Manchester City Council
Report for Resolution

Report to: Council – 3 March 2017
Resource and Governance Scrutiny Committee – 20 February 2017
Executive – 8 February 2017

Subject: Treasury Management Strategy Statement and Borrowing Limits and Annual Investment Strategy 2017/18

Report of: City Treasurer

Summary

To set out the proposed Treasury Management Strategy Statement and Borrowing Limits for 2017/18 and Prudential Indicators for 2017/18 to 2019/20.

Recommendations

The Resource and Governance Scrutiny Committee is requested to:

1. Recommend the report to Council.

The Executive is requested to:

1. Recommend the report to Council.
2. Delegate authority to the City Treasurer, in consultation with the Executive Member for Finance, to:
   - approve changes to the borrowing figures as a result of changes to the Council's Capital or Revenue budget; and
   - submit these changes to Council.

The Council is requested to:

1. Approve the proposed Treasury Management Strategy Statement, in particular the:
   - Treasury Indicators listed in Appendix A of this report
   - MRP Strategy outlined in Appendix B
   - Treasury Management Policy Statement at Appendix C
   - Treasury Management Scheme of Delegation at Appendix D
   - Borrowing Requirement listed in Section 5
   - Borrowing Strategy outlined in Section 8
   - Annual Investment Strategy detailed in Section 9

2. Delegate to the City Treasurer, in consultation with the Executive Member for Finance, the power to pursue any restructuring, rescheduling or redemption opportunities available, including amendments to the Treasury Management Strategy if the changes require it. Any changes required to the Strategy will be reported to members at the earliest opportunity.

Wards Affected: Not Applicable

Contact Officers:

Name: Carol Culley
Position: City Treasurer
Telephone: 0161 234 3406
E-mail: c.culley@manchester.gov.uk

Name: Janice Gotts
Position: Deputy City Treasurer
Telephone: 0161 234 1017
Email: j.gotts@manchester.gov.uk

Name: Tim Seagrave
Position: Finance Lead
Telephone: 0161 234 3445
E-mail: t.seagrave@manchester.gov.uk

Name: David Williams
Position: Principal Finance Manager
Telephone: 0161 234 8493
E-mail: d.williams8@manchester.gov.uk

Background documents (available for public inspection):

The following documents disclose important facts on which the report is based and have been relied upon in preparing the report. Copies of the background documents are available up to 4 years after the date of the meeting. If you would like a copy please contact one of the officers noted above.

- Treasury Management Strategy Report framework provided by Capita Treasury Solutions (Treasury Advisors)

1. Introduction

1.1. Background

Treasury management is defined 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. Statutory requirements

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

The Act therefore requires the Council to set out its treasury strategy for borrowing and to prepare an Annual Investment Strategy (as required by Investment Guidance subsequent to the Act and included as section 9 of this report); the Strategy sets out the Council's policies for managing its investments and for giving priority to the security and liquidity of those investments.

The Department of Communities and Local Government (DCLG) issued revised investment guidance which came into effect from the 1 April 2010. There were no major changes required over and above the changes already required by the revised CIPFA Treasury Management Code of Practice 2009.

1.3. CIPFA requirements

The CIPFA Code of Practice on Treasury Management (Revised November 2009) was adopted by the Council on the 3 March 2010, having been approved by Executive on the 10 February 2010. The Code was revised in November 2011, acknowledging the effect the Localism Bill could have on local authority treasury management. This strategy has been prepared in accordance with the revised November 2011 Code.

The primary requirements of the Code are as follows:

a) Creation and maintenance of a Treasury Management Policy Statement which sets out the policies and objectives of the Council's treasury management activities;

b) Creation and maintenance of Treasury Management Practices which set out the manner in which the Council will seek to achieve those policies and objectives;

c) Receipt by the full Council of an annual Treasury Management Strategy Statement, including the Annual Investment Strategy and Minimum Revenue Provision Policy for the year ahead, a Mid-year Review Report and an Annual Report covering activities during the previous year;

d) Delegation by the Council of responsibilities for implementing and monitoring treasury management policies and practices and for the execution and administration of treasury management decisions;

e) Delegation by the Council of the role of responsible body for treasury management strategy and practices, budget consideration and approval, monitoring and selection of external service providers to a specific named body. For this Council the delegated body is the Audit Committee.

f) Delegation by the Council of the role of scrutiny of treasury management strategy and policies to a specific named body. For this Council the delegated body is the Resource and Governance Scrutiny Committee.

1.4. **Treasury Management Strategy for 2017/18**

The suggested strategy for 2017/18 in respect of the following aspects of the treasury management function is based upon the treasury officers' views on interest rates, supplemented with market forecasts provided by the Council's treasury advisor, Capita Treasury Solutions.

The strategy covers:

Section 1: Introduction
Section 2: Treasury Limits and Prudential Indicators
Section 3: Impact of 2012 HRA reform
Section 4: Current Portfolio Position
Section 5: Borrowing Requirement
Section 6: Treasury Limits and Prudential Indicators for 2017/18 to 2019/20
Section 7: Prospects for Interest Rates
Section 8: Borrowing Strategy
Section 9: Annual Investment Strategy
Section 10: MRP Strategy
Section 11: Recommendations
Appendix A: Treasury Limits and Prudential Indicators for approval
Appendix B: MRP Strategy
Appendix C: Treasury Management Policy Statement
Appendix D: Treasury Management Scheme of Delegation
Appendix E: The Treasury Management Role of the Section 151 Officer
Appendix F: Economic Background - Capita Treasury Solutions
Appendix G: Prospects for Interest Rates
Appendix H: Glossary of Terms
Appendix I: Treasury Management Implications of HRA Reform

1.5. **Balanced Budget Requirement**

It is a statutory requirement under Section 33 of the Local Government Finance Act 1992, revised under Section 31 of the Localism Bill 2011, for the Council to produce a balanced budget. In particular, Section 31 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from:

- increases in interest charges caused by increased borrowing to finance additional to capital expenditure; and
- any increases in running costs from new capital projects

are limited to a level which is affordable within the projected income of the Council for the foreseeable future.

2. Treasury Limits and Prudential Indicators

2.1. It is a statutory duty under Section 3 of the Act and supporting regulations that the Council determines and keeps under review how much it can afford to borrow. The amount so determined is termed the 'Affordable Borrowing Limit'. In England the Authorised Limit represents the legislative limit specified in the Act.

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

2.3. Whilst termed an Affordable Borrowing Limit, the capital plans to be considered for inclusion incorporate financing by both external borrowing and other forms of liability, such as credit arrangements. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years.

2.4. The Authorised Limit is one of the Prudential and Treasury indicators recommended by the Code, which the Council operates for monitoring its treasury operations. The full set of indicators recommended by the Code and used by the Council is listed below. A note of the purpose of these indicators together with their suggested levels for 2017/18 can be found in Appendix A of this report.

2.5. The Prudential Indicators are:

- Authorised Limit – external debt
- Operational Boundary – external debt
- Actual external debt
- Upper limit for total principal sums invested for over 364 days
- Upper limit for fixed interest rate deposits
- Upper limit for variable interest rate deposits
- Maturity structure of fixed rate borrowing during the year
- Confirmation the Council has adopted the CIPFA Treasury Management Code

2.6 It should be noted that the Treasury limits and Prudential indicators noted in this report may be subject to change dependent on decisions taken on the Capital and Revenue budgets which will be reported to the Executive in February.

3. Impact of 2012 HRA reform

3.1. The Treasury Management Strategy for 2013/14 was the first to incorporate the split of the debt portfolio following the Housing Revenue Account (HRA) debt settlement of March 2012. Details of how the split was calculated and the corresponding effect on treasury management activities are at Appendix I.

3.2. It is important to note that the treasury position of the Council will continue to be monitored at a Council level, alongside the separate positions for the General Fund (GF) and the HRA. The HRA is also limited in terms of the treasury activity it can undertake, in so much as any temporary borrowing or investing it requires can only be engaged with the GF. Any long-term borrowing will be through the GF. This ensures that the overall Council position is managed as effectively and efficiently as possible.

3.3. To reflect the fact that the HRA now has its own treasury position, this report will mention, when appropriate, where the HRA treasury strategy may be different to that of the GF. However, where the Council's strategy is mentioned, this applies to both the GF and the HRA.

4. Current Portfolio Position

4.1. The Council's forecast treasury portfolio position at 31 March 2017 is:

Table 1		**Principal**			**Av Rate**
		GF £'000	HRA £'000	**Total £'000**	%
Fixed rate funding	PWLB	0	0	**0**	0.00
	Market	235,037	43,213	**278,250**	4.90
	Stock	8,083	0	**8,083**	3.37
		243,120	43,213	**286,333**	4.86
Variable rate funding	PWLB	0	0	**0**	0.00
	Market	152,016	27,949	**179,965**	4.76
		152,016	27,949	**179,965**	4.76
Government debt (HCA/HIF)		69,464	0	**69,464**	0.00
Gross debt		**464,600**	**71,162**	535,762	4.19
External Investments		(133,441)	0	**(113,441)**	0.22
Internal balances (GF/HRA)		41,384	(41,384)	**0**	0.00
Net debt		**372,543**	**29,778**	**403,321**	
Capital Financing Requirement				**1,228,522**	
Gross Debt				**535,762**	
Internal Borrowing				**692,760**	

4.2. The capital financing requirement of the City Council excluding credit arrangements, as at 31 March 2017 is forecast to be c. £1,228.5m. The difference between this and the actual gross debt of the Council, as shown above, is c. £692.8m, which is the amount of funding that the Council has internally borrowed. This is a reflection of the treasury strategy that the Council has pursued, as internal cash has been utilised to reduce the amount of borrowing required rather than being held as investments. In the current interest rate environment, where the rate of interest on investments is significantly lower than that on borrowing and there are substantial counterparty risks, this has been a prudent approach and has provided value for money for the Council.

4.3. As part of the reform of the HRA, DCLG repaid all of the Council's Public Works Loan Board (PWLB) debt, which had been gradually reduced over recent years by various stock transfers. Subsequently, the debt portfolio consists almost exclusively of market debt, the majority of which are Lender Option Borrower Option (LOBO) loans which have long-term maturity dates. Whilst this provides some stability for the Council, as LOBOs are unlikely to be called in the near future due to the current and forecast market environment, it does mean that when seeking to take new debt the Council should consider diversifying the portfolio, not least to ensure a wider range of maturity dates.

