APPENDIX H

TREASURY MANAGEMENT STRATEGY 2017-18

Cygnor Bwrdeistref Sirol Pen-y-bont ar Ogwr

BRIDGEND County Borough Council

1.0 Introduction

The Council adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services*: *Code of Practice 2011 Edition* (the CIPFA Code) in February 2012 which requires the Council to approve a treasury management strategy before the start of each financial year. In addition to the CIPFA Code, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Council to approve an Investment Strategy before the start of each financial year. This Strategy fulfils the Council's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

The Council has an integrated Treasury Management Strategy (TMS) where borrowing and investments are managed in accordance with best professional practice. The Council borrows money either to meet short term cash flow needs or to fund capital schemes approved within the capital programme. Therefore any actual loans taken are not associated with particular items of expenditure or assets. The Council is exposed to financial risks including the potential 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 Council's TMS.

The Council delegates responsibility for the implementation and regular monitoring of its treasury management policies and practices to Cabinet, and for the execution and administration of treasury management decisions to the Section 151 Officer, who will act in accordance with the organisation's strategy, Treasury Management Practices (TMP) and CIPFA's Standard of Professional Practice on Treasury Management. Council will receive reports on its treasury management activities, including as a minimum, an annual strategy in advance of the year, a mid-year review and an annual report after its financial year end. Quarterly reports will also be received by Cabinet.

The Council nominates the Audit Committee to be responsible for ensuring effective scrutiny of the treasury management strategy and policies.

2.0 Economic Context and Forecasts for Interest Rates

Economic background: The major external influence on the Council's treasury management strategy for 2017-18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017-18.

The fall and continuing weakness in sterling and the near doubling in the price of oil in 2016 have combined to drive inflation expectations higher. The Bank of England is forecasting that Consumer Price Inflation will breach its 2% target in 2017, the first time since late 2013, but the Bank is expected to look through inflation overshoots over the course of 2017 when setting interest rates so as to avoid derailing the economy.

Credit outlook: Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard. 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 European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other secured investment options available to the Council in our investment strategy; returns from cash deposits however continue to fall.

Interest rate forecast: The Council's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017-18, but there is a low possibility of a drop to close to zero, with a very small chance of a reduction below zero. The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. A negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Arlingclose (Council's TM Advisers) central interest rate forecast December 2016

	Bank Rate	3 month LIBID rate	1 Year LIBID rate	5-year gilt yield	10 year gilt yield	20 year gilt yield	50 year gilt yield
Mar 2017	0.25	0.25	0.50	0.50	0.95	1.50	1.40
June 2017	0.25	0.25	0.50	0.45	0.90	1.45	1.35
Sept 2017	0.25	0.30	0.50	0.45	0.90	1.45	1.35
Dec 2017	0.25	0.30	0.50	0.45	0.90	1.45	1.35
Mar 2018	0.25	0.30	0.50	0.50	0.95	1.50	1.40
June 2018	0.25	0.30	0.50	0.50	0.95	1.50	1.40
Sept 2018	0.25	0.30	0.60	0.50	0.95	1.50	1.40
Dec 2018	0.25	0.30	0.70	0.55	1.00	1.55	1.45
Mar 2019	0.25	0.30	0.85	0.60	1.05	1.60	1.50
Jun 2019	0.25	0.30	0.90	0.65	1.10	1.65	1.55
Sept 2019	0.25	0.30	0.90	0.70	1.15	1.70	1.60
Dec 2019	0.25	0.30	0.90	0.75	1.20	1.75	1.65
Mar 2020	0.25	0.30	0.95	0.80	1.25	1.80	1.70
Average	**0.25**	**0.29**	**0.68**	**0.57**	**1.02**	**1.57**	**1.47**

3.0 The Council's Current Treasury Management Position

Table 1: Council's debt and investment position as at 31 December 2016

		Principal as at 31-12-16 £m	Average Rate %
Fixed rate long term funding	PWLB(i)	77.62	4.70
Variable rate long term funding	PWLB	-	-
	LOBO(ii)	19.25	4.65
Total Long Term External Borrowing(iii)		**96.87**	**4.69**
Other Long Term Liabilities(iii) (including PFI)		**21.93**	
TOTAL GROSS DEBT		**118.80**	
Fixed rate investments		36.30	**0.52**
Variable rate investments		6.00	**0.42**
TOTAL INVESTMENTS(iv)		**42.30**	**0.51**
TOTAL NET DEBT		**76.50**	

