

HAMPSHIRE COUNTY COUNCIL

Decision Report

Decision Maker:	Audit Committee
Date:	4 February 2016
Title:	Treasury Management Strategy 2016-17 to 2018-19
Reference:	7239
Report From:	Director of Corporate Resources – Corporate Services

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1. Summary

- 1.1. The Chartered Institute of Public Finance and Accountancy's Code of Practice for Treasury Management in Public Services (the CIPFA Code) and the Prudential Code require authorities to determine the Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Department for Communities and Local Government's (DCLG) Investment Guidance.
- 1.2. As per the requirements of the Prudential Code, Hampshire County Council adopted the CIPFA Treasury Management Code at its meeting in February 2012. This report fulfils the Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance.
- 1.3. The purpose of this TMSS is, therefore, to approve:
 - Treasury Management Strategy for 2016/17
 - Annual Investment Strategy for 2016/17, including proposals for changes to the investment of the County Council's cash balances to increase the yield earned on investments
 - Prudential Indicators for 2016/17, 2017/18 and 2018/19 shown in Appendix C
 - Minimum Revenue Provision (MRP) Statement shown in Appendix D
- 1.4. The County Council has potentially large exposures to financial risks through its investment and borrowing activity, including the loss of invested funds and the effect of changing interest rates. The successful identification, monitoring

and control of risk are therefore central to the Council's treasury management strategy.

2. Introduction

- 2.1. In February 2012 the County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition (the CIPFA Code) which requires the County Council to approve a treasury management strategy before the start of each financial year.
- 2.2. In addition, the Department for Communities and Local Government (DCLG) issued revised Guidance on Local Authority Investments in March 2010 that requires the County Council to approve an investment strategy before the start of each financial year.
- 2.3. This report fulfils the County Council's legal obligation under the Local Government Act 2003 to have regard to both the CIPFA Code and the DCLG Guidance.
- 2.4. The County Council has potentially large exposures to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the County Council's treasury management strategy.

3. External Context

- 3.1. The following paragraphs explain the economic and financial background against which the Treasury Management Strategy is set.

Economic background

- 3.2. Domestic demand has grown robustly, supported by sustained real income growth and a gradual decline in private sector savings. Movements in transport costs, and alcohol and tobacco prices contributed to annual CPI inflation rising to 0.0% in November. Wages are growing at 2.4% a year, and the unemployment rate has dropped to 5.2%. Mortgage approvals have risen to over 70,000 a month and annual house price growth is around 3.5%. These factors have boosted consumer confidence, helping to underpin retail spending and hence GDP growth, which was an encouraging 2.3% a year in the third quarter of 2015. Although speeches by the Bank of England's Monetary Policy Committee (MPC) members sent signals that some were willing to countenance higher interest rates, the MPC held policy rates at 0.5% for the 82nd consecutive month at its meeting in December 2015.

Interest rate forecast

- 3.3. Uncertainty over the outcome of the forthcoming EU referendum could put downward pressure on UK GDP growth and interest rates. The County Council's treasury advisor, Arlingclose, projects the first 0.25% increase in UK Bank Rate in the third quarter of 2016, rising by 0.5% a year thereafter, finally settling between 2% and 3% in several years' time. Persistently low inflation, subdued global growth and potential concerns over the UK's position in

Europe mean that the risks to this forecast are weighted towards the downside.

- 3.4. A more detailed economic and interest rate forecast provided by Arlingclose is attached at Appendix A.

Credit outlook

- 3.5. The varying fortunes of different parts of the global economy are reflected in market indicators of credit risk. UK banks operating in the Far East and parts of mainland Europe have seen their perceived risk increase, while those with a more domestic focus continue to show improvement. The sale of most of the government's stake in Lloyds and the first sale of its shares in RBS have generally been seen as credit positive.
- 3.6. Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the UK, USA and Germany. The rest of the European Union will follow suit in January 2016, while Australia, Canada and Switzerland are well advanced with their own plans. Meanwhile, changes to the UK Financial Services Compensation Scheme and similar European schemes in July 2015 mean that most private sector investors are now partially or fully exempt from contributing to a bail-in. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the County Council; returns from cash deposits however remain stubbornly low.