4.4. The portfolio at 31 March 2017 includes Council stock with a forecast value of £8.1m. This debt will fall by £5.1m during 2017/18 following redemption action taken by the Council. There is a possibility that the remaining £3m of stock debt, or part of it, may also be redeemed during the year. The class of stock associated with this component of debt has irredeemable status and therefore the option to redeem lies with the holder rather than the Council. Further detail on the stock redemption exercise is noted in paragraph 8.25 of this report.

4.5. The portfolio shown above, and the borrowing requirements shown at paragraph 5.1, contain funding for capital investment which the City Council is undertaking on behalf of Greater Manchester. With the wider powers of the Greater Manchester Combined Authority (GMCA) expected to be in place in the early part of 2017/18, it may be that this investment and associated funding can be transferred to the GMCA if the Government confers wider borrowing powers on the Authority. If this is the case, it will materially impact on the Council's existing and forecast debt portfolio and borrowing requirements, and therefore a revised Treasury Management Strategy Statement will be submitted to members with revised prudential indicators.

5. Borrowing Requirement

5.1 The potential long-term borrowing requirements over the next three years are:

Table 2	2017/18	2018/19	2019/20
	£'000 estimate	£'000 estimate	£'000 estimate
Planned Capital Expenditure funded by Borrowing	302,793	287,254	109,907
Change in Grants & Contributions	8,927	-4,497	-3,064
Change in Capital Receipts	-20,170	12,620	15,050
Change in Reserves	7,243	2,636	7,703
MRP Provision	-17,374	-23,913	-30,762
Refinancing of maturing debt (GF)	8,447	40,546	-
Refinancing of maturing debt (HRA)	1,553	7,454	-
Movement in Working Capital	109,375	-	-
Estimated Borrowing Requirement	**400,794**	**322,100**	**98,834**
Funded by:			
GF	294,241	192,989	98,834
HRA	1,553	7,454	-
HCA/HIF	105,000	121,657	-
	400,794	**322,100**	**98,834**

5.1. The borrowing detailed in Table 2 maintains the Council within its previously agreed Government debt deal limit.

6. Prudential and Treasury Indicators for 2017/18 to 2019/20

6.1. Prudential and Treasury Indicators (as set out in Appendix A to this report) are relevant for the purposes of setting an integrated treasury management strategy.

6.2. The Council is also required to indicate if it has adopted the CIPFA Code of Practice on Treasury Management. The original 2001 Code was adopted on the 8 October 2003 by the full Council, and the revised 2009 code was adopted on the 3 March 2010. This strategy has been prepared under the revised code of November 2011, which was adopted in February 2012.

7. Prospects for Interest Rates

7.1 The Council has appointed Capita Treasury Solutions as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates.
Appendix G draws together a number of current City forecasts for short term (Bank Rate) and longer fixed interest rates. The following gives the Capita's central view:

Capita Treasury Solutions Bank Rate forecast for financial year ends (March)

- 2017: 0.25%
- 2018: 0.25%

- 2019: 0.25%
- 2020: 0.75%

7.2 There is no certainty to these forecasts. In an attempt to stimulate the economy the Bank of England in August 2016 reduced Base Rate to 0.25%, the first change since 2009. If economic growth begins to slow or weaken more than currently expected it is likely rates will remain lower for longer. Conversely, if growth is stronger than expected the Bank Rate may increase sooner than forecast. A detailed view of the current economic background prepared by Capita is at Appendix F to this report.

8. Borrowing Strategy

General Fund

8.1. The proposed Capital Budget, submitted to Executive in February and Council in March, contains significant capital investment across the city. The scale of the investment is such that it is highly likely that the Council will need to undertake external borrowing in the immediate future, and will not be able on to rely on internal borrowing alone. However, where possible, internal borrowing will be the first option due to the interest savings generated.

8.2. The Council's borrowing strategy should utilise the annual provision it is required to make to reduce debt, in the form of its Minimum Revenue Provision (MRP). The most efficient arrangement is for the Council's existing long term debt to be matched to MRP. As in the past, if the Council continued to use long term borrowing whilst having a need to borrow in the short term MRP would accumulate. This is because there would be no opportunity to use MRP to repay debt other than at considerable cost.

8.2 In previous years this has not been an issue as the Council has had significant borrowing requirements year on year which have allowed it to use the MRP to reduce the borrowing required. However, the borrowing requirement may well be expected to fall in the long term and therefore, a prudent strategy is to seek to borrow in the medium term, with maturities to match the estimated MRP that is generated in that period. This avoids an accumulation of cash on the Balance Sheet that would need to be invested (at a net cost and investment risk to the Council).

8.3 The overall aim of the borrowing strategy is to rebalance the portfolio by introducing more medium term debt when there is a borrowing requirement, whilst seeking to continue to utilise the Council's significant level of reserves and provisions by internally borrowing when possible.

HRA

8.4 The current business plan for the HRA suggests a borrowing requirement of £1.553m in 2017/18.

8.5 However, in the event that some of the current debt is required to be repaid, perhaps through a bank calling one of the LOBO loans, it would be the aim of the HRA to rebalance the portfolio by introducing more medium term debt whilst also seeking to use any reserves or provisions by internally borrowing.

Internal cash balances will be utilised before any borrowing is undertaken.

8.6 Should the HRA require temporary borrowing, this will be sought from the General Fund. This is discussed further in Appendix I.

Borrowing Options

8.7 The Council's borrowing strategy will firstly utilise internal borrowing. Forgoing investment income at historically low rates provides the cheapest option. However
as the overall forecast is for long term borrowing rates to increase over the next few years, consideration will also be given to weighing the short term advantage of internal borrowing against potential long term costs. Rates are expected to be higher in future years for longer term loans.

8.8 After this, new borrowing will be considered in the forms noted below. At the time of the borrowing requirement the options will be evaluated alongside their availability and an assessment made regarding which option will provide value for money. The options described below are not presented in a hierarchical order. At the point of seeking to arrange borrowing all options will be reviewed.

i Public Works Loan Board (PWLB)

PWLB borrowing is available for between 1 and 50 year maturities on various bases. This offers a range of options for new borrowing which will spread debt maturities away from a concentration in longer dated debt, and allow the Council to align maturities to MRP.

In the March 2012 Budget, the Chancellor announced the availability of a PWLB 'Certainty Rate' for local authorities, which could be accessed upon the submission of data around borrowing plans for individual authorities. The Council submitted their return in April 2015. The Certainty Rate allows a local authority to borrow from the PWLB at 0.20% below their published rates. The Government are also currently consulting with local authorities regarding the potential introduction of a PWLB Infrastructure Rate which will could be at 0.4% lower than standard PWLB rates.

These reductions, alongside the flexibility the PWLB provides in terms of loan structures and maturity dates, together with the current lack of availability of market debt options, suggests that should long term borrowing be required, PWLB borrowing might provide the best value for money.

The Capita forecast for the PWLB Certainty Rate is as follows:

Table 3	Mar 17	Jun 17	Sep 17	Dec 17	Mar 18	Mar 19	Mar 20
Bank Rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.75%
5 yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.80%	2.00%
10 yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.50%	2.70%
25 yr PWLB rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.20%	3.40%
50 yr PWLB rate	2.70%	2.70%	2.70%	2.80%	2.80%	3.00%	3.20%

A more detailed Capita forecast is included in Appendix G to this report.

ii European Investment Bank (EIB)

Rates can be forward fixed for borrowing from the EIB and this will be considered if the arrangement represents better value for money. The Council has agreed a £100m facility with the EIB which will form part of the Council's future overall borrowing strategy. There has not been any advice from the EIB that post Brexit these arrangements will change.

The EIB's rates for borrowing are generally favourable compared to PWLB, allowing for existing planned future borrowing from PWLB to be replaced by cheaper funding from the EIB. The EIB appraises its funding plans against individual schemes, particularly around growth and employment and energy efficiency, and any monies borrowed are part of the Council's overall pooled borrowing.

iii Third Party Loans

These are loans from third parties that are offered at lower than market rates, for example, Salix Finance Ltd is offering loans to the public sector at 0% to be used specifically to improve their energy efficiency and reduce carbon emissions.

iv Housing Investment Funding and the Homes and Communities Agency

Both HIF and HCA are DCLG funding, see paragraphs 8.11-15 for further details.

v Market Loans including inter-Local Authority advances

Both short and long term loans are often available in the inter Local Authority market in addition to offers from the general market.

8.9 These types of borrowing will need to be evaluated alongside their availability, particularly whilst there is a very limited availability of traditional market loans. The traditional market loans available tend to be Lender Option Borrower Option (LOBO) loans and they are not currently offered at competitive rates of interest. LOBOs provide the lender with future options to increase the interest rate, whilst the local authority has the option to repay if the increase in the rate is unacceptable to them.

8.10 Further to this, following HRA reform the vast majority of the Council's existing debt portfolio consists of LOBOs, and the Authority needs to consider diversifying its loan book to reduce the impact of any volatility that may cause these loans to be called. It should be noted, however, that the Council's current LOBO loans are unlikely to be called in the medium term at current interest rates.

Homes and Communities Agency Funding

8.11 The Homes and Communities Agency (HCA) has made £23m funding available
to the City Council and this was received in 2015/16 and 2016/17 The funding is, in effect, a ‘loan’ of the HCA’s receipts from the disposal of its land and property within Greater Manchester (GM), as agreed in the GM City Deal. The funds can be used to invest in any project which supports GM City Deal objectives. Some of the funds will be passed on to other GM authorities for projects within their areas.

8.12 The funding from the HCA is held as an interest free loan, until such time as an investment approval is made. At this point, the approved element of the loan becomes risk-based, with the return to the HCA based on the performance of that investment. The funds are to be used for projects within Greater Manchester; the location depends on where the receipts originate from, and whether the receipt is due to the sale of residential or commercial property. Proceeds from commercial property will not be borough-specific, whereas proceeds from residential property will be.

8.13 The funds received are to be repaid to the HCA in March 2022. No interest will be charged to MCC for the receipt of the funds, however, should an investment made with HCA funds not be recovered, the loss is deducted from the amount due to HCA. Conversely, should any profit be made by an investment these will be added to the amount due to the HCA.