(i) Public Works Loan Board (PWLB)
(ii) Lender's Option Borrower's Option (LOBO)
(iii) Long term borrowing/liabilities include all instruments with an initial term of 365 days or more and long term liabilities includes the short term element of the liability
(iv) The investment totals include instant access deposit accounts which are included as "Cash" in the Council's balance sheet in the Statement of Accounts and also investments shown as "Cash Equivalents" in the Council's balance sheet that mature in 1 month or less from the date of acquisition and that are readily convertible to known amounts of cash with insignificant risk of change in value

Fixed rate in the above table includes instruments which are due to mature in the year and also a £3m structured deal where the change in interest rate has been agreed and fixed in advance

The £19.25 million relates to Lender's Option Borrower's Option (LOBO) loans which have a maturity date of 2054, however these may be re-scheduled in advance of this maturity date. The LOBO rate and term may vary in the future depending upon the prevailing market rates, the lender exercising their option to increase rates at one of the bi-annual trigger points and therefore the Council being given the option to accept the increase or to repay the loan without incurring a penalty. The next trigger point is July 2017 and although the Council understands that the lender is unlikely to exercise this option in the current low interest rate environment, an element of refinancing risk remains and the Council would take the option to repay these loans at no cost if it has the opportunity to do so in the future. The long term liabilities figure of £21.93 million at 31 December 2016 includes £18.37 million for the Council's Private Finance Initiative (PFI) arrangement (for the provision of a Secondary School in Maesteg) and £2.40 million relating to a loan from the WG Central Capital Retained Fund for regeneration works within the Llynfi Valley.

Investments are anticipated to drop from £42.00 million on 31 December 2016 to between £25 and £30 million by the 31 March 2017. As in previous years this is due partly to the reduction in income collected from Council Tax and National Non-Domestic Rates in February and March 2017 and increased expenditure expected to be incurred for the capital programme.

The underlying need to borrow for capital purposes is measured by the Capital Financing Requirement (CFR), while usable reserves and working capital are the underlying resources available for investment. The Council's current strategy is to maintain borrowing and investments below their underlying levels, sometimes known as internal borrowing. CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Council's total debt should be lower than its highest forecast CFR over the next three years. Forecast changes in these sums are included in the Prudential Indicators shown in **Schedule A** which shows that the Council expects to comply with this recommendation during 2016-17, 2017-18 and the following three years.

4.0 Borrowing Strategy

The major **objectives** to be followed in 2017-18 are:-

- to minimise the revenue costs of debt
- to manage the Council's debt maturity profile i.e. to leave no one future year with a high level of repayments that could cause problems in re-borrowing
- to effect funding in any one year at the cheapest cost commensurate with future risk
- to forecast average future interest rates and borrow accordingly
- to monitor and review the level of variable interest rate loans in order to take greater advantage of interest rate movement
- to reschedule debt if appropriate, in order to take advantage of potential savings as interest rates change
- to optimise the use of all capital resources including borrowing, both supported and unsupported, usable capital receipts, revenue contributions to capital and grants and contributions

Given the significant cuts to public expenditure and in particular to local government funding, the Council's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. The uncertainty over future interest rates increases the risks associated with treasury activity. As a result the Council will take a cautious approach to its treasury strategy. 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 borrow short term. By doing so, the Council is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. Short term and variable rate loans expose the Council to the risk of short term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates as shown in the Treasury Management Indicators in **Schedule A.**

The Section 151 Officer will take the most appropriate form of borrowing depending on the prevailing interest rates at the time however, with long term rates forecast to rise modestly in future years, any such short term savings will need to be balanced against the potential longer-term costs. The Council's Treasury Management advisers will assist the Council with this 'cost of carry' and breakeven analysis. No long term borrowing has been taken to date during 2016-17 and it is not expected that there will be a requirement for any new long term borrowing for the remainder of 2016-17 or 2017-18. Alternatively, the Council may arrange forward starting loans during 2017-18 where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period. In addition, the Council may borrow short term loans (normally for up to one month) to cover unexpected cash flow shortages.

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see Investment Strategy)
- any other bank or building society authorised to operate in the UK
- UK public and private sector pension funds (except the Council's Pension Fund)
- capital market bond investors
- special purpose companies created to enable local authority bond issues

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

The Council has previously raised the majority of its long-term borrowing from the PWLB, but will also investigate other sources of finance, such as Welsh Government and local authority loans and bank loans, that may be available at more favourable rates.

