	60%	0%
10 years and within 20 years	60%	0%
20 years and within 30 years	60%	0%
30 years and within 40 years	60%	0%
40 years and within 50 years	100%	0%
50 years and above	100%	0%

The limits in Indicator E3 represent the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate at the start of the period.

E4: Prudential indicator – Principle sums invested for periods longer than 364 days

Indicator	2016/17 £'000	2017/18 £'000	2018/19 £'000
Limit	65,000	65,000	65,000

E5: Prudential indicator – Credit Risk:

The Council employs Treasury advisors (Arlingclose) who provide monthly updates that consider security, liquidity and yield in that order, when making investment decisions. Credit ratings remain an important element of assessing credit risk, but, they are not a sole feature in the Council's assessment of counterparty credit risk The Council also considers alternative assessments of credit strength and information on corporate developments and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum BBB- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns)
- Sovereign support mechanisms
- Credit default swaps (where quoted)
- Share prices (where available)
- Economic fundamentals, such as country's net debt as a percentage of its GDP

- Corporate developments, news, articles, market sentiment and momentum
- Subjective overlay

The only indicators with prescriptive values remain to be credit ratings. All other indicators of creditworthiness are considered in relative rather than absolute terms

APPENDIX 2

Approved Investment Counterparties:

Credit Rating	**Banks/Building Societies Unsecured**		**Bank/Building Societies Secured**		**Government**		**Corporates**		**Registered Providers**	
	Amount	Period	Amount	Period	Amount	Period	Amount	Period	Amount	Period
UK Govt	N/A	N/A	N/A	N/A	£unlimited	50 years	N/A	N/A	N/A	N/A
AAA	£5m	5 years	£10m	20 years	£10m	50 years	£5m	20 years	£5m	20 years
AA+	£5m	5 years	£10m	10 years	10m	25 years	£5m	10 years	£5m	10 years
AA	£5m	4 years	£10m	5 years	£10m	15 years	£5m	5 years	£5m	10 years
AA-	£5m	3 years	£10m	4 years	£10m	10 years	£5m	4 years	£5m	10 years
A+	£5m	2 years	£10m	3 years	£5m	5 years	£5m	3 years	£5m	5 years
A	£5m	1 year	£10m	2 years	£5m	5 years	£5m	2 years	£5m	5 years
A-	£5m	13 months	£10m	13 months	£5m	5 years	£5m	13 months	£5m	5 years
BBB+	£2.5m	6 months	£5m	6 months	£2.5m	2 years	£2.5m	6 months	£2.5m	2 years
BBB	£2.5m	100 days	£5m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
BBB-	£2.5m	100 days	£5m	100 days	N/A	N/A	N/A	N/A	N/A	N/A
None	£2.5m	6 months	N/A	N/A	£5m	25 years	N/A	N/A	N/A	N/A

Pooled Funds and External Fund Managers – Decisions are based on each individual case.

The above limits are the maximum that the Council would expect to have in place at any time. However, in practice the actual duration limits in place are continually assessed in conjunction with Arlingclose and are often much shorter than the limits in the above table.

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 is used, otherwise the counterparty credit rating is used.

Banks and Building Societies Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds. 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| and Building Societies Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements. These investments are secured on the bank's assets, which limits the potential loss 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.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multi 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.

Other Organisations – The Council may also invest cash with other organisations, for example making loans to small businesses as part of a diversified pool in order to spread the risk widely. Because of the higher perceived risk of unrated businesses such investments may provide considerably higher rates of return.

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 Community 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 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. 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.

Bond, equity and property funds offer enhanced returns over the longer term, but, are more volatile in the short term. These allow authorities to diversify into asset classes other than cash without the need to own and manage the underlying investments. These funds have no defined maturity date but are available for withdrawal after a notice period. As a result their performance and continued suitability in meeting the authority's investment objectives will be monitored regularly and decisions made on entering such funds will be made on an individual basis.

Risk assessment and credit ratings: Credit ratings are obtained and monitored by the authorities' 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 investment 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 investments with the affected counterparty.

Where a credit rating agency announces that a credit rating is on review for possible downgrade 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 authorities cash balances then the surplus will be deposited with the UK Government via the Debt Management Office or invested in 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.

Specified Investments

Specified investments will be those that meet the criteria in the CLG Guidance, i.e. the investment

- is sterling denominated
- has a maximum maturity of one year
- meets the ''high credit quality'' as determined by the Council or is made with the UK government or is made with a local authority in England, Wales, Scotland or Northern Ireland or a parish or community council.
- The making of which is not defined as capital expenditure under section 25(1)(d) in SI 2003 No 3146 (i.e. the investment is not loan capital or share capital in a body corporate)

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

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 Investment Limits

	Cash Limit
Total Long Term Investments	£65m
Total Investments without credit ratings or rated below A-	£25m
Total Investments in foreign countries rated below AA+	£10m
Maximum total non-specified investments	£100m