Housing Investment Funding (HIF)

8.14 The Council has arranged with the Homes and Communities Agency to receive housing investment funding on behalf of Greater Manchester. The funds will be treated as a loan to the Council in a similar manner to HCA funds as detailed in paragraphs 8.11-13. These monies will then be invested in housing related projects with any losses met by Government (up to 20%) or by guarantee from the ten Greater Manchester authorities (including Manchester).

8.15 Total HIF funding of £300m has been agreed the Department for Communities and Local Government (DCLG), of which £98.3m has been received to date. DCLG require any HIF receipts that are not utilised by the financial year end to be returned on the 31st March. The return of these funds does not mean that the HIF financing is lost as it can be called down again starting in 2017/18, and it is consequently anticipated the Council will receive £105m in 2017/18, £122m in 2018/19 as shown in Table 2 at paragraph 5.1.

Sensitivity of the forecast

8.16 In normal circumstances the main sensitivities of the forecast are likely to be the two scenarios noted below. Council officers, in conjunction with the treasury advisors, will continually monitor both the prevailing interest rates and the market forecast, adopting the following responses to a change of sentiment:

- ***If it were felt that there was a significant risk of a sharp FALL in long and short term rates****,* e.g. due to a marked increase of risks around relapse into recession or of risks of deflation, then long term borrowings will be postponed.
- ***If it were felt that there was a significant risk of a much sharper RISE in long and short term rates than that current forecast****,* perhaps arising from a greater than expected increase in world economic activity or a sudden increase in inflation risks, the portfolio position will be re-appraised. The likely action will be that fixed rate funding will be drawn whilst interest rates were still relatively cheap.

External v. Internal borrowing

8.17 There is currently a difference of around £133m between the Council's General Fund gross debt and net debt, i.e. the gross debt after deducting cash balances. The current borrowing position reflects the historic strong Balance Sheet of the Council, as highlighted in Section 4. It enables net interest costs to be minimised and reduces credit risk by making temporary use of internal borrowing (reserves, provisions, positive cash flows, etc). The policy remains to keep cash as low as possible and minimise temporary investments.

8.18 The next financial year is again expected to be one of very low Bank Rate. This provides a continuation of the window of opportunity for local authorities to fundamentally review their strategy of undertaking new external borrowing.

8.19 Over the next three years, investment rates are expected to be significantly below long term borrowing rates and so value for money considerations would indicate that value could best be obtained by limiting new external borrowing and by using internal cash balances to finance new capital expenditure, or to replace maturing external debt. This is referred to as internal borrowing and maximises short term savings.

8.20 However, short term savings from avoiding new long term external borrowing in 2017/18 will also be weighed against the potential for incurring additional long term extra costs by delaying new external borrowing until later years when longer term rates are forecast to be significantly higher. Consideration will also be given to forward fixing rates whilst rates are favourable.

8.21 Against this background caution will be adopted within 2017/18 treasury operations. The City Treasurer will monitor the interest rate market and adopt a pragmatic approach to changing circumstances, reporting any decisions to the appropriate decision making body at the next available opportunity.

Policy on borrowing in advance of need

8.22 Any decision to borrow in advance will be considered carefully to ensure value for money can be demonstrated and that the Council can ensure the security of such funds. In determining whether borrowing is undertaken in advance of need the Council will:

- ensure that there is a clear link between the capital programme and maturity profile of the existing debt profile which supports the need to take funding in advance of need;
- ensure the ongoing revenue liabilities created, and the implications for the future plans and budgets have been considered;
- evaluate the economic and market factors that might influence the manner and timing of any decision to borrow;
- consider the merits and demerits of alternative forms of funding;
- consider the alternative interest rate bases available, the most appropriate periods to fund and repayment profiles to use; and
- consider the impact of borrowing in advance temporarily (until required to finance capital expenditure) increasing investment cash balances and the consequent increase in exposure to counterparty risk, and other risks, and the level of such risks given the controls in place to minimise them.

Debt rescheduling

8.23 It is likely that opportunities to reschedule debt in the 2017/18 financial year will be limited, particularly as the Council no longer holds any PWLB loans. This leaves the possibility of rescheduling other funding sources, such as market loans, but it should be stressed that the likelihood of any rescheduling remains very remote.

8.24 An exception to this is that the required 12 month’s notice will be given to stockholders before the close of the 2016/17 financial year of the Council’s intention to redeem the stock it issued between 1874 and 1891. This will result in a £5.1m reduction in long term debt by the end of 2017/18. The reduction might be realised in a staged manner before the 2017/18 year end as the Council’s redemption offer will allow stockholders the opportunity to redeem their stock before the end of the 12 month notice period if they wish to do so. There is also £3m of long term debt relating to irredeemable stock. Before the close of the 2016/17 financial year the Council will make a further redemption offer to the holders of this stock. The offer will be open to the end of the 2017/18 financial year, however take up is at the discretion of the stockholder.

8.25 As short term borrowing rates will be considerably cheaper than longer term rates, there may be potential for some residual opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the size of the premiums incurred, their short term nature, and the likely cost of refinancing those short term loans once they mature, compared to the current rates of longer term debt in the existing debt portfolio.

8.26 The debt portfolio of the Council following HRA reform consists mainly of LOBOs, and the premia associated with rescheduling these make it unlikely that it will provide a cost effective rescheduling opportunity. This is because the premia will not only relate to the future interest payments associated with the loan, but also because the Council would need to compensate the lender for the buy-back of the interest rate options the loan has embedded in it.

8.27 The Council will continue to monitor the LOBO market and in particular opportunities to reschedule, redeem or effectively alter the profile of existing LOBO debt. The reasons for any rescheduling to take place will include:

- the generation of cash savings and / or discounted cash flow savings;
- helping to fulfil the strategy outlined in section 8 above;
- enhancing the balance of the portfolio (amending the maturity profile and/or the balance of volatility)

8.28 Any restructuring of LOBOs will only be progressed if it provides value for money for the Council, and reduces the overall treasury risk the Council faces, for example interest rate risk or credit risk. Members are requested to delegate authority to the City Treasurer, in consultation with the Executive Member for Finance to pursue any restructuring, rescheduling or redemption opportunities available, including amendments to the Treasury Management Strategy if the changes require it. Any changes required to the Strategy will be reported to Members at the earliest opportunity.

8.29 Consideration will also be given to identify if there is any residual potential left for making savings by running down investment balances to repay debt prematurely. It is likely short term rates on investments will be lower than rates paid on current debt.

8.30 All rescheduling will be reported to the Executive, as part of the normal treasury management activity reports.

9. Annual Investment Strategy

General Fund

Introduction

9.1 The Council will have regard to the DCLG’s Guidance on Local Government Investments (the Guidance) and the 2011 revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes (the CIPFA TM Code). The Council’s investment priorities are:

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

9.2 The Council will also aim to achieve the optimum return on its investments commensurate with desired levels of security and liquidity. The risk appetite of the Council is low in order to give priority to the security of its investments.

9.3 The borrowing of monies by an Authority purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity.

9.4 These principles would be important in normal circumstances, however the Icelandic banks crisis, and the financial difficulties faced by UK and international banks that followed, have placed security of investments at the forefront of Treasury Management investment policy.

Changes to Credit Rating Methodology

9.5 Through much of the financial crisis the main rating agencies (Fitch, Moody's and Standard & Poor's) provided some institutions with a ratings 'uplift' due to implied levels of sovereign support (government backing should an institution fail).
In response to the evolving regulatory regime and the declining probability of government support, the rating agencies are removing these 'uplifts'. The result of this is that some institutions ratings have been downgraded by up to two notches.

9.6 The rating agency changes do not reflect any changes in the underlying status of the institution or credit environment, merely the removal of the implied levels of sovereign support that were built into ratings throughout the financial crisis. The removal of sovereign support is taking place now that the regulatory and economic environments have ensured that financial institutions are much stronger and less prone to failure in a financial crisis. As a result of these rating agency changes, the credit element of Capita's future methodology focuses solely on the short and long term ratings of an institution, and officers believe that the Council should follow the same methodology.

9.7 The key change to the regulatory framework in respect of banks is the introduction of the European Union's Banking Recovery and Resolution Directive (BRRD).
In response to the banking crisis some governments used taxpayer funds to support banks in danger of failing. In future BRRD will require 'bail-in' to be applied in such a scenario. In the UK this will mean that after shareholders' equity, depositors' funds comprising balances over c£85k (linked to the value of the Euro) will be used to support a bank at risk. The £85k threshold is not available to local authorities and therefore all their bank deposits will be at risk of bail-in. This increases the risk to the Council of holding unsecured cash deposits with banks and building societies.

Investment Policy

9.8 As previously, the Council will not just utilise ratings as the sole determinant of the quality of an institution. It is important to continually assess and monitor the financial sector on both a micro and macro basis and in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of the markets. To this end the Council will engage with its advisors to maintain a monitor on market pricing such as 'credit default swaps'[1] and overlay that information on top of the credit ratings.

[1] A credit default swap is a financial instrument that effectively provides the holder insurance against a loan defaulting. The CDS spread is the difference between the price at which providers are willing to sell the swap, and

9.9 Investment in banks and building societies are now exposed to bail-in risk as described above and rather than increase investment in banks and building societies in practice lower limits for investment in banks and building societies have been adopted in 2016/17. This is apart from the limit with Barclays bank; Barclays is the Council's main banker and is the investment destination of last resort for the close of daily trading. These revised limits are interim operational changes and to preserve flexibility should circumstances change the overall investment limits approved for banks and building societies for 2016/17 will be maintained in 2017/18.

9.10 The investment constraint brought by bail-in risk means the Council needs to continue to identify ways that it can broaden and diversify its basis for lending. During 2016/17 after the reduced level of bank deposits, the strategy saw a significant proportion of the Council's investments placed with the Government (via the DMO) or with other Local Authorities. In the financial year 2016/17 to December 2016 an average of
c. 88% of the investment portfolio was with the DMO and other Local Authorities. This highlights the relatively low credit risk that the Council takes when investing.