4. Balance Sheet Summary and Forecast

- 4.1. As at 31 December 2015 the County Council had £526m of borrowing and £512m of investments. This is set out in further detail at Appendix B. Forecast changes in these sums are shown in the balance sheet analysis in Table 1.

Table 1: Balance Sheet Summary and Forecast

	31.03.15	31.03.16	31.03.17	31.03.18	31.03.19
	Actual	Estimate	Forecast	Forecast	Forecast
	£m	£m	£m	£m	£m
Capital Financing Requirement	762	753	739	724	696
Less: Other Long-term Liabilities					
- Street Lighting PFI	(115)	(117)	(113)	(110)	(106)
- Waste Management Contract	(65)	(60)	(55)	(49)	(42)
Borrowing CFR	582	576	571	565	548
Less: External borrowing:					
- Public Works Loan Board	(277)	(270)	(257)	(243)	(236)
- Market Loans (LOBOs)	(73)	(73)	(73)	(73)	(73)
Internal (over) borrowing	232	233	241	249	239
Less: Reserves and balances	(462)	(421)	(391)	(360)	(336)
Less: Allowance for Working capital	(252)	(250)	(250)	(250)	(250)
Resources for Investments	(714)	(671)	(641)	(610)	(586)
New Borrowing or (Investments)	(482)	(438)	(400)	(361)	(347)

4.2. The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The County Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing.

4.3. The Council's CFR is forecast to reduce over the next few years, and the Council's reserves are forecast to remain stable and therefore the current internally borrowed position can be maintained if this continues to be advantageous.

4.4. CIPFA's Prudential Code for Capital Finance in Local Authorities recommends that the County Council's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the County Council expects to comply with this recommendation during 2016/17.

5. Borrowing Strategy

5.1. The County Council currently holds £350m of loans, a decrease of £6m on the previous year, as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in Table 1 shows that the County Council does not expect to need to borrow in 2016/17. The County Council may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £640m.

Objectives

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

Strategy

- 5.3. Given the significant cuts to public expenditure and in particular to local government funding, the County Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost effective in the short-term to either use internal resources, or to borrow short-term loans instead.
- 5.4. By doing so, the County Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise.
- 5.5. In addition, the County Council may borrow short-term loans (normally for up to one month) to cover unexpected cash flow shortages.

Sources

- 5.6. The approved sources of long-term and short-term borrowing are:
- Public Works Loan Board (PWLB) and any successor body
 - UK local authorities
 - any institution approved for investments (see below)
 - any other bank or building society authorised to operate in the UK
 - UK public and private sector pension funds (except the Hampshire Pension Fund)
 - capital market bond investors
 - special purpose companies created to enable local authority bond issues
- 5.7. In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:
- operating and finance leases
 - hire purchase
 - Private Finance Initiative
 - sale and leaseback
- 5.8. The County Council has previously raised the majority of its long-term borrowing from the PWLB but it continues to investigate other sources of

finance, such as local authority loans and bank loans that may be available at more favourable rates.

LOBOs

- 5.9. The County Council holds £73m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the County Council has the option to either accept the new rate or to repay the loan at no additional cost. In the current low interest rate environment it is unlikely that any lender will exercise their options but there remains an element of refinancing risk. The County Council will take the option to repay LOBO loans at no cost if it has the opportunity to do so.

Short-term and Variable Rate loans

- 5.10. These loans leave the County Council exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators at Section 7 of this strategy.

Debt Rescheduling

- 5.11. The PWLB allows authorities to repay loans before maturity and either pay a premium or receive a discount according to a set formula based on current interest rates. The County Council may take advantage of this and replace some loans with new loans, or repay loans without replacement, where this is expected to lead to an overall cost saving or a reduction in risk.

6. Investment Strategy

- 6.1. The County Council holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the County Council's investment balance has ranged between £491m and £633m, and similar levels are expected to be maintained in the forthcoming year.