The Council is currently maintaining an under-borrowed position. This means that the underlying need to borrow for capital purposes (the Capital Financing Requirement), has not been fully funded with loan debt as cash supporting the Council's reserves, balances and cash flow has been used as a temporary measure. This is known as Internal Borrowing. This strategy is prudent as investment returns are low and counterparty risk is relatively high.

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

City Deal: The City Deal will have significant capital expenditure and treasury management implications. Under the current financial model, it is envisaged that project capital expenditure will be incurred at a faster rate than Her Majesty's Treasury (HMT) grant funding, thus requiring Local Authorities to meet the shortfall in the interim which is expected to be met from internal borrowing. The financial model is still being worked on and the profile of capital spend included are not yet finalised but estimates have been included in the capital programme and this Treasury Management Strategy and updates will be reported as they become available.

5.0 Investment Strategy

Both the CIPFA Code and the WG Guidance require the Council to invest its funds prudently, and to have regard to the security and liquidity of its investments before seeking the highest rate of return, or yield. The Council's objective when investing money is to strike an appropriate balance between risk and return, balancing the risk of incurring losses from defaults against receiving unsuitably low investment income. Where balances are expected to be invested for more than one year, the Council will aim to achieve a total return that is equal or higher than the prevailing rate of inflation, in order to maintain the spending power of the sum invested.

Negative Interest Rates: If the UK enters into a recession in 2017-18, there is a very small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in a number of European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

Investment Balances: The Council holds surplus funds representing income received in advance of expenditure plus balances and reserves. Based on its cash flow forecasts, the Council anticipates its investment balances in 2017-18 to range between £24 million to £55 million with an average investment rate of between 0.25% to 0.50% depending on the bank rate and investment types used but this will be reviewed at half year and reported to Council. The actual balance varies because of the cash flow during the month and year as to when income is received (such as specific grant income, housing benefits subsidy and Revenue Support Grant) and payments are made (such as salaries and wages, major capital expenditure and loan repayments).

The major **objectives** to be followed in 2017-18 are:

- to maintain capital **security**
- to maintain **liquidity** so funds are available when expenditure is needed
- to achieve the **yield** on investments commensurate with the proper levels of security and liquidity

The Council's investments have historically been placed in short term bank and building society unsecured deposits and local and central government, however, investments may be made with any public or private sector organisations that meet the credit criteria detailed below. The Council is looking to diversify into more secure and/or higher yielding asset classes during 2017-18 but any new instruments used will be in full consultation with the Council's treasury management advisers.

With short term interest rates currently much lower than long-term rates, due consideration will also be given to using surplus funds to make early repayments of long term borrowing if appropriate options are available.

Credit Rating: Investment limits are set 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. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

<u>Approved Counterparties:</u> The Council may invest with any of the counterparty types shown in Table 2 below, subject to the cash limits and the time limits shown. **These cash/time limits are per counterparty and relate to principal only and exclude any accrued interest.**

Table 2: Approved Investment Counterparties and Limits

These limits must be read in conjunction with the notes immediately below the table and the combined secured and unsecured investments in any one bank must not exceed the cash limit for secured investments:

Credit Rating	Banks (including building societies) Unsecured	Banks (including building societies) Secured	Government	Corporates	Registered Providers
UK Central Government	N/A	N/A	£ Unlimited	N/A	N/A
			50 Years		
UK Local Authorities *	N/A	N/A	£12,000,000	N/A	N/A
			10 Years		
AAA	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	5 Years	20 Years	50 Years	20 Years	20 Years
AA+	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	5 Years	10 Years	25 Years	10 Years	10 Years
AA	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	4 Years	5 Years	15 Years	5 Years	10 Years
AA-	£3,000,000	£6,000,000	£6,000,000	£3,000,000	£3,000,000
	3 Years	4 Years	10 Years	4 Years	10 Years
A+	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	2 Years	3 Years	5 Years	3 Years	5 Years
A	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	13 Months	2 Years	5 Years	2 Years	5 Years
A-	£3,000,000	£6,000,000	£3,000,000	£3,000,000	£3,000,000
	6 Months	13 Months	5 Years	13 Months	5 Years
BBB+	£1,000,000	£3,000,000	£1,000,000	£1,000,000	£1,000,000
	100 Days	6 Months	2 Years	6 Months	2 Years
None	£1,000,000	N/A	N/A	N/A	£3,000,000
	6 Months				5 Years
Pooled Funds	£6,000,000				
	Per Fund				

** excluding parish and community councils*

Banks Unsecured: Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. Where additional amounts received into our accounts with our own bankers are received too late in the day to make an investment the same day, the limit in the above table will not apply as this does not count as an investment.