9.11 For 2017/18 investment the Council will consider trading in Money Market Funds, Treasury Bills, Certificates of Deposit and Covered Bonds. In addition to diversification of the investment portfolio each of these options offer the Council benefits which are noted in paragraphs 9.25 to 9.32 below. Treasury Bills, Certificates of Deposit and Covered Bonds require the Council to have specific custodian and broker facilities. This provision has been opened in 2016/17, however work is continuing to open further access points to markets. Officers are also working to ensure they are in a position to monitor these new markets to identify opportunities for benefit.

9.12 It should be noted that, whilst seeking to broaden the investment base, officers will seek to limit the level of risk taken by the Council. It is not expected that the measures considered above will have a significant impact on the rates of return the Council currently achieves.

HRA

9.13 In order to maintain efficient, effective and economic treasury management for the Council as a whole, the HRA will only be able to invest with the General Fund. This is discussed further in Appendix I.

Specified and Non-Specified Investments

9.14 Investment instruments identified for use in the financial year are listed below, and are all specified investments. Any proposals to use other non-specified investments will be reported to Members for approval.

9.15 Specified investments are sterling denominated, with maturities up to a maximum of one year and meet the minimum 'high' rating criteria where

the price at which buyers are willing to buy. A relatively high spread may suggest that the loan is more likely to default.

applicable. Further details about some of the specified investments below can be found in later paragraphs within Section 9.

Table 4	Minimum 'High' Credit Criteria	Use
Term deposits – banks and building societies*	See Para 9.9.	In-house
Term deposits – other Local Authorities	High security. Only one or two local authorities credit-rated	In-house
Debt Management Agency Deposit Facility	UK Government backed	In-house
Certificates of deposit issued by banks and building societies covered by UK Government guarantees	UK Government explicit guarantee	In-house
Money Market Funds (MMFs)	AAA_M	In-house
Non-UK Banks/ Building Societies	Domiciled in a country which has a minimum sovereign Long Term rating of AAA	In-house
Treasury Bills	UK Government backed	In-house
Covered Bonds	AAA	In-house

* Banks & Building Societies

The Council will keep the investment balance below or at the maximum limit based on the institutions credit rating as detailed in paragraph 9.21 below. If this limit is breached, for example due to significant late receipts, the Treasurer will be notified as soon as possible after the breach, along with the reasons for it. Please note this relates to specific investments and not balances held within the Council's bank accounts, including the general bank account.

Creditworthiness policy

9.16 The Council applies the creditworthiness service provided by Capita Asset Services. This service employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies; Fitch, Moody's and Standard & Poor's. Capita supplement the credit ratings of counterparties with the following overlays:

- credit watches and credit outlooks from credit rating agencies
- Credit Default Swap spreads to provide early warning of likely changes in credit ratings
- sovereign ratings to select counterparties from only the most creditworthy countries

9.17 This modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads. The end product is a series of colour coded bands which indicate the relative creditworthiness of counterparties. This classification is called durational banding.

9.18 The Council has regard to Capita's approach to assessing creditworthiness when selecting counterparties. It will not apply the approach of using the lowest rating from all three rating agencies to determine creditworthy counterparties. The Capita creditworthiness service uses a wider array of information than just primary ratings and by using a risk weighted scoring system does not give undue preponderance to just one agency's ratings.

9.19 In summary therefore the Council will approach assessment of creditworthiness by using the Capita counterparty list as a starting point, and then applying as an overlay its own counterparty limits and durations. All credit ratings will be monitored on a daily basis and re-assessed weekly. The Council is alerted to changes to ratings of all three agencies through its use of the Capita creditworthiness service.

- if a downgrade results in the counterparty/investment scheme no longer meeting the Council's minimum criteria, its further use as a new investment will be withdrawn immediately.

- in addition to the use of Credit Ratings, the Council will be advised of information in Credit Default Swap against the iTraxx benchmark[2] and other market data on a weekly basis. Extreme market movements may result in the downgrade of an institution or removal from the Council's lending list.

9.20 Sole reliance will not be placed on the use of this external service. In addition the Council will also use market data and market information, information on government support for banks and the credit ratings of that government support. The Council will assess investments only against the criteria listed above, and will not seek to evaluate an organisation's ethical policies when making these assessments.

Investment Limits

9.21 As advised by Capita Asset Services, the Council's treasury advisors, the financial investment limits of banks and building societies are linked to their short and long-term ratings (Fitch or equivalent) as follows:

Banks & Building Societies

Long Term	Amount
Fitch AA+ and above	£20 million
Fitch AA/AA-	£15 million
Fitch A+/A	£15 million
Fitch A-	£10 million
Fitch BBB+	£10 million

The Council will only utilise those institutions that have a short term rating of F2 or higher, (Fitch or equivalent).

UK Government (includes Debt Management Office) £200 million

[2] The Markit iTraxx Senior Financials Index is a composite of the 25 most liquid financial entities in Europe. The index is calculated through an averaging process by the Markit Group and is used as the benchmark level of CDS spreads on Capita Asset Services' Credit List.

Greater Manchester Combined Authority	£200 million
Other Local Authorities	£20 million

9.22 It may be prudent, depending on circumstances, to temporarily increase the limits shown above as in the current economic environment, it is increasingly difficult for officers to place funds. If this is the case officers will seek approval from the City Treasurer for such an increase and approval may be granted at the City Treasurer's discretion. Any increase in the limits will be reported to Members as part of the normal treasury management reporting process. It should be noted that any HCA funds invested with other local authorities will form part of the £20m limit detailed above.

Country Limits

9.23 The Council has determined that it will only use approved counterparties from countries that meet the Council's criteria based on the creditworthiness policy described in paragraph 9.21. The list of countries that qualify using this credit criteria as at 4th January 2017 are shown below:

- Australia
- Canada
- Denmark
- Germany
- Netherlands
- Singapore
- Sweden
- Switzerland
- USA

9.24 Every country on this list is rated AAA by two or more of the three main rating agencies. This list will be added to, or deducted from should ratings change. The Council will only invest outside the UK with institutions of the highest credit rating AAA, who are therefore higher rated and less risky to utilise than the UK.

Money Market Funds

9.25 The removal of the implied levels of sovereign support that were built into ratings throughout the financial crisis has impact on bank and building society ratings across the world. Rating downgrades can limit the number of counterparties available to the Council. To provide flexibility for the investment of surplus funds the Council will use Money Market Funds when appropriate as an alternative specified investment.

9.26 Money Market funds are investment instruments that invest in a variety of institutions, therefore diversifying the investment risk. The funds are managed by a fund manager and they have objectives to preserve capital, provide daily liquidity and a competitive yield. The majority of money market funds invest both inside and outside the UK.

9.27 Money Market funds are rated through a separate process to bank deposits. This looks at the average maturity of the underlying investments in the fund as well as the credit quality of those investments. It is proposed that the Council will only use Money Market Funds where the institutions hold the highest AAA credit rating. Furthermore where the Money Market Funds invest outside the UK the countries concerned must be on the list of approved counterparties noted in paragraph 9.23 above.

Treasury Bills

9.28 Treasury Bills are marketable securities issued by the UK Government and as such counterparty and liquidity risk is relatively low, although there is potential risk to value arising from an adverse movement in interest rates unless they are held to maturity.

9.29 Weekly tenders are held for Treasury Bills so the Council could invest funds on a regular basis, based on projected cash flow information. This would provide a spread of maturity dates and reduce the volume of investments maturing at the same time.

9.30 There is a large secondary market for Treasury Bills so it is possible to trade them in earlier than the maturity date if required; and also purchase them in the secondary market. It is anticipated however that in the majority of cases the Council will hold to maturity to avoid any potential capital loss from selling before maturity. The Council will only sell the Treasury Bills early if it can demonstrate value for money in doing so.

Certificates of Deposit

9.31 Certificates of Deposit are short dated marketable securities issued by financial institutions, and as such counterparty risk is low. The instruments have flexible maturity dates, so it is possible to trade them in early if necessary, however there is a potential risk to capital if they are traded ahead of maturity and there is an adverse movement in interest rates. Certificates of Deposit are given the same priority as fixed deposits if a bank was to default. The Council would only deal with Certificates of Deposit that are issued by banks which meet the credit criteria.

Covered Bonds

9.32 Covered Bonds are debt instruments secured by assets such as mortgage loans. They are issued by banks and other non-financial institutions. The loans remain on the issuing institutions Balance Sheet and investors have a preferential claim in the event of the issuing institution defaulting. All issuing institutions are required to hold sufficient assets to cover the claims of all covered bondholders. The Council would only deal with bonds that are issued by banks which meet the credit criteria, or AAA rated institutions, (e.g. insurance companies).

Liquidity

9.33 Based on cash flow forecasts, the level of cash balances in 2017/18 is estimated to range between £0m and £230m. The higher level can arise where for instance large Government grants are received, or long term borrowing has recently been undertaken.

Investment Strategy to be followed in-house

9.34 Capita's view of forecast Bank Rate is at Section 7. The current economic outlook viewed by Capita is that the structure of market interest rates and government debt yields have several key treasury management implications:

- The Bank of England interpreted confidence indicators following the referendum vote for Brexit as anticipating a sharp slowdown in the UK economy. In 2016 the Monetary Policy Committee attempted to counter this expectation with a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals;

- Capita's view is that Bank Rate will remain unchanged at 0.25% until a first increase to 0.50% in quarter 2, 2019 with a rise to 0.75% by March 2020. Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in August 2016, with huge volatility during 2016 as a whole. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling;

- Forecasting as far ahead as 2019 is difficult as there are many potential economic factors which could impact on the UK economy. There are also political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on forecasts;

- Investment returns are likely to remain relatively low during 2017/18 and beyond;

- In the Eurozone, the ECB commenced, in March 2015, its €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017;

- These measures have struggled to make a significant impact in boosting Eurozone economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Forward indications are that economic growth in the EU is likely to continue at moderate levels.
- There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

9.35 The Council will avoid locking into longer term deals while investment rates are at historically low levels, this is unless attractive rates are available with counterparties of particularly high creditworthiness which make longer term deals worthwhile and within the risk parameters set by the Council.

9.36 For 2017/18 it is suggested that the Council should budget for an investment return of 0.25% on investments placed during the financial year. For cash flow generated balances, the Council will seek to utilise its business reserve accounts and short-dated deposits (overnight to three months) in order to benefit from the compounding of interest.

End of year Investment Report

9.38 At the end of the financial year, the Council will receive a report on investment activity as part of the Annual Treasury Report.