Objectives

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

Strategy

- 6.3. Due to the increasing risk from bank 'bail-ins' and continued low returns from short-term unsecured bank investments, the County Council aims to further diversify into more secure and/or higher yielding asset classes during 2016/17. This is especially the case for the estimated £285m that is available for longer-term investment. Approximately 70% of the County Council's surplus cash is not subject to bail-in risk as it is invested in local authorities, corporate bonds, pooled property funds, and secured bonds. Whilst the

remaining cash is subject to bail-in risk, 65% of these instruments are saleable, and 11% is subject to a reduced risk of bail-in as it is invested in money market funds. The remaining 24% that is subject to bail-in risk is invested either in instant access bank accounts, or in notice accounts which have interest rates that are commensurate with level of the risk. This diversification will represent a continuation of the new strategy adopted in 2015/16.

Investment Limits

- 6.4. Given the impact of the Bank Reform Act, Bank Recovery and Resolution Directive, and the recast Deposit Guarantee Schemes Directive, which have increased the credit risk that unsecured bank/building society investments could be 'bailed-in', the following investment limits are proposed to mitigate the risk whilst allowing sufficient flexibility to manage the County Council's investment balances.
- 6.5. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Maximum limits will also be placed on fund managers, and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 2: Investment Limits

	Cash limit
Any single organisation, except the UK Central Government	£70m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£70m per group
Any group of pooled funds under the same management	£70m per manager
Registered Providers	£70m in total
Money Market Funds	50% in total

Approved Counterparties

- 6.6. The County Council may invest its surplus funds with any of the counterparty types in Table 3 below, subject to the cash limits (per counterparty) and the time limits shown.

Table 3: Approved Investment Counterparties and Limits

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers Unsecured	Registered Providers Secured
UK Govt	n/a	n/a	£ Unlimited 30 years	n/a	n/a	n/a
AAA	£35m 5 years	£70m 20 years	£70m 30 years	£35m 20 years	£35m 20 years	£35m 25 years
AA+	£35m 5 years	£70m 10 years	£70m 25 years	£35m 10 years	£35m 10 years	£35m 10 years
AA	£35m 4 years	£70m 5 years	£70m 15 years	£35m 5 years	£35m 10 years	£35m 10 years
AA-	£35m 3 years	£70m 4 years	£70m 10 years	£35m 4 years	£35m 10 years	£35m 10 years
A+	£35m 2 years	£70m 3 years	£35m 5 years	£35m 3 years	£35m 5 years	£35m 5 years
A	£35m 13 months	£70m 2 years	£35m 5 years	£35m 2 years	£35m 5 years	£35m 5 years
A-	£35m 6 months	£70m 13 months	£35m 5 years	£35m 13 months	£35m 5 years	£35m 5 years
BBB+	£20m 100 days	£35m 6 months	£20m 2 years	£20m 6 months	£20m 2 years	£35m 2 years
BBB	£20m next day only	£35m 100 days	n/a	n/a	n/a	n/a
None	£35m 6 months	n/a	£35m 25 years	n/a	£35m 5 years	£35m 25 years
Pooled funds	£70m per fund					

This table must be read in conjunction with the notes below

Credit Rating

- 6.7. Investment decisions are made by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used.

Banks Unsecured

- 6.8. Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Unsecured investment with banks rated BBB are restricted to overnight deposits at the

County Council's current account at NatWest bank (which is currently rated as BBB+).

Banks Secured

- 6.9. Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank/building society's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank/building society will not exceed the cash limit for secured investments.

Government

- 6.10. Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 30 years.

Corporates

- 6.11. Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Investing with any unrated corporate entity will be judged on a case-by-case basis and only considered if suitable security can be obtained for the County Council's investment.

Registered Providers Secured and Unsecured

- 6.12. Registered Providers of Social Housing, formerly known as Housing Associations; these bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain a high likelihood of receiving government support if needed. Registered Providers can issue loans and bonds, either on an unsecured or secured basis. The secured loans and bonds are secured on the underlying assets of the Registered Provider.

Pooled Funds

- 6.13. Shares in diversified investment vehicles consisting of any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and aim for consistent net asset value will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

- 6.14. Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the County Council to diversify into asset classes other than cash without the need to own and manage the underlying investments. Depending on the type of pooled fund invested in, it may have to be classified as capital expenditure. Because pooled funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the County Council's investment objectives will be monitored regularly.