Banks Secured: Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits.

Government: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Central Government may be made in unlimited amounts for up to 50 years.

Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made as part of a diversified pool in order to spread the risk widely.

Registered Providers: Loans and bonds issued by, guaranteed by, or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Welsh Government and, as providers of public services, they retain the likelihood of receiving government support if needed.

Money Market Funds (type of pooled fund): These funds are pooled investment vehicles consisting of money market deposits and similar instruments. They have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager. Short term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts. To date the Council has not used money market funds.

Other Pooled Funds: The Council may consider using pooled bond, equity and property funds whose value changes with market prices and/or have a notice period for longer investment periods as they offer enhanced returns over the longer term, and are potentially more volatile in the shorter term. To date the Council has not used any pooled funds but if it did their performance and continued suitability in meeting the Council's investment objectives would be monitored regularly.

Custodian Accounts: Investments in bonds and certificates of deposit are no longer evidenced by paper certificates and must therefore be held by a custodian. The Council will need to use a nominee account(s) with a third party for safe custody of such investments (in the process of legal approval) and any new instruments used will be in full consultation with the Council's treasury management advisors.

Risk Assessment and Credit Ratings: Credit ratings are obtained and monitored by the Council's treasury advisers, who will notify changes as they occur.

Long-term ratings are expressed on a scale from AAA (the highest quality) through to D (indicating default). Ratings of BBB- and above are described as investment grade, while ratings of BB+ and below are described as speculative grade. The Council's credit rating criteria are set to ensure that it is very unlikely the Council will hold speculative grade investments, despite the possibility of repeated downgrades.

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
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty

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

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

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

Specified Investments: This is an investment which offers high security and high liquidity. It is a low risk investment where the possibility of loss of principal or investment income is negligible and satisfies the conditions below as defined by *WG Investment Guidance*:-

- denominated in pound sterling
- contractually committed to be paid within 12 months of arrangement (364 days)
- not defined as capital expenditure by legislation, and
- invested with one of:
    - the UK Government
    - a UK local authority
    - a UK parish or community council or
    - body or investment scheme of "high credit quality"

The Council defines **"high credit quality"** organisations and securities as those having a credit rating of A- or higher. For those domiciled outside of the UK, investments would only be made with a country having a sovereign rating of AA+ or higher.

Non-specified Investments: Any investment that does not fall into the criteria detailed above under the Specified definition. The 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
- those that are defined as capital expenditure by legislation, such as shares in money market funds and other pooled funds
- investments with bodies and schemes not meeting the definition on high credit quality

All investments longer than 364 days will be made with a cautious approach to cash flow requirements and advice from the Council's treasury management advisers will be sought as necessary.

The WG Guidance requires the Council's Investment Strategy to set an overall limit for non-specified investments which is currently set at £25 million. Table 3 below shows the non-specified categories and the relevant limits – the total of the individual limits exceed £25 million, however at any one point in time a maximum of **£25 million** of investments could be in one of the following non-specified categories with the following category limits:

Table 3: Non-Specified Investment Limits

	Category Cash limit
Total long-term investments	£15m
Total Money Market Funds	£10m
Total other pooled funds	£10m
Total investments without credit ratings (excluding Local Authorities) or rated below the Council's definition of "high credit quality" (A-)	£ 6m
Total investments (except pooled funds)with institutions domiciled in foreign countries with a sovereign rating below AA+	£ 3m

Investment Limits:

The combined values of specified and non-specified investments with any one organisation are subject to the investment limits detailed below in Table 4, the approved counterparties and limits shown in Table 2 above and also the non-specified limits in Table 3 above. A group of banks under the same ownership will be treated as a single organisation for limit purposes.