Investment Limits

The maximum that will be lent to any one organisation (except the UK Government) is £5m. A group of banks under the same ownership, a group of funds under the same management, brokers nominee accounts, foreign countries and industry sectors will all have limits placed on them as in the table below:

	Cash Limit
Any single organisation, except the UK Central Government	£5m each

UK Central Government	unlimited
Any group of organisations under the same ownership	£10m
Any group of pooled funds under the same management	£30m
Any external Fund Manager	£60m
Negotiable instruments held in a brokers nominee account	£10m
Foreign countries (total per country)	£15m
Registered Providers in total	£10m
Building Societies in total (excluding overnight investments)	£25m
Loans to small businesses	£10m
Money Market Funds	£25m

Liquidity Management

The Council maintains a cash flow spreadsheet that forecasts the Council's cash flows into the future. This is used to determine the maximum period for which funds may be prudently committed. The forecast is compiled on a pessimistic basis, with receipts under estimated and payments over estimated to minimise the risk of the Council having to borrow on unfavourable terms to meet its financial commitments.

APPENDIX 3
The Minimum Revenue Provision Statement

INTRODUCTION:

The rules for Minimum Revenue Provision (MRP) were set out in the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. These rules have now been revised by the Local Authorities (Capital Finance and Accounting (England) (Amendment) Regulations 2008.

Authorities are required to submit to a meeting of their Council an annual statement of their policy on making MRP.

BACKGROUND:

Each year the Council borrows money in order to finance some of its capital expenditure. The loans taken out for this purpose, unlike a mortgage which is repaid in part each month, are fully repayable at a future point in time. The repayment date is chosen to secure the best financial result for the Council.

The concept of Minimum Revenue Provision was introduced in 1989 to prescribe a minimum amount which must be charged to the revenue account each year in order to make provision to meet the cost of repaying that borrowing.

The detailed rules and formulae to be used in the more recent method of calculation were laid down in the Regulations mentioned in the introduction section.

This system has now been radically revised and requires an annual statement to full Council setting out the method the Council intends to adopt for the calculation of MRP.

ISSUES AND/OR OPTIONS:

Under the old regulations Local Authorities were required to set aside each year, from their revenue account an amount that, in simple terms equalled approximately 4% of the amount of capital expenditure financed by borrowing. Local Authorities had no freedom to exercise any discretion over this requirement.

The amendment regulations introduce a simple duty for an authority each year to set aside an amount of MRP which it considers to be 'prudent'. The regulation does not define a 'prudent provision' but the MRP guidance makes recommendations to authorities on the interpretation of that term.

The MRP guidance document is a statutory document and authorities are obliged by section 21 of the Local Government Act 2003 to have regard to such guidance. The guidance aims to provide more flexibility and in particular for development schemes it is possible to have an MRP "holiday" for assets or infrastructure under construction.

Officers have been in discussion with the external auditors on accounting for the wholly owned housing company, Gloriana. This has given officers an additional view of how to account for MRP on projects where a capital receipt is expected. It has been accepted that there is not a requirement to set aside MRP for loans, through prudential borrowing, that are taken by the Council for onward lending to Gloriana. The basis of this decision is that Gloriana will be making repayments at some point in the future, through either the disposal of properties or rental streams, and that these be set aside for debt repayment purposes. This approach could also be utilised for other schemes, especially in terms of regeneration and economic development purposes with Purfleet regeneration being such an example.

The operative date of the change was 31 March 2008, which means the new rules have applied since the financial year 2007/08.

The Annual MRP Statement

As stated above, Local Authorities are required to prepare an annual statement of their policy on making MRP for submission to their full Council. This mirrors the existing requirements to report to the Council on the Prudential borrowing limits and Treasury Management strategy. The aim is to give elected Members the opportunity to scrutinise the proposed use of the additional freedoms conferred under the new arrangements. The statement must be made before the start of each financial year.

The statement should indicate how it is proposed to discharge the duty to make prudent MRP in the financial year in question for the borrowing that is to take place in that financial year. If it is ever proposed to vary the terms of the original statement during any year, a revised statement should be put to Council at that time.

The guidance includes specific examples of options for making a prudent provision. The aim of this is to ensure that the provision to repay the borrowing is made over a period that bears some relation to the useful life of the assets in question or where a capital receipt will be received to repay the debt in part or in full.

The current approach to the calculation of MRP is that the total of all supported borrowing is written down over a period of 50 years on an equal annual instalment basis and that any unsupported borrowing is written down over the expected life of the asset on an annuity calculated basis.

Proposals

To amend the Minimum Revenue Provision Policy Statement for 2015/16 and also confirm the policy for 2016/17 as follows:

- In accordance with the Local Authorities (Capital Finance and Accounting) (England) (Amendment) Regulations 2008 the Council's policy for the calculation of MRP in 2016/17 shall be that the Council will set aside an amount each year which it deems to be prudent and appropriate, having regard to statutory requirements and relevant guidance issued by DCLG.
- The Council will also consider the use of capital receipts to pay down any MRP incurred.

The policy will be reviewed on an annual basis.