Risk Assessment and Credit Ratings

- 6.15. Credit ratings are obtained and monitored by the County Council's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:
- no new investments will be made,
 - any existing investments that can be recalled or sold at no cost will be, and
 - full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.
- 6.16. Where a credit rating agency announces that a credit rating is on review for possible downgrade (also known as "rating watch negative" or "credit watch negative") so that it may fall below the approved rating criteria, then only investments that can be withdrawn on the next working day will be made with that organisation until the outcome of the review is announced. This policy will not apply to negative outlooks, which indicate a long-term direction of travel rather than an imminent change of rating.

Investments Targeting Higher Returns

- 6.17. As part of the 2014/15 Investment Strategy it was agreed to target £90m for higher yielding investments such as long-term investments with other Local Authorities, or equity, bond or property investments. This amount is in addition to £15m that was identified for long term investments, associated with the Street Lighting PFI. Investments yielding higher returns will contribute additional income to the County Council, although some come with the risk that they may suffer falls in the principle instead.
- 6.18. The Investment Strategy gives the flexibility to allow the Director of Corporate Resources' staff with the assistance of the advisers, Arlingclose, to continue to look for opportunities and invest the remaining target in higher return instruments.
- 6.19. The 2015/16 Investment Strategy recommended that the initial returns from a pooled property fund be used to create a reserve of £0.5m in the County Council's accounts as protection against the irrecoverable fall in value of any investments. It is recommended that a further £0.5m is added to this reserve to further protect the County Council's funds. This is prudent given the additional risk that is being taken in targeting investments with higher returns.

Other Information on the Security of Investments

- 6.20. The County Council understands that credit ratings are good, but not perfect predictors of investment default. Full regard will therefore be given to other available information on the credit quality of the organisations in which it invests, including credit default swap prices, financial statements, information on potential government support and reports in the quality financial press. No investments will be made with an organisation if there are substantive doubts about its credit quality, even though it may meet the credit rating criteria.
- 6.21. Based on the available information and the advice of the County Council's advisers, Arlingclose, the Director of Corporate Resources may reduce the investment limits shown in Tables 2 and 3, and suspend investing with certain counterparties as necessary.
- 6.22. If these restrictions mean that insufficient commercial organisations of high credit quality are available to invest the County Council's cash balances, then the surplus will be deposited with the UK Government, via the Debt Management Office or invested in government treasury bills for example, or with other local authorities. This will cause a reduction in the level of investment income earned, but will protect the principal sum invested.

Specified Investments

- 6.23. The DCLG Guidance defines specified investments as those:
- denominated in pound sterling,
 - due to be repaid within 12 months of arrangement,
 - not defined as capital expenditure by legislation, and
 - invested with one of:
 - the UK Government,
 - a UK local authority, parish council or community council, or
 - a body or investment scheme of "high credit quality".
- 6.24. The County Council defines "high credit quality" organisations and securities as those having a credit rating of A- or higher that are domiciled in the UK or a foreign country with a sovereign rating of AA+ or higher. For money market funds and other pooled funds "high credit quality" is defined as those having a credit rating of A- or higher.

Non-specified Investments

- 6.25. Any investment not meeting the definition of a specified investment is classed as non-specified. The County Council does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, (i.e. those that are due to mature 12 months or longer from the date of arrangement), pooled funds that the County Council intends to hold as long-term investments (for more than one year) and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in Table 5 below.

Table 5: Non-Specified Investment Limits

	Cash limit
Total long-term investments	£285m
Total investments without credit ratings or rated below A- (excluding investments with other local authorities)	£190m
Total non-Sterling investments	-
Total investments in foreign countries rated below AA+	-
Total non-specified investments	£475m

Liquidity Management

- 6.26. The County Council has due regard for its future cash-flows when determining the maximum period for which funds may prudently be committed. Historic cash-flows are analysed in addition to significant future cash movements, such as payroll, grant income and council tax precept. Limits on long-term investments are set by reference to the County Council's medium term financial position (summarised in Table 1) and forecast short-term balances.