Table 4: Investments Limits

	Category Cash limit
Any single organisation, except the UK Central and Local Government	£6m
UK Central Government	unlimited
UK Local Authorities (per counterparty)	£12m
Any group of organisations under the same ownership	£6m per group
Any group of pooled funds under the same management	£6m per manager
Negotiable instruments held in a broker's nominee account	£10m per broker
Foreign countries	£6m per country
Registered Providers	£5m in total
Unsecured investments with Building Societies	£6m in total

Liquidity Management: The Council forecasts on a prudent basis the maximum period for which funds may be committed therefore minimising the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments. A limit of £15 million (table 3 above) has been set for 2016-17 for long term investments and this has been set with reference to the Medium Term Financial Strategy and cash flow forecast. This represents just under 30% of the maximum amount of investments that the Council anticipates to have at any one point in time during 2017-18.

6.0 Treasury Management and Prudential Indicators

The 2011 Treasury Management Code and Prudential Code require the Council to set and report on a number of Treasury Management and Prudential Indicators. **Schedule A** revises some of the indicators for 2016-17, 2017-18, 2018-19, and 2019-20 and introduces new indicators for 2020-21 to be consistent with the principles contained in the Medium Term Financial Strategy. The indicators either summarise the expected activity or introduce limits upon the activity, and reflect the underlying capital programme.

7.0 Annual Minimum Revenue Provision Statement 2017-18

Where a Council finances capital expenditure by debt, it must put aside revenue resources to repay that debt in later years. This amount charged to revenue is called the Minimum Revenue Provision (MRP). Under the Local Authority (Capital Finance and Accounting) (Amendment) (Wales) Regulations 2008, an Annual Minimum

Revenue Provision (MRP) Statement needs to be produced that details the methodology for the MRP charge. There is not a statutory minimum for the amount set aside. It needs to be considered a prudent provision to ensure that the 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 Welsh Government's Revenue Support Grant reasonably commensurate with the period implicit in the determination of that grant. This is detailed in **Schedule B.**

8.0 Performance Indicators

The Code of Practice on Treasury Management requires the Council to set performance indicators to assess the adequacy of the treasury function over the year. These are distinct historic indicators as opposed to the treasury management and prudential indicators which are predominantly forward looking. One debt performance indicator is where the average portfolio rate of interest is compared to an appropriate average available such as the average PWLB Debt for Welsh and UK Local Authorities. The rate of return on investments can be monitored against the benchmark of the average one month London Inter Bank Bid (LIBID) rate, the average Bank Rate and the average rate of return on investments at each quarter end as compared to the average rate of Arlingclose's Welsh Local Authority Clients.

9.0 Other Items

The Council is required by CIPFA or WG to include the following additional items:

Policy on Use of Financial Derivatives: The Localism Act 2011 includes a general power competence that removes the uncertain legal position over English local authorities' use of standalone financial derivatives (i.e. those that are not embedded into a loan or investment). These instruments are used by organisations to manage exposure to interest rate or exchange rate fluctuations. Although this change does not apply to Wales, the latest CIPFA Code requires authorities to clearly state their policy on the use of derivatives in the annual strategy. In the absence of any explicit legal power to do so, the Council will not use standalone financial derivatives transactions such as swaps, forwards, futures and options. Derivatives embedded into loans and investments including pooled funds and forward starting transactions may be used and the risks they present will be managed in line with the overall treasury risk management strategy.

Investment Advisers: The Council appointed Arlingclose Limited following a tender exercise in August 2016, as treasury management advisers to provide advice and information relating to its borrowing and investment activities. The quality of this service is controlled by having regular meetings with the advisers and regularly reviewing the service provided.

Investment of Money Borrowed in Advance of Need: The Welsh Government maintains that the borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity, however, the Council could potentially borrow in advance of need where this is expected to provide the best long term value for money. Since amounts borrowed will be invested until spent, the Council is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Council's overall management of its treasury risks.

The Council has an integrated Treasury Management Strategy and borrowing is not linked to the financing of specific items of expenditure. The Council's Capital Financing Requirement (CFR) as at 1 January 2017 was in excess of the actual debt of the Council (as detailed in the Prudential Indicators in Schedule A) indicating there was no borrowing in advance of need.

Investment Training: The Treasury Management Team receives training from the Council's Treasury Management advisers. The Council also supports personal development so individuals enhance their own knowledge through reading CIPFA guidance, publications and research on the internet.

Schedule A

TREASURY MANAGEMENT INDICATORS

The following indicators (which are forward looking parameters) form part of the CIPFA Code of Practice on Treasury Management. They enable the Council to measure and manage its exposure to treasury management risks using the following indicators.