Policy on the use of External Service Providers

9.39 The Council uses Capita Treasury Management Solutions as external treasury management advisors and has access to another provider who is an approved supplier should a second opinion or additional work be required. 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 its external service providers.

9.40 The Council recognises there is value in employing external providers of treasury management services to acquire access to specialist skills and resources. It will ensure the terms of the Advisor's appointment and the methods by which their value is assessed are properly agreed and documented, and subjected to regular review.

Scheme of delegation

9.41 Appendix D describes the responsibilities of Member groups and officers in relation to treasury management.

Role of the Section 151 Officer

9.42 Appendix E notes the definition of the role of the City Treasurer in relation to treasury management.

10. Minimum Revenue Provision (MRP) Strategy

10.1 Appendix B contains the Council's policy for spreading capital expenditure charges to revenue through the annual MRP charge. The revised policy for 2016/17 was
approved by the Audit Committee on 1 December 2016.

11. Recommendations

11.1 Please see page 1 of the report for the list of recommendations.

Appendix A

Treasury Limits and Prudential Indicators for approval

Please note last years approved figures are shown in brackets.

Treasury Management Indicators	2017-18		2018-19		2019-20
	£m		£m		£m
Authorised Limit - external debt					
Borrowing	1,555.4	(1,245.0)	1,595.7	(1,245.0)	1,814.1
other long term liabilities	216.0	(216.0)	216.0	(216.0)	216.0
TOTAL	1,771.4	(1,461.0)	1,811.7	(1,461.0)	2,030.1
Operational Boundary - external debt					
borrowing	1,159.8	(1,096.2)	1,412.9	(1,187.4)	1,541.6
other long term liabilities	216.0	(216.0)	216.0	(216.0)	216.0
TOTAL	1,375.8	(1,312.2)	1,628.9	(1,403.4)	1,757.6
Actual external debt	936.6	(954.9)	1,258.7	(1,074.2)	1,357.5
Upper limit for total principal sums invested for over 364 days	0	(0)	0	(0)	0
Upper limit for fixed interest rate exposure Net borrowing at fixed rates as a % of total net borrowing	96%	(100%)	100%	(100%)	100%
Upper limit for variable interest rate exposure Net borrowing at variable rates as a % of total net borrowing	92%	(95%)	97%	(100%)	100%

Maturity structure of new fixed rate borrowing during 2017-18	Upper Limit		Lower limit	
under 12 months	70%	(70%)	0%	(0%)
12 months and within 24 months	1000%	(100%)	0%	(0%)
24 months and within 5 years	80%	(90%)	0%	(0%)
5 years and within 10 years	70%	(70%)	0%	(0%)
10 years and above	70%	(70%)	0%	(0%)
Has the Authority adopted the CIPFA Treasury Management Code?				Yes

The status of the indicators will be included in Treasury Management reporting during 20017/18. They will also be included in the Council’s Global Revenue Budget monitoring.

Definitions and Purpose of the Treasury Management noted in the table above

(Indicators are as recommended by the CIPFA Prudential Code)

Authorised Limit - external debt

The local authority will set for the forthcoming financial year and the following two financial years an authorised limit for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the Authorised Limit.

Operational Boundary - external debt

The local authority will also set for the forthcoming financial year and the following two financial years an operational boundary for its total external debt, excluding investments, separately identifying borrowing from other long-term liabilities. This prudential indicator is referred to as the Operational Boundary.

Both the Authorised Limit and the Operational Boundary need to be consistent with the authority's plans for capital expenditure and financing; and with its treasury management policy statement and practices. The Operational Boundary should be based on the authority's estimate of most likely, i.e. prudent, but not worst case scenario. Risk analysis and risk management strategies should be taken into account.

The Operational Boundary should equate to the maximum level of external debt projected by this estimate. Thus, the Operational Boundary links directly to the authority's plans for capital expenditure; its estimates of capital financing requirement; and its estimate of cash flow requirements for the year for all purposes. The Operational Boundary is a key management tool for in-year monitoring.

It will probably not be significant if the Operational Boundary is breached temporarily on occasions due to variations in cash flow. However, a sustained or regular trend above the Operational Boundary would be significant and should lead to further investigation and action as appropriate. Thus, both the Operational Boundary and the Authorised Limit will be based on the authority's plans. The authority will need to assure itself that these plans are affordable and prudent. The Authorised Limit will in addition need to provide headroom over and above the Operational Boundary sufficient for example for unusual cash movements.

Actual external debt

After the year end, the closing balance for actual gross borrowing plus (separately), other long-term liabilities is obtained directly from the local authority's Balance Sheet.

The prudential indicator for Actual External Debt considers a single point in time and hence is only directly comparable to the Authorised Limit and Operational Boundary at that point in time. Actual debt during the year can be compared.

Upper limit for total principal sums invested for over 364 days

The authority will set an upper limit for each forward financial year period for the maturing of investments made for a period longer than 364 days. This indicator is referred to as the prudential limit for Principal Sums Invested for periods longer than 364 days.

The purpose of this indicator is so the authority can contain its exposure to the possibility of loss that might arise as a result of its having to seek early repayment or redemption of principal sums invested.

Upper limit for fixed interest rate exposure

The authority will set for the forthcoming financial year and the following two financial years upper limits to its exposures to the effects of changes in interest rates. These indicators will relate to both fixed and variable interest rates. They may relate to either the authority's net interest on, or to its net principal sum outstanding on its borrowing/investments.

Upper limit for variable interest rate exposure

This indicator is as described and calculated above for Fixed Interest Rate Exposures, but substitutes 'variable rates' for 'fixed rates'.

Maturity structure of new fixed rate borrowing

The authority will set for the forthcoming financial year both upper and lower limits with respect to the maturity structure of its borrowing. These indicators are referred to as the Upper and Lower limits respectively for the Maturity Structure of Borrowing.

Has the Authority adopted the CIPFA Treasury Management Code?

This prudential indicator in respect of treasury management is to confirm that the local authority has adopted the CIPFA Treasury Management in the Public Services: Code of Practice and Cross-Sectoral Guidance Notes. The aim is to ensure that treasury management is led by a clear and integrated forward treasury management strategy, and a recognition of the preexisting structure of the authority's borrowing and investment portfolios.

Appendix B

Minimum Revenue Provision Strategy

The Council implemented the new Minimum Revenue Provision (MRP) guidance in 2011/12 and has assessed its MRP for 2016/17 in accordance with the main recommendations contained within the guidance issued by the Secretary of State under section 21(1A) of the Local Government Act 2003.

The Council is required to make provision for repayment of an element of the accumulated General Fund capital spend each year through a revenue charge (the Minimum Revenue Provision - MRP).

DCLG Regulations require full Council to approve an MRP Statement, in advance of each year. If the Council wishes to amend its policy during the year this would need to be approved by full Council. A variety of options are available to councils to replace the previous Regulations, so long as there is a prudent provision. The options are:

- ***Option 1:*** Regulatory Method – can only be applied to capital expenditure incurred prior to April 2008 or Supported Capital Expenditure. This is calculated as 4% of the non-housing CFR at the end of the preceding financial year, less some transitional factors relating to the movement to the new Prudential Code in 2003.

- ***Option 2:*** CFR Method – a provision equal to 4% of the non-housing CFR at the end of the preceding financial year.

- ***Option 3:*** Asset Life Method – MRP is calculated based on the life of the asset, on either an equal instalment or an annuity basis.

- ***Option 4:*** Depreciation Method – MRP is calculated in accordance with the depreciation accounting required for the asset.

Options 1 and 2 may be used only for supported expenditure, which is capital expenditure for which the Council has been notified by Government that the costs of that expenditure will be taken into account in the calculation of revenue grant due to the Council.

It is important to note that the Council can deviate from these options provided that the approach taken ensures that there is a prudent provision. The Council has historically followed option 1 for supported expenditure based on the level of support provided by Government through Revenue Support Grant (RSG).

The assets created or acquired under Supported Capital Expenditure predominantly had long asset lives of .c 50 years, such as land or buildings, and an MRP of 4% suggests a significantly shorter asset life. As the level of RSG the Council receives has reduced in recent years, it is prudent to review the approach to MRP on supported borrowing to reflect the Government support received.

It is therefore proposed to make a provision of 2% of the non-housing CFR from the end of the preceding financial year. This is in line with many over local authorities who have reviewed the basis for their MRP or something similar.

There will be no adjustment to MRP charged before 2016/17.

The Council approved the following MRP Statement in January 2017:
It is the Council's policy that MRP relating to an asset will start to be incurred in the year after the capital expenditure on the asset is incurred or, in the case of new assets, in the year following the asset coming into use, in accordance with DCLG's guidance.

The Council recognises that there are different categories of capital expenditure, for which it will incur MRP as follows:

- For non HRA Supported Capital Expenditure: MRP policy will be charged at a rate of 2% on a similar basis to option 1 of the guidance (the regulatory method) but at a lower rate, better reflecting the asset lives of the assets funded through Supported Borrowing.

- For non HRA unsupported capital expenditure incurred the MRP policy will be:

- Asset Life Method – MRP will be based on a straight line basis or annuity method so linking the MRP to the future flow of benefits from the asset, dependant on the nature of the capital expenditure, in accordance with option 3 of the guidance.

- If the expenditure is capital by virtue of a Ministerial direction, has been capitalised under a Capitalisation Directive, or does not create a council asset, MRP will be provided in accordance with option 3 of the guidance with asset lives calculated as per the table below:

Expenditure type	**Maximum period over which MRP to be made**
Expenditure capitalised by virtue of a direction under s16 (2) (b).	20 years.
Regulation 25(1) (a). Expenditure on computer programs.	Same period as for computer hardware.
Regulation 25(1) (b). Loans and grants towards capital expenditure by third parties.	The estimated life of the assets in relation to which the third party expenditure is incurred.
Regulation 25(1) (c). Repayment of grants and loans for capital expenditure.	25 years or the period of the loan if longer.
Regulation 25(1) (d). Acquisition of share or loan capital.	20 years, or the estimated life of the asset acquired.
Regulation 25(1) (e). Expenditure on works to assets not owned by the authority.	The estimated life of the assets.
Regulation 25(1) (ea). Expenditure on assets for use by others.	The estimated life of the assets.

