Gedling Borough Council

Report to Cabinet

Subject: Prudential and Treasury Indicators and Treasury Management Strategy Statement (TMSS) 2018/19

Date: 15 February 2018

Author: Deputy Chief Executive and Chief Financial Officer

Wards Affected

All

Purpose

To present for Members' approval the Council's Prudential Code Indicators and Treasury Strategy for 2018/19, for referral to Full Council.

Key Decision

This is a key decision.

Background

1.1 Definition of treasury management

CIPFA defines treasury management as "the management of the local authority's borrowing, investments and cash flows, its banking, money-market and capital-market transactions; the effective control of the risks associated with those activities, and the pursuit of optimum performance consistent with those risks."

Investments in the definition above include all the Council's financial assets (treasury investments) as well as other non-financial assets (non-financial investments) held primarily for financial returns, such as investment property portfolios. They may therefore include investments that are not managed as part of normal treasury management function. All investments require appropriate risk management under the Treasury Management Code, and the key principle of the control of risk and optimisation of returns should be applied across all investment activities, including those that are more commercially based.

The Council is required to operate a "balanced budget", which broadly means that cash raised during the year will meet cash expenditure. The

Localism Act 2011 places a duty on a local authority to calculate its "council tax requirement" for each financial year, and this includes the revenue costs which result from the capital investment decisions of the authority.

Part of the treasury management service is to ensure that cashflow is adequately planned, with cash available when it is needed. Surplus cash is invested in counterparties and instruments commensurate with the Council's low risk appetite, providing adequate liquidity before considering investment return.

A further treasury management function is the funding of the Council's capital plans. These plans provide a guide to the Council's borrowing needs, and require longer term cashflow planning to ensure the Council can meet its spending obligations. The management of longer term cash may involve arranging long or short-term loans or the use of longer term cashflow surpluses. On occasion, debt previously drawn may be restructured to meet the Council's risk or cost objectives.

1.2 Statutory reporting requirements

As a minimum, the Treasury Management Code requires that Council receives and approves three main reports each year, which incorporate a variety of polices, estimates and actuals.

1.2.1 Prudential and Treasury Indicators and Treasury Management Strategy Statement (TMSS) - this report

This first, and most important report covers:

- The capital plans (including prudential indicators),
- A minimum revenue provision (MRP) policy (how residual capital expenditure is charged to revenue over time),
- The treasury management strategy (how the investments and borrowings are to be organised) including treasury indicators,
- An investment strategy (the parameters on how investments are to be managed).

1.2.2 Mid-year Treasury Management Report

This updates Members on the progress of the capital position, amending prudential indicators as necessary, and whether the treasury strategy is appropriate or whether any policies require revision. The Council has adopted a policy of presenting quarterly treasury management reports to Cabinet, and this exceeds the minimum requirement.

1.2.3 Annual Treasury Report

This provides details of a selection of actual prudential and treasury indicators and actual treasury operations compared to the estimates within the strategy.

1.2.4 Scrutiny

All treasury management reports are required to be adequately scrutinised before being recommended to Council. This role is undertaken by Cabinet. The TMSS is part of the Council's Budget and Policy Framework and accordingly the Chair of the Overview and Scrutiny Committee must also be consulted. Any comments received will be taken into account before referral to Council.

1.2.5 Capital Strategy

CIPFA issued revised Prudential and Treasury Management Codes in December 2017. The revised Prudential Code includes the explicit requirement for the preparation of a Capital Strategy, which is intended to provide the following:

- A high level overview of how capital expenditure, capital financing and treasury management activities contribute to the provision of services;
- An overview of how the associated risk is managed;
- The implications for future sustainability.

The aim of this report is to ensure that all elected Members, ie. Full Council fully understand the overall strategy, governance procedures and risk appetite entailed in the strategy. The Capital Strategy will include capital expenditure, investments and liabilities, and treasury management, in sufficient detail to allow all Members to understand how stewardship, value for money, prudence and sustainability and affordability will be secured. Reference will be made, if appropriate, to significant purchases of non-financial investments (eg. commercial property), indicating how these have been financed and what powers have been used to undertake them.

The Council already produces a Capital Programme and Capital Investment Strategy, which can be found elsewhere on this agenda. This document will be reviewed during 2018/19 to ensure that any additional requirements of the revised Code are implemented in future reports.

In the light of the requirements of both the Treasury Management Code and the revised Prudential Code, it is currently envisaged that the TMSS and the Capital Programme and Capital Investment Strategy reports will be combined to avoid duplication, particularly with regard to the Prudential Indicators, however this is subject to the review of both documents and no final decision has yet been taken.

1.3 Treasury management strategy for 2018/19

The treasury management strategy for 2018/19 covers two main areas:

Capital issues:

- The capital plans and the prudential indicators
- The minimum revenue provision (MRP) policy

Treasury management Issues:

- The current treasury position
- Treasury indicators which limit the treasury risk and activities of the Council
- Prospects for interest rates
- The borrowing strategy
- Policy on borrowing in advance of need
- Debt rescheduling
- The investment strategy
- Creditworthiness policy
- Policy on use of external service providers

These elements cover the requirements of the Local Government Act 2003, the CIPFA Prudential Code, Communities and Local Government (CLG) MRP Guidance, the CIPFA Treasury Management Code and CLG Investment Guidance.

1.4 Training

The CIPFA Code requires the responsible officer to ensure that Members with responsibility for treasury management receive adequate training in treasury management. This especially applies to Members responsible for Treasury Management, ie. Cabinet, and the Chief Financial Officer will arrange training for Members as required. The Council's treasury management advisers, Link Asset Services-Treasury Solutions (LAS), will provide more detailed training sessions for Members as appropriate.

The training needs of officers involved with treasury management are reviewed periodically.

1.5 Treasury management consultants

The Council uses LAS as its treasury management advisors, recognising that there is value in employing external providers in order to acquire access to specialist skills and resources. The Council will ensure that the terms of appointment and the methods by which value will be assessed are properly agreed and documented, and subjected to regular review. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon the external service providers.

Proposal

2.1 The Capital Affordability and Prudential Indicators 2018/19 to 2020/21

The Council's capital expenditure plans are the key driver of treasury management activity.

The output of the Council's capital expenditure plans is reflected in prudential indicators, which are designed to assist Members to overview and confirm such capital expenditure plans. The indicators for 2018/19 to 2020/21 are attached at Appendix 1.

2.1.1 Capital expenditure

The indicator includes a summary of the proposed capital expenditure plans for 2018/19 to 2020/21, including both those agreed previously and those forming part of this budget cycle. Expenditure includes sums for "non-financial" investments, eg. commercial investment property, the management of which is not part of the treasury management function.

Portfolio Capital Expenditure:	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
Housing, Health & Wellbeing	760,300	0	0
Public Protection	900,000	900,000	900,000
Environment	1,723,200	589,000	205,000
Growth & Regeneration