The Council needs to set the upper limits to its **Interest Rate Exposure** for the effects of changes in interest rates. There are two treasury management indicators that relate to both fixed interest rates and variable interest rates. These limits have been calculated with reference to the net outstanding principal sums and are set to control the Council's exposure to interest rate risk.

No.	Interest Rate Exposure	2016-17 £m	2017-18 £m	2018-19 £m	2019-20 £m	2020-21 £m
	Total Projected Principal Outstanding on Borrowing 31 March	96.87	96.87	96.87	96.87	96.87
	Total Projected Principal Outstanding on Investments 31 March	30.00	24.00	17.00	13.00	8.00
	Net Principal Outstanding	**66.87**	**72.87**	**79.87**	**83.87**	**88.87**
1.	**Upper Limit on fixed interest rates (net principal) exposure**	140.00	130.00	130.00	130.00	130.00
2.	**Upper Limit on variable interest rates (net principal) exposure**	50.00	50.00	50.00	50.00	50.00

The Section 151 Officer will manage interest rate exposures between these limits.

A further indicator for Treasury Management measures the **Maturity Structure of Borrowing** and is the amount of projected borrowing that is fixed rate, maturing in each period as a percentage of total projected fixed rate borrowing. This indicator is set to control the Council's exposure to refinancing risk and has been set to allow for the possible restructuring of long term debt where this is expected to lead to an overall saving or reduction in risk.

No	Maturity structure of fixed rate borrowing during 2017-18	Upper limit	lower limit
3.	Under 12 months	50%	0%
	12 months and within 24 months	25%	0%
	24 months and within 5 years	25%	0%
	5 years and within 10 years	50%	0%
	10 years and within 20 years	60%	0%
	20 years and above	100%	40%

The Upper Limit for **Total Principal Sums Invested over 364 days** indicator controls the amount of longer term investments which mature beyond the period end. This is set to control the Council's exposure to the risk of incurring losses by seeking early repayment of its investments.

No.		2017-18 £m	2018-19 £m	2019-20 £m	2020-21 £m
4.	**Upper Limit - Total Principal Sum Invested more than 364 day days**	15	10	8	6

2.0 PRUDENTIAL INDICATORS

The Prudential Indicators are required to be set and approved by Council in accordance with CIPFA's *Prudential Code for Capital Finance in Local Authorities.*

Council is required to formally adopt CIPFA's Treasury Management Code and the revised version of the 2011 code was adopted by Council on 22 February 2012.

Prudential Indicators for Prudence

The following Prudential Indicators are based on the Council's capital programme which is subject to change.

The Council's capital expenditure plans are summarised below and this forms the first prudential indicator for Prudence. The total capital expenditure is funded from capital grants and contributions, capital receipts and revenue with the remainder being the **Net Financing Need for the Financial Year** to be met from borrowing.

No.	Prudential indicators For Prudence	2016-17 £m Proj.	2017-18 £m Est.	2018-19 £m Est.	2019-20 £m Est.	2020-21 £m Est.
1	**Estimates of Capital Expenditure** Non – HRA	26.90	63.85	12.75	10.41	9.13
	Total Capital Expenditure	**26.90**	**63.85**	**12.75**	**10.41**	**9.13**
	Financed by :-					
	Capital Grants and Contributions	12.12	24.37	6.44	4.84	4.52
	Capital Receipts	6.86	20.04	0.14	0.86	0.01
	Revenue Contribution to Capital	3.29	9.92	0.94	0.80	0.69
	Net Financing Need for Year	**4.63**	**9.52**	**5.23**	**3.91**	**3.91**

The second Prudential Indicator is the **Capital Financing Requirement (CFR)** for the Council. This shows the total outstanding capital expenditure that has not been funded from either revenue or other capital resources. It is derived from the actual Balance Sheet of the Council. It is essentially a measure of the underlying need to finance capital expenditure and forms the basis of the charge to the General Fund under the Prudential Code system.