Regulation 25(1) (f). Payment of levy on Large Scale Voluntary Transfers (LSVTs) of dwellings.	25 years.

- For PFI service concessions and some lessee interests: Following the move to International Accounting Standards arrangements under private finance initiatives (PFIs) service concessions and some lessee interests (including embedded leases) are accounted for on the Council's balance sheet. Where this occurs, a part of the contract charge or rent payable will be taken to reduce the balance sheet liability rather than being charged as revenue expenditure. The MRP element of these schemes will be the amount of contract charge or rental payment charged against the balance sheet liability. This approach will produce an MRP charge comparable to that under option 3 in that it will run over the life of the lease or PFI scheme.

In some exceptional cases, the Council will deviate from the policy laid out above provided such exceptions remain prudent. Any exceptions are listed below:

- Where capital expenditure is incurred through providing loans to organisations, and where those loans are indemnified or have financial guarantees protecting against loss, no MRP will be charged in relation to the capital expenditure. Similarly, loans given by the Council where any losses incurred on the investment will impact solely on a third party, such as those provided under the City Deal arrangement with the HCA, will not require an MRP charge.

Appendix C

Treasury Management Policy Statement

1. This organisation defines its treasury management activities as:
   The management of the organisation's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks.

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

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

The Council will invest its monies prudently, considering security first, liquidity second, and yield last, carefully considering its investment counterparties. It will similarly borrow monies prudently and consistent with the Council's service objectives.

Appendix D

Treasury Management Scheme of Delegation

i **Full Council**

- receiving and reviewing reports on treasury management policies, practices and activities
- approval of annual strategy

ii **Responsible body – Audit Committee**

- approval of/amendments to the organisation's adopted clauses, treasury management policy statement and treasury management practices
- budget consideration and approval
- approval of the division of responsibilities
- receiving and reviewing regular monitoring reports and acting on recommendations
- approving the selection of external service providers and agreeing terms of appointment

iii **Body with responsibility for scrutiny** - Resource and Governance Scrutiny

Committee

- reviewing the treasury management policy and procedures and making recommendations to the responsible body

iv **City Treasurer**

- delivery of the function

Appendix E

The treasury management role of the Section 151 Officer

The S151 (responsible) Officer

- recommending clauses, treasury management policy/practices for approval, reviewing the same regularly, and monitoring compliance
- submitting regular treasury management policy reports
- submitting budgets and budget variations
- receiving and reviewing management information reports
- reviewing the performance of the treasury management function
- ensuring the adequacy of treasury management resources and skills, and the effective division of responsibilities within the treasury management function
- ensuring the adequacy of internal audit, and liaising with external audit
- recommending the appointment of external service providers.

Appendix F

Economic Background as at January 2017 – Capita Treasury Solutions Limited

UK. GDP growth rates in 2013, 2014 and 2015 of 2.2%, 2.9% and 1.8% were some of the strongest rates among the G7 countries. Growth is expected to have strengthened in 2016 with the first three quarters coming in respectively at +0.4%, +0.7% and +0.5%. The latest Bank of England forecast for growth in 2016 as a whole is +2.2%. The figure for quarter 3 was a pleasant surprise which confounded the downbeat forecast by the Bank of England in August of only +0.1%, (subsequently revised up in September, but only to +0.2%). During most of 2015 and the first half of 2016, the economy had faced headwinds for exporters from the appreciation of sterling against the Euro, and weak growth in the EU, China and emerging markets, and from the dampening effect of the Government's continuing austerity programme.

The referendum vote for Brexit in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August, which were interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the economy. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys so that it is generally expected that the economy will post reasonably strong growth numbers through the second half of 2016 and also in 2017, albeit at a slower pace than in the first half of 2016.

The Monetary Policy Committee, (MPC), meeting of 4th August was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in Bank Rate from 0.50% to 0.25%, a renewal of quantitative easing, with £70bn made available for purchases of gilts and corporate bonds, and a £100bn tranche of cheap borrowing being made available for banks to use to lend to businesses and individuals.

The MPC meeting of 3 November left Bank Rate unchanged at 0.25% and other monetary policy measures also remained unchanged. This was in line with market expectations, but a major change from the previous quarterly Inflation Report MPC meeting of 4 August, which had given a strong steer, in its forward guidance, that it was likely to cut Bank Rate again, probably by the end of the year if economic data turned out as forecast by the Bank. The MPC meeting of 15 December also left Bank Rate and other measures unchanged.

The latest MPC decision included a forward view that Bank Rate could go either up or down depending on how economic data evolves in the coming months. Our central view remains that Bank Rate will remain unchanged at 0.25% until the first increase to 0.50% in quarter 2, 2019 (unchanged from our previous forecast). However, we would not, as yet, discount the risk of a cut in Bank Rate if economic growth were to take a significant dip downwards, though we think this is unlikely. We would also point out that forecasting as far ahead as mid 2019 is highly fraught as there are many potential economic headwinds which could blow the UK economy one way or the other as well as political developments in the UK, (especially over the terms of Brexit), EU, US and beyond, which could have a major impact on our forecasts.

The pace of Bank Rate increases in our forecasts has been slightly increased beyond the three year time horizon to reflect higher inflation expectations.

The August quarterly Inflation Report was based on a pessimistic forecast of near to zero GDP growth in quarter 3, i.e. a sharp slowdown in growth from +0.7% in quarter 2, in reaction to the shock of the result of the referendum in June. However, consumers have very much stayed in a ‘business as usual’ mode and there has been no sharp downturn in spending; it is consumer expenditure that underpins the services sector which comprises about 75% of UK GDP. After a fairly flat three months leading up to October, retail sales in October surged at the strongest rate since September 2015 and were again strong in November. In addition, the GfK consumer confidence index recovered quite strongly to -3 in October after an initial sharp plunge in July to -12 in reaction to the referendum result. However, in November it fell to -8 indicating a return to pessimism about future prospects among consumers, probably based mainly around concerns about rising inflation eroding purchasing power.

Bank of England GDP forecasts in the November quarterly Inflation Report were as follows, (August forecasts in brackets) - 2016 +2.2%, (+2.0%); 2017 1.4%, (+0.8%); 2018 +1.5%, (+1.8%). There has, therefore, been a sharp increase in the forecast for 2017, a marginal increase in 2016 and a small decline in growth, now being delayed until 2018, as a result of the impact of Brexit.

Capital Economics’ GDP forecasts are as follows: 2016 +2.0%; 2017 +1.5%; 2018 +2.5%. They feel that pessimism is still being overdone by the Bank and Brexit will not have as big an effect as initially feared by some commentators.

The Chancellor has said he will do ‘whatever is needed’ i.e. to promote growth; there are two main options he can follow – fiscal policy e.g. cut taxes, increase investment allowances for businesses, and/or increase government expenditure on infrastructure, housing etc. This will mean that the PSBR deficit elimination timetable will need to slip further into the future as promoting growth, (and ultimately boosting tax revenues in the longer term), will be a more urgent priority.

The Governor of the Bank of England, Mark Carney, had warned that a vote for Brexit would be likely to cause a slowing in growth, particularly from a reduction in business investment, due to the uncertainty of whether the UK would have continuing full access, (i.e. without tariffs), to the EU single market. He also warned the Bank could not do all the heavy lifting to boost economic growth and suggested that the Government would need to help growth e.g. by increasing investment expenditure and by using fiscal policy tools.

The newly appointed Chancellor, Phillip Hammond, announced, in the aftermath of the referendum result and the formation of a new Conservative Cabinet, that the target of achieving a budget surplus in 2020 would be eased in the Autumn Statement on
23 November. This was duly confirmed in the Statement which also included some increases in infrastructure spending.

The other key factor in forecasts for Bank Rate is inflation where the MPC aims for a target for CPI of 2.0%. The November Inflation Report included an increase in the peak forecast for inflation from 2.3% to 2.7% during 2017; (Capital Economics are forecasting a peak of just under 3% in 2018). This increase was largely due to the effect of the sharp fall in the value of sterling since the referendum, although during November, sterling has recovered some of this fall to end up 15% down against the Dollar, and 8% down against the Euro (as at the MPC meeting date – 15.12.16).

This depreciation will feed through into a sharp increase in the cost of imports and materials used in production in the UK. However, the MPC is expected to look through the acceleration in inflation caused by external, (outside of the UK), influences, although it has given a clear warning that if wage inflation were to rise significantly as a result of these cost pressures on consumers, then they would take action to raise Bank Rate.

What is clear is that consumer disposable income will come under pressure, as the latest employers' survey is forecasting median pay rises for the year ahead of only 1.1% at a time when inflation will be rising significantly higher than this. The CPI figure has been on an upward trend in 2016 and reached 1.2% in November. However, prices paid by factories for inputs rose to 13.2% though producer output prices were still lagging behind at 2.3% and core inflation was 1.4%, confirming the likely future upwards path.

Gilt yields, and consequently PWLB rates, have risen sharply since hitting a low point in mid-August. There has also been huge volatility during 2016 as a whole. The year started with 10 year gilt yields at 1.88%, fell to a low point of 0.53% on 12 August, and hit a new peak on the way up again of 1.55% on 15 November. The rebound since August reflects the initial combination of the yield-depressing effect of the MPC's new round of quantitative easing on 4 August, together with expectations of a sharp downturn in expectations for growth and inflation as per the pessimistic Bank of England Inflation Report forecast, followed by a sharp rise in growth expectations since August when subsequent business surveys, and GDP growth in quarter 3 at +0.5% q/q, confounded the pessimism. Inflation expectations also rose sharply as a result of the continuing fall in the value of sterling.

Employment had been growing steadily during 2016 but encountered a first fall in over a year, of 6,000, over the three months to October. The latest employment data in December, (for November), was distinctly weak with an increase in unemployment benefits claimants of 2,400 in November and of 13,300 in October. House prices have been rising during 2016 at a modest pace but the pace of increase has slowed since the referendum; a downturn in prices could dampen consumer confidence and expenditure.

USA. The American economy had a patchy 2015 with sharp swings in the quarterly growth rate leaving the overall growth for the year at 2.4%. Quarter 1 of 2016 at +0.8%, (on an annualised basis), and quarter 2 at 1.4% left average growth for the first half at a weak 1.1%. However, quarter 3 at 3.2% signalled a rebound to strong growth.