7. Treasury Management Indicators

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

Interest Rate Exposures

- 7.2. This indicator is set to control the County Council's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the amount of principal borrowed or invested will be:

	2016/17	2017/18	2018/19
Upper limit on fixed interest rate investment exposure	£285m	£250m	£250m
Upper limit on variable interest rate investment exposure	£700m	£700m	£700m
Upper limit on fixed interest rate borrowing exposure	£780m	£760m	£730m
Upper limit on variable interest rate borrowing exposure	£780m	£760m	£730m

- 7.3. Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. Short-term interests (with a maturity of less than one year) are classed as variable rate.

Maturity Structure of Borrowing

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

	Upper	Lower
Under 12 months	50%	0%
12 months and within 24 months	50%	0%
24 months and within 5 years	50%	0%
5 years and within 10 years	75%	0%
10 years and within 20 years	75%	0%
20 years and within 30 years	75%	0%
30 years and above	100%	0%

- 7.5. Time periods start on the first day of each financial year.

Principal Sums Invested for Periods Longer than 364 days

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

	2016/17	2017/18	2018/19
Limit on principal invested beyond 364 days	£285m	£250m	£250m

8. Other Items

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

Policy on Use of Financial Derivatives

- 8.2. Local authorities have previously made use of financial derivatives embedded into loans and investments both to reduce interest rate risk (e.g. interest rate collars and forward deals) and to reduce costs or increase income at the expense of greater risk (e.g. LOBO loans and callable deposits). The general power of competence in Section 1 of the Localism Act 2011 removes much of the uncertainty over local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment).
- 8.3. The County Council will only use standalone financial derivatives (such as swaps, forwards, futures and options) where they can be clearly demonstrated to reduce the overall level of the financial risks that the County Council is exposed to. Additional risks presented, such as credit exposure to derivative counterparties, will be taken into account when determining the

overall level of risk. Embedded derivatives, including those present in pooled funds and forward starting transactions, will not be subject to this policy, although the risks they present will be managed in line with the overall treasury risk management strategy.

- 8.4. Financial derivative transactions may be arranged with any organisation that meets the approved investment criteria. The current value of any amount due from a derivative counterparty will count against the counterparty credit limit and the relevant foreign country limit. The use of financial derivatives is not planned as part of the implementation of the Treasury Management Strategy and any changes to this would be reported to members in the first instance.

Investment Training

- 8.5. The needs of the County Council's treasury management staff for training in investment management are assessed annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.
- 8.6. Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA and other appropriate organisations.
- 8.7. CIPFA's Code of Practice requires that the County Council ensures that all members tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities. All County Council members were invited to a workshop presented by Arlingclose on 23 November 2015, which gave an update on treasury matters.

Investment Advisers

- 8.8. The County Council has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The quality of this service is controlled through quarterly review meetings with the Director of Corporate Resources, her staff and Arlingclose.

Investment of Money Borrowed in Advance of Need

- 8.9. The County Council may, from time to time, borrow in advance of need, where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the County Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the County Council's overall management of its treasury risks. The total amount borrowed will not exceed the authorised borrowing limit of £640m.

9. Recommendations

- 9.1. It is recommended that the Audit Committee note the following recommendations that are being made to Cabinet:

- 9.2. Treasury Management Strategy and Annual Investment Strategy for 2016/17 (and the rest of 2015/16) including:
- Prudential Indicators for 2016/17, 2017/18 and 2018/19 – Appendix C
 - Minimum Revenue Provision (MRP) Statement – Appendix D
 - That authority is delegated to the Director of Corporate resources to manage the Council's investments according to the risk assessment process in the Investment Strategy as appropriate to most effectively manage the Council's investments.
- 9.3. An additional £0.5m is added to the £0.5m reserve created in the County Council's accounts in the Treasury Management Strategy 2015/16 as protection against the irrecoverable fall in value of any investments.

Appendix A – Arlingclose Economic & Interest Rate Forecast November 2015

Forecast:

- Arlingclose forecasts the first rise in UK Bank Rate in Q3 2016. Further weakness in inflation, and the MPC's expectations for its path, suggest policy tightening will be pushed back into the second half of the year. Risks remain weighted to the downside. Arlingclose projects a slow rise in Bank Rate, the appropriate level of which will be lower than the previous norm and will be between 2 and 3%.
- The projection is for a shallow upward path for medium term gilt yields, with continuing concerns about the Eurozone, emerging markets and other geo-political events, weighing on risk appetite, while inflation expectations remain subdued.
- The uncertainties surrounding the timing of UK and US monetary policy tightening, and global growth weakness, are likely to prompt short term volatility in gilt yields.