The process for charging the financing of capital expenditure to revenue is a statutory requirement and is called the Minimum Revenue Provision (MRP).The actual MRP charge needs to be prudent – as detailed in the Council's MRP policy in **Schedule B.**

No.	Prudential indicators For Prudence	2016-17 £m Proj.	2017-18 £m Est.	2018-19 £m Est.	2019-20 £m Est.	2020-21 £m Est.
2	**Capital Financing Requirement (CFR)**					
	Opening CFR (1 April) adjusted excluding PFI & other liabilities	154.82	150.65	153.55	152.15	149.47
	Opening PFI CFR	18.79	18.24	17.64	17.00	16.31
	Opening Innovation Centre	0.72	0.66	0.60	0.54	0.45
	Opening Coychurch Crematorium	0.13	0.08	0	0	0
	Total Opening CFR	**174.46**	**169.63**	**171.79**	**169.69**	**166.23**
	Movement in CFR excl. PFI & other liabilities	(4.18)	2.90	(1.39)	(2.68)	(2.61)
	Movement in PFI CFR	(0.55)	(0.60)	(0.65)	(0.69)	(0.74)
	Movement in Innovation Centre CFR	(0.05)	(0.06)	(0.06)	(0.09)	(0.10)
	Movement in Crem CFR	(0.05)	(0.08)	0	0	0
	Total Movement in CFR	**(4.83)**	**2.16**	**(2.10)**	**(3.46)**	**(3.45)**
	Closing CFR (31 March)	**169.63**	**171.79**	**169.69**	**166.23**	**162.78**
	Movement in CFR represented by :-					
	Net Financing Need for Year (above)	4.63	9.52	5.23	3.91	3.91
	Minimum and Voluntary Revenue Provisions*	(9.46)	(7.36)	(7.33)	(7.37)	(7.36)
	Total Movement	**(4.83)**	**2.16**	**(2.10)**	**(3.46)**	**(3.45)**

*Minimum Revenue Provision (MRP) and Voluntary Revenue Provision (VRP) represent the revenue charge for the repayment of debt and includes MRP for the Public Finance Initiative (PFI) and the Innovation Centre

Limits to Borrowing Activity

The Council's long term borrowing at the 31 December 2016 was £96.87million as detailed in section 3 of the Strategy. External borrowing can arise as a result of both capital and revenue expenditure and timing of cash flows. As the Council has an integrated Treasury Management Strategy there is no association between individual loans and particular types of expenditure. Therefore, the Capital Financing Requirement and actual external borrowing can be very different.

The **Gross Debt** position (Borrowing and Long Term Liabilities) is shown below:

No.	Prudential indicators For Prudence Gross Debt 31 March	2016-17 £m Proj.	2017-18 £m Est.	2018-19 £m Est.	2019-20 £m Est.	2020-21 £m Est.
3	External Borrowing	96.87	96.87	96.87	96.87	96.87
	Long Term Liabilities (including PFI)	21.77	21.07	20.32	17.10	16.22
	Total Gross Debt	**118.64**	**117.94**	**117.19**	**113.97**	**113.09**

Within the Prudential Indicators, there are a number of key indicators to ensure the Council operates its activities within well-defined limits. One key control is to ensure that over the medium term, debt will only be for a capital purpose. The Council needs to ensure that external debt does not, except in the short term, exceed the Capital Financing Requirement for 2016-17 (i.e. the preceding year) plus the estimates of any additional capital financing requirement for the current and next three financial years, however 2020-21 has also been included to be consistent with the Medium Term Financial Strategy.

No.	Prudential indicators For Prudence	2016-17 £m Proj.	2017-18 £m Est.	2018-19 £m Est.	2019-20 £m Est.	2020-21 £m Est.
4	**Gross Debt & the CFR**					
	Total Gross Debt	118.64	117.94	117.19	113.97	113.09
	Closing CFR (31 March)	**169.63**	**171.79**	**169.69**	**166.23**	**162.78**

As can be seen from the above table, the Council does not have any difficulty meeting this requirement in 2016-17 and does not envisage any difficulties in the current and future years. This view takes into account current commitments, existing plans and the proposals for next year's budget.

A further two Prudential Indicators control the Council's overall level of debt to support Capital Expenditure. These are detailed below:-

- The **Authorised Limit** for External Debt – this represents the limit beyond which borrowing is prohibited. It reflects a level of borrowing that could not be sustained even though it would be affordable in the short term. It needs to be set and approved by Members.

- The **Operational Boundary** for External Debt – this is not an actual limit and actual borrowing could vary around this boundary during the year. It is based on the probable external debt during the course of the year.