The Fed. embarked on its long anticipated first increase in rates at its December 2015 meeting. At that point, confidence was high that there would then be four more increases to come in 2016. Since then, more downbeat news on the international scene, and then the Brexit vote, have caused a delay in the timing of the second increase of 0.25% which came, as expected, in December 2016 to a range of 0.50% to 0.75%.

Overall, despite some data setbacks, the US is still, probably, the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation: this is going to require the central bank to take action to raise rates so as to make progress towards normalisation of monetary policy, albeit at lower central rates than prevailed before the 2008 crisis. The Fed. Therefore also indicated that it expected three further increases of 0.25% in 2017 to deal with rising inflationary pressures.

The result of the presidential election in November is expected to lead to a strengthening of US growth if Trump's election promise of a major increase in expenditure on infrastructure is implemented. This policy is also likely to strengthen inflation pressures as the economy is already working at near full capacity. In addition, the unemployment rate is at a low point verging on what is normally classified as being full employment. However, the US does have a substantial amount of hidden unemployment in terms of an unusually large, (for a developed economy), percentage of the working population not actively seeking employment.

Trump's election has had a profound effect on the bond market and bond yields rose sharply in the week after his election. Time will tell if this is a reasonable assessment of his election promises to cut taxes at the same time as boosting expenditure. This could lead to a sharp rise in total debt issuance from the current level of around 72% of GDP towards 100% during his term in office.

However, although the Republicans now have a monopoly of power for the first time since the 1920s, in having a President and a majority in both Congress and the Senate, there is by no means any certainty that the politicians and advisers he has been appointing to his team, and both houses, will implement the more extreme policies that Trump outlined during his election campaign. Indeed, Trump may even rein back on some of those policies himself.

In the first week since the US election, there was a major shift in investor sentiment away from bonds to equities, especially in the US. However, gilt yields in the UK and bond yields in the EU have also been dragged higher. Some commentators are saying that this rise has been an overreaction to the US election result which could be reversed. Other commentators take the view that this could well be the start of the long expected eventual unwinding of bond prices propelled upwards to unrealistically high levels, (and conversely bond yields pushed down), by the artificial and temporary power of quantitative easing.

EZ. In the Eurozone, the ECB commenced, in March 2015, its massive €1.1 trillion programme of quantitative easing to buy high credit quality government and other debt of selected EZ countries at a rate of €60bn per month. This was intended to run initially to September 2016 but was extended to March 2017 at its December 2015

meeting. At its December and March 2016 meetings it progressively cut its deposit facility rate to reach
-0.4% and its main refinancing rate from 0.05% to zero. At its March meeting, it also increased its monthly asset purchases to €80bn.

These measures have struggled to make a significant impact in boosting economic growth and in helping inflation to rise significantly from low levels towards the target of 2%. Consequently, at its December meeting it extended its asset purchases programme by continuing purchases at the current monthly pace of €80 billion until the end of March 2017, but then continuing at a pace of €60 billion until the end of December 2017, or beyond, if necessary, and in any case until the Governing Council sees a sustained adjustment in the path of inflation consistent with its inflation aim.

It also stated that if, in the meantime, the outlook were to become less favourable or if financial conditions became inconsistent with further progress towards a sustained adjustment of the path of inflation, the Governing Council intended to increase the programme in terms of size and/or duration.

EZ GDP growth in the first three quarters of 2016 has been 0.5%, +0.3% and +0.3%, (+1.7% y/y). Forward indications are that economic growth in the EU is likely to continue at moderate levels. This has added to comments from many forecasters that those central banks in countries around the world which are currently struggling to combat low growth, are running out of ammunition to stimulate growth and to boost inflation. Central banks have also been stressing that national governments will need to do more by way of structural reforms, fiscal measures and direct investment expenditure to support demand and economic growth in their economies.

There are also significant specific political and other risks within the EZ:

- **Greece** continues to cause major stress in the EU due to its tardiness and reluctance in implementing key reforms required by the EU to make the country more efficient and to make significant progress towards the country being able to pay its way – and before the EU is prepared to agree to release further bail out funds.

- **Spain** has had two inconclusive general elections in 2015 and 2016, both of which failed to produce a workable government with a majority of the 350 seats. At the eleventh hour on 31 October, before it would have become compulsory to call a third general election, the party with the biggest bloc of seats (137), was given a majority confidence vote to form a government. This is potentially a highly unstable situation, particularly given the need to deal with an EU demand for implementation of a package of austerity cuts which will be highly unpopular.

- The under capitalisation of **Italian banks** poses a major risk. Some **German banks** are also undercapitalised, especially Deutsche Bank, which is under threat of major financial penalties from regulatory authorities that will further weaken its capitalisation. What is clear is that national governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, while, at the same time, those banks are unable realistically to borrow additional capital in financial markets due to their vulnerable financial state. However, they are also 'too big, and too important to their national economies, to be allowed to fail'.

- **4 December Italian constitutional referendum** on reforming the Senate and reducing its powers; this was also a confidence vote on Prime Minister Renzi who has resigned on losing the referendum. However, there has been remarkably little fall out from this result which probably indicates that the financial markets had already fully priced it in.
  A rejection of these proposals is likely to inhibit significant progress in the near future to fundamental political and economic reform which is urgently needed to deal with Italy's core problems, especially low growth and a very high debt to GDP ratio of 135%.

  These reforms were also intended to give Italy more stable government as no western European country has had such a multiplicity of governments since the Second World War as Italy, due to the equal split of power between the two chambers of the Parliament which are both voted in by the Italian electorate but by using different voting systems. It is currently unclear what the political, and other, repercussions are from this result.

- **Dutch general election 15.3.17**; a far right party is currently polling neck and neck with the incumbent ruling party. In addition, anti-big business and anti-EU activists have already collected two thirds of the 300,000 signatures required to force a referendum to be taken on approving the EU – Canada free trade pact. This could delay the pact until a referendum in 2018 which would require unanimous approval by all EU governments before it can be finalised. In April 2016, Dutch voters rejected by 61.1% an
  EU – Ukraine cooperation pact under the same referendum law. Dutch activists are concerned by the lack of democracy in the institutions of the EU.

- **French presidential election;** first round 13 April; second round 7 May 2017.

- **French National Assembly election June 2017.**

- **German Federal election August – 22 October 2017.** This could be affected by significant shifts in voter intentions as a result of terrorist attacks, dealing with a huge influx of immigrants and a rise in anti EU sentiment.

- The core EU, (note, not just the Eurozone currency area), principle of free movement of people within the EU is a growing issue leading to major stress and tension between EU states, especially with the Visegrad bloc of former communist states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an identifiable risk for the EU project to be called into fundamental question. The risk of an electoral revolt against the EU establishment has gained traction after the shock results of the UK referendum and the US Presidential election. But it remains to be seen whether any shift in sentiment will gain sufficient traction to produce any further shocks within the EU.

Asia. Economic growth in **China** has been slowing down and this, in turn, has been denting economic growth in emerging market countries dependent on exporting raw materials to China. Medium term risks have been increasing in China e.g. a dangerous build up in the level of credit compared to the size of GDP, plus there is a need to address a major over supply of housing and surplus industrial capacity, which both need to be eliminated.

This needs to be combined with a rebalancing of the economy from investment expenditure to consumer spending. However, the central bank has a track record of supporting growth through various monetary policy measures, though these further stimulate the growth of credit risks and so increase the existing major imbalances within the economy.

Economic growth in **Japan** is still patchy, at best, and skirting with deflation, despite successive rounds of huge monetary stimulus and massive fiscal action to promote consumer spending. The government is also making little progress on fundamental reforms of the economy.

Emerging countries. There have been major concerns around the vulnerability of some emerging countries exposed to the downturn in demand for commodities from China or to competition from the increase in supply of American shale oil and gas reaching world markets. The ending of sanctions on Iran has also brought a further significant increase in oil supplies into the world markets.

While these concerns have subsided during 2016, if interest rates in the USA do rise substantially over the next few years, (and this could also be accompanied by a rise in the value of the Dollar in exchange markets), this could cause significant problems for those emerging countries with large amounts of debt denominated in dollars. The Bank of International Settlements has recently released a report that $340bn of emerging market corporate debt will fall due for repayment in the final two months of 2016 and in 2017,
a 40% increase on the figure for the last three years.

Financial markets could also be vulnerable to risks from those emerging countries with major sovereign wealth funds, that are highly exposed to the falls in commodity prices from the levels prevailing before 2015, especially oil, and which, therefore, may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years if the price of oil does not return to pre-2015 levels.

Brexit timetable and process

- March 2017: UK government notifies the European Council of its intention to leave under the Treaty on European Union Article 50.

- March 2019: two-year negotiation period on the terms of exit. This period can be extended with the agreement of all members, view - not that likely.

- UK continues as an EU member during this two-year period with access to the single market and tariff free trade between the EU and UK.

- The UK and EU would attempt to negotiate, among other agreements, a bi-lateral trade agreement over that period.

- The UK would aim for a negotiated agreed withdrawal from the EU, although the UK may also exit without any such agreements.

- If the UK exits without an agreed deal with the EU, World Trade Organisation rules and tariffs could apply to trade between the UK and EU - but this is not certain.

- On exit from the EU: the UK parliament would repeal the 1972 European Communities Act.

- The UK will then no longer participate in matters reserved for EU members, such as changes to the EU's budget, voting allocations and policies.

It is possible that some sort of agreement could be reached for a transitional time period for actually implementing Brexit after March 2019 so as to help exporters to adjust in both the EU and in the UK.

Appendix G

Prospects for Interest Rates

The data below shows a variety of forecasts published by a number of institutions. They include those of Capita and Capital Economics (an independent forecasting consultancy). The forecast within this strategy statement has been drawn from these diverse sources and officers' own views. Please Note – The current PWLB rates and forecast shown above have taken into account the 20 basis point certainty rate reduction effective as of the 1st November 2012.