	Dec-15	Mar-16	Jun-16	Sep-16	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18
Official Bank Rate													
Upside risk		0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50
Arlingclose Central Case	0.50	0.50	0.50	0.75	0.75	1.00	1.00	1.25	1.25	1.50	1.50	1.75	1.75
Downside risk				-0.25	-0.25	-0.50	-0.50	-0.75	-0.75	-1.00	-1.00	-1.25	-1.25
3-month LIBID rate													
Upside risk	0.20	0.30	0.30	0.30	0.35	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.40
Arlingclose Central Case	0.55	0.60	0.70	0.80	0.95	1.05	1.15	1.30	1.40	1.55	1.65	1.80	1.85
Downside risk		-0.20	-0.30	-0.45	-0.55	-0.65	-0.80	-0.90	-1.05	-1.10	-1.20	-1.20	-1.20
1-yr LIBID rate													
Upside risk	0.25	0.35	0.35	0.35	0.40	0.40	0.40	0.40	0.45	0.45	0.45	0.45	0.45
Arlingclose Central Case	1.10	1.20	1.35	1.45	1.55	1.70	1.80	1.95	2.00	2.10	2.15	2.15	2.15
Downside risk	-0.15	-0.25	-0.35	-0.50	-0.60	-0.70	-0.85	-0.95	-1.10	-1.15	-1.25	-1.25	-1.25
5-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	1.50	1.55	1.60	1.70	1.80	1.90	2.00	2.10	2.20	2.25	2.30	2.35	2.35
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
10-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.00	2.05	2.10	2.20	2.30	2.40	2.50	2.60	2.65	2.70	2.75	2.80	2.80
Downside risk	-0.35	-0.45	-0.55	-0.60	-0.70	-0.80	-0.90	-1.00	-1.10	-1.15	-1.20	-1.25	-1.25
20-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	2.95
Downside risk	-0.30	-0.40	-0.50	-0.55	-0.65	-0.75	-0.85	-0.95	-1.05	-1.10	-1.15	-1.20	-1.20
50-yr gilt yield													
Upside risk	0.40	0.50	0.50	0.50	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60
Arlingclose Central Case	2.45	2.50	2.55	2.60	2.65	2.70	2.75	2.80	2.85	2.90	2.95	3.00	3.00
Downside risk	-0.25	-0.35	-0.45	-0.50	-0.60	-0.70	-0.80	-0.90	-1.00	-1.05	-1.10	-1.15	-1.15

Appendix B – Existing Investment & Debt Portfolio Position

	31.12.2015 Actual Portfolio £m	31.12.2015 Rate Paid/Earned %
External Borrowing:		
PWLB – Fixed Rate	276.79	
Other Loans	73.00	
Total External Borrowing	349.79	4.85%
Other Long Term Liabilities:		
Street Lighting PFI	116.60	
Waste Management Contract	60.19	
Total Gross External Debt	526.58	
Investments		
Direct Deposits		
- Close Brothers	15.00	
- Svenska Handelsbanken	1.45	
	16.45	0.95%
Certificates of Deposit		
- Bank of Montreal	15.00	
- Credit Suisse	10.00	
- Landesbank Hessen Thueringen	20.00	
- Lloyds	20.00	
- Nationwide	5.00	
- Nordea AB	30.00	
- Rabobank	10.00	
- Standard Chartered	10.00	
	120.00	0.64%
Covered Floating Rate Notes		
- Lloyds	7.20	
- Nova Scotia	10.00	
- Toronto Dominion	10.00	
- Yorkshire Building Society	15.00	
	42.20	0.74%
Covered Fixed Bonds		
- Lloyds	10.00	
- Yorkshire Building Society	15.00	
	25.00	1.16%
Corporate Floating Rate Notes		
- BMW US Capital LLC	10.00	0.84%
- Corporate Fixed Bonds		
- Heathrow Funding Ltd	5.36	
- Linde Finance	5.00	
- Transport for London	10.01	
	20.37	2.26%
Pooled Property Funds		
- CCLA	20.00	