No.	Prudential indicators For Prudence	2016-17 £m	2017-18 £m	2018-19 £m	2019-20 £m	2020-21 £m
5	**Authorised limit for external debt**					
	Borrowing	140	140	140	140	140
	Other long term liabilities	30	30	30	30	30
	Total	**170**	**170**	**170**	**170**	**170**
6	**Operational Boundary**					
	Borrowing	105	105	105	105	105
	Other long term liabilities	25	25	25	20	20
	Total	**130**	**130**	**130**	**125**	**125**

Prudential Indicators for Affordability

The Prudential Code Indicators Numbered 1 to 6 above cover the overall controls on borrowing and financing of capital expenditure within the Council. The second suite of indicators detailed below assesses the affordability of capital investment plans and the impact of capital decisions on the Council's overall finances.

The **Ratio of Financing Costs to Net Revenue Stream** indicator demonstrates the trend in the cost of capital against the total revenue amount to be met from local taxpayers and the amount provided by the WG in the form of Revenue Support Grant. The estimates of capital financing costs include interest payable and receivable on Treasury Management activities and the MRP charged to the Comprehensive Income and Expenditure Statement. The revenue stream is the amount to be met from government grants and local taxpayers. The projection has

No.	Prudential Indicators for Affordability	2016-17 Proj. %	2017-18 Est. %	2018-19 Est. %	2019-20 Est. %	2020-21 Est. %
7.	**Estimate - Ratio of Financing Costs to Net Revenue Stream**	5.76	4.84	4.85	4.89	4.90

The indicator of the **Incremental Impact of Capital Investment Decisions on Council Tax** identifies the estimate of the incremental impact to the Council Tax from the capital expenditure proposals, particularly changes in borrowing requirements that have occurred since the Capital Programme was approved for the year. This is a purely notional calculation designed to show the effect of changes in capital investment decisions.

No.	Incremental Impact of Capital Investment Decisions on Council Tax	2016-17 Proj. £	2017-18 Est. £	2018-19 Est. £	2019-20 Est. £	2020-21 Est. £
8.	**Estimate - Increase in Band D Council Tax as per Capital Programme**	1.54	1.51	1.51	1.51	1.51

Schedule B

ANNUAL MINIMUM REVENUE PROVISION STATEMENT 2017-18

The Annual Minimum Revenue Provision Statement needs to be approved by Council before the start of each financial year. The MRP charges for 2017-18 will be on the following bases:-

i. Capital expenditure incurred before 1 April 2008 and any capital expenditure after 1 April 2008 that is government supported expenditure and does not result in a significant asset will be based on the Capital Financing Requirement after accounting adjustments at 4% of the opening balance. This charge was supplemented by voluntary MRP (based on the useful asset life) in respect of those assets which were financed by unsupported borrowing before 1 April 2008
ii. Supported capital expenditure that results in a significant asset (based on an internal assessment) incurred on or after 1 April 2008 and all unsupported capital expenditure, exercised under the Prudential Code, the MRP charge will be based on the Asset Life Method. The minimum revenue provision will be at equal annual instalments over the life of the asset. The first charge can be delayed until the year after the asset is operational but this will be at the discretion of the Section 151 Officer
iii. for assets reclassified as finance leases under International Financial Reporting Standards (IFRS) or resulting from a Private Finance Initiative, the MRP charge will be regarded as met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability for the year
iv. Where loans are made to other bodies for their capital expenditure with an obligation for the bodies to repay, no MRP will be charged. The capital receipts generated by the annual repayments on those loans will be put aside to repay debt instead
v. MRP may be waived on expenditure recoverable within a prudent period of time through capital receipts (e.g. land purchases) or deferred to when the benefits from investment are scheduled to begin or when confirmed external grant payments towards that expenditure are expected.

The MRP Charge 2017-18 based on the estimated capital financing requirement is detailed below:-

	Options	Estimated Capital Financing Requirement 01-04-17 £m	2017-18 Estimated MRP £m
Capital expenditure before 01-04-2008 and any after 01-04-2008 that does not result in a significant asset (Supported)	**(i)**	**123.81**	**4.95**
Capital Expenditure before 01-04-2008 (Unsupported)		**-**	**-**
Supported capital expenditure that results in a significant asset, incurred on or after 1 April 2008 (Supported)	**(ii)**	**3.55**	**0.13**
Unsupported capital expenditure, exercised under the Prudential Code (Unsupported)		**23.29**	**1.54**
PFI, Finance Leases and other arrangements	**(iii)**		
PFI School		**18.24**	**0.60**
Innovation Centre		**0.66**	**0.06**
Coychurch Crematorium		**0.08**	**0.08**
TOTAL		**169.63**	**7.36**