Capita Asset Services Interest Rate View													
	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank Rate View	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
3 Month LIBID	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.30%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%
6 Month LIBID	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.40%	0.50%	0.60%	0.70%	0.80%	0.90%	1.00%
12 Month LIBID	0.70%	0.70%	0.70%	0.70%	0.70%	0.80%	0.80%	0.90%	1.00%	1.10%	1.20%	1.30%	1.40%
5yr PWLB Rate	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB Rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB Rate	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB Rate	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Bank Rate													
Capita Asset Services	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
Capital Economics	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.50%
5yr PWLB Rate													
Capita Asset Services	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
Capital Economics	1.60%	1.70%	1.90%	2.00%	2.10%	2.20%	2.30%	2.40%	2.50%	2.70%	2.80%	2.90%	3.00%
10yr PWLB Rate													
Capita Asset Services	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
Capital Economics	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	3.10%	3.20%	3.30%	3.40%
25yr PWLB Rate													
Capita Asset Services	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
Capital Economics	2.95%	3.05%	3.05%	3.15%	3.25%	3.25%	3.35%	3.45%	3.55%	3.65%	3.75%	3.95%	4.05%

50yr PWLB Rate													
Capita Asset Services	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%
Capital Economics	2.80%	2.90%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%	3.70%	3.80%	3.90%

Appendix H

Glossary of Terms

Authorised Limit - This Prudential Indicator represents the limit beyond which borrowing is prohibited, and needs to be set and revised by Members. It reflects the level of borrowing which, while not desired, could be afforded in the short term, but is not sustainable. It is the expected maximum borrowing need, with some headroom for unexpected movements.

Bank Rate - the rate at which the Bank of England offers loans to the wholesale banks, thereby controlling general interest rates in the economy.

Counterparty - one of the opposing parties involved in a borrowing or investment transaction.

Covered Bonds - Debt instruments secured by assets such as mortgage loans. These loans remain on the issuer's balance sheet and investors have a preferential claim in the event of the issuing institution defaulting.

Credit Rating - A qualified assessment and formal evaluation of an institution's (bank or building society) credit history and capability of repaying obligations. It measures the probability of the borrower defaulting on its financial obligations, and its ability to repay these fully and on time.

Discount - Where the prevailing interest rate is higher than the fixed rate of a long-term loan, which is being repaid early, the lender can refund the borrower a discount, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender is able to offer the discount, as their investment will now earn more than when the original loan was taken out.

Fixed Rate Funding - A fixed rate of interest throughout the time of the loan. The rate is fixed at the start of the loan and therefore does not affect the volatility of the portfolio, until the debt matures and requires replacing at the interest rates relevant at that time.

Gilts - The loan instruments by which the Government borrows. Interest rates will reflect the level of demand shown by investors when the Government auctions Gilts.

High/Low Coupon - High/Low interest rate

LIBID (London Interbank Bid Rate) - This is an average rate, calculated from the rates at which individual major banks in London are willing to borrow from other banks for a particular time period. For example, 6 month LIBID is the average rate at which banks are willing to pay to borrow for 6 months.

LIBOR (London Interbank Offer Rate) - This is an average rate, calculated from the rates which major banks in London estimate they would be charged if they borrowed from other banks for a particular time period. For example, 6 month LIBOR is the average rate which banks believe they will be charged for borrowing for 6 months.

Liquidity - The ability of an asset to be converted into cash quickly and without any price discount. The more liquid a business is, the better able it is to meet short-term financial obligations.

LOBO (Lender Option Borrower Option) - This is a type of loan where, at various periods known as call dates, the lender has the option to alter the interest rate on the loan. Should the lender exercise this option, the borrower has a corresponding option to repay the loan in full without penalty.

Market -The private sector institutions - Banks, Building Societies etc.

Maturity Profile/Structure - an illustration of when debts are due to mature, and either have to be renewed or money found to pay off the debt. A high concentration in one year will make the Council vulnerable to current interest rates in that year.

Monetary Policy Committee - the independent body that determines Bank Rate.

Money Market Funds - Investment instruments that invest in a variety of institutions, therefore diversifying the investment risk.

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

Premium - Where the prevailing current interest rate is lower than the fixed rate of a long-term loan, which is being repaid early, the lender can charge the borrower a premium, the calculation being based on the difference between the two interest rates over the remaining years of the loan, discounted back to present value. The lender may charge the premium, as their investment will now earn less than when the original loan was taken out.

Prudential Code - The Local Government Act 2003 requires the Council to ‘have regard to‘ the Prudential Code and to set Prudential Indicators for the next three years to ensure that the Council’s capital investment plans are affordable, prudent and sustainable.

PWLB - Public Works Loan Board. Part of the Government’s Debt Management Office, which provides loans to public bodies at rates reflecting those at which the Government is able to sell Gilts.

Specified Investments - Sterling investments of not more then one-year maturity. These are considered low risk assets, where the possibility of loss of principal or investment income is very low.

Non-specified investments - Investments not in the above, specified category, e.g., foreign currency, exceeding one year or outside our minimum credit rating criteria.

Treasury Bills - These are marketable securities issued by the UK Government and as such counterparty and liquidity risk is very low.

Variable Rate Funding - The rate of interest either continually moves reflecting interest rates of the day, or can be tied to specific dates during the loan period. Rates may be updated on a monthly, quarterly or annual basis.

Volatility - The degree to which the debt portfolio is affected by current interest rate movements. The more debt maturing within the coming year and needing replacement, and the more debt subject to variable interest rates, the greater the volatility.

Yield Curve - A graph of the relationship of interest rates to the length of the loan. A normal yield curve will show interest rates relatively low for short-term loans compared to long-term loans. An inverted Yield Curve is the opposite of this.

Appendix I

Treasury Management Implications of HRA Reform

As discussed in Section 3 of the report, the reform of the HRA finance system has consequences for the treasury management of the Council. As part of the reform, the HRA's debt portfolio needs to be separately identifiable to that of the General Fund, and the HRA will hold some autonomy over the management of its debt portfolio. However, in order to ensure that the treasury management function of the Council remains effective and provides value for money, and given that the Section 151 officer for both the General Fund and the HRA is the Treasurer, the HRA's treasury portfolio must be run in the context of the overall Council portfolio.

This appendix seeks to explain how the debt portfolio of the Council has been split between the General Fund and the HRA, and how the HRA treasury position will be managed going forward.

The Portfolio Split

One of the principles behind the reform of HRA finance was to provide some level of treasury autonomy for the HRA, separating its debt from the Council's so that its treasury position could be managed separately. To achieve this, the debt portfolio was to be split at the point that the debt settlement was made.

On the 28 March 2012, the Council received c. £294m which was to be used to reduce the debt held by the Council. The table below shows the Council's treasury portfolio before and after the settlement:

	Pre reform		Post reform
	£'000		*£'000*
PWLB	199,966		0
Market	549,640		480,215
Stock	8,159		8,159
Gross Debt	**757,765**		**488,374**
Deposits	-17,954		-42,839
Net Debt	**739,811**		**445,535**

At this point, the debt was to be split according to the relative capital financing requirements (CFRs) of both the General Fund and the HRA. The cash remainder of the settlement could not be used to redeem further market debt so, to ensure that the HRA CFR fell by the full level of the settlement, a notional transaction took place. An amount of debt equivalent to the cash remainder was transferred from the HRA to the General Fund, alongside the cash. This had a neutral effect on the General Fund's net debt.

The table below shows the CFRs before and after the debt settlement, with the HRA CFR falling by the settlement:

CFRs	Pre reform		Post reform	% of total
	£'000		*£'000*	
General Fund	675,454		675,454	84.47%
HRA	418,463		124,187	15.53%
Total	**1,093,917**		**799,641**	**100.00%**
		Of which financed:	*488,374*	
		Of which unfinanced:	*311,267*	

As can be seen from the tables below, the debt was to split in a ratio of 84.47:15.53 between the General Fund and the HRA, including the unfinanced CFR element. This is the level of internal borrowing undertaken in lieu of external borrowing, through the use of cash balances to fund expenditure rather than external borrowing. It was decided, for administrative reasons, that all of the Council's remaining stock debt should be held by the General Fund, which increased the relative level of unfinanced CFR held by the HRA.

The final split of the debt portfolio is shown in the table below:

	General Fund	HRA	Total
	£'000	*£'000*	*£'000*
Market	405,636	74,579	480,215
% of total market	*84.47%*	*15.53%*	
Stock	8,159	0	8,159
% of stock	*100.00%*	*0.00%*	
Total Loans	**413,795**	**74,579**	**488,374**
% of total loans	*84.73%*	*15.27%*	
Unfinanced CFR	261,659	49,608	311,267
% of unfinanced CFR	*84.06%*	*15.94%*	
Total CFR	**675,454**	**124,187**	**799,641**
% of total CFR	*84.47%*	*15.53%*	

Future HRA borrowing

Following the split of the portfolio, the HRA can make borrowing decisions according to the needs of their business plan, provided those decisions are aligned with their treasury strategy and are agreed by the Section 151 officer. The amounts and maturity periods of any future loans will be determined by the HRA, in conjunction with the Treasury Management team and the City Treasurer. Any future borrowing made by the Council will be for either the General Fund or the HRA and not for the Council in general.

Use of Temporary Cash Balances and Temporary Borrowing

Although the HRA’s treasury position is now independent of the General Fund, both are managed in the name of the Council as a whole. As such, the day to day treasury position of the Council, whilst having regard to the impact on the HRA and the General Fund, will be run on a Council basis – this simplifies the risk management of the treasury position, and should help to ensure that the treasury function is providing value for money.

To achieve this, the General Fund will deposit and temporarily borrow externally, but the HRA will only be able to deposit with the General Fund and, should it be required, will only be able to access temporary borrowing through the General Fund. In order to ensure that this is fair, interest rates will be applied to any such internal transfers, as summarised below:

- If the General Fund has temporary investments, HRA investments with the General Fund will earn – ***average portfolio temporary investment rate***

- If the General Fund does not have temporary investments, HRA investments with the General Fund will earn – ***7-day LIBID***

- If the General Fund has temporary borrowing, HRA temporary borrowing from the General Fund will be charged – ***average portfolio temporary borrowing rate***

- If the General fund does not have temporary borrowing, HRA temporary borrowing from the General Fund will be charged – ***7-day LIBOR***

The market rates to be used (7-day LIBID and LIBOR) are the benchmark rates used by the Council for investments and temporary borrowing.

Future Reporting

The intention is to continue to report to Members the overall treasury position of the Council, including both the General Fund and the HRA. Separate reports will be provided on the General Fund and the HRA, when required.