	31.12.2015 Actual Portfolio £m	31.12.2015 Rate Paid/Earned %
- Aviva Lime	15.00	
	35.00	4.56%*
Other Local Authorities	226.00	1.71%
Money Market Funds - Aberdeen (SWIP)	17.12	0.50%
Total Investments	512.14	1.49%
Net Debt	14.44	-

*average estimated annual income return to 31 December 2015

Appendix C - Prudential Indicators 2016/17

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

Estimates of Capital Expenditure

The County Council's planned capital expenditure and financing may be summarised as follows.

Capital Expenditure and Financing	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Total Expenditure	243	237	219	156
Capital Receipts	13	6	9	4
Grants and other income	134	195	176	148
Revenue contributions	73	21	16	1
Contributions from reserves	6	2	4	2
Total Financing	226	224	205	155
Prudential borrowing	17	22	19	3
Less: payments from capital receipts etc	(5)	(9)	(5)	(2)
Finance lease	5	0	0	0
Total Funding	17	13	14	1
Total Financing and Funding	243	237	219	156

Estimates of Capital Financing Requirement

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

Capital Financing Requirement	31.03.16 Revised £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
Total CFR	753	739	724	696

The CFR is forecast to fall by £59m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment.

Gross Debt and the Capital Financing Requirement

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

Debt	31.03.16 Revised £m	31.03.17 Estimate £m	31.03.18 Estimate £m	31.03.19 Estimate £m
Borrowing	343	330	316	309
PFI liabilities	177	168	159	148
Total Debt	520	498	475	457

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

Operational Boundary for External Debt

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

Operational Boundary	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	620	610	600	580
Other long-term liabilities	180	170	160	150
Total Debt	800	780	760	730

Authorised Limit for External Debt

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

Authorised Limit	2015/16 Revised £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Borrowing	640	640	630	620
Other long-term liabilities	230	210	200	190
Total Debt	870	850	830	810

Ratio of Financing Costs to Net Revenue Stream

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

Ratio of Financing Costs to Net Revenue Stream	2015/16 Revised %	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %
General Fund	5.87%	5.73%	5.61%	5.66%

Incremental Impact of Capital Investment Decisions

This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed earlier in this report.

Incremental Impact of Capital Investment Decisions	2016/17 Estimate £	2017/18 Estimate £	2018/19 Estimate £
General Fund - increase in annual band D Council Tax	1.72	4.15	2.66

Adoption of the CIPFA Treasury Management Code

The County Council adopted the Chartered Institute of Public Finance and Accountancy's Treasury Management in the Public Services: Code of Practice 2011 Edition in February 2012.

Appendix D – Annual Minimum Revenue Provision Statement 2016/17

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

The broad aim of the DCLG Guidance is to ensure that debt is repaid over a period that is either reasonably commensurate with that over which the capital expenditure provides benefits, or, in the case of borrowing supported by Government Revenue Support Grant, reasonably commensurate with the period implicit in the determination of that grant.

The DCLG Guidance requires the County Council to approve an Annual MRP Statement each year, and whilst it provides a range of options for the calculation of MRP the guidance also notes that other options are permissible provided that they are fully consistent with the statutory duty to make prudent revenue provision.

MRP in 2016/17: As agreed by Cabinet in December 2015 for the calculation of MRP from 2015/16 onwards the County Council will change from calculating MRP for supported borrowing from a 4% reducing balance to a 50 year straight line basis. To be more prudent the 50 years has been started from 2008 and the actual calculation will therefore be 1/43's This will ensure that the County Council continues to take a prudent approach to repaying its Supported Borrowing, ensuring that the supported borrowing is repaid sooner, as well as contributing to the County Council's immediate financial pressures.

The County Council will continue to apply the Asset Life or Depreciation Method (which are Options 3 and 4 from the range provided by the DCLG) in respect of unsupported capital expenditure funded from borrowing.

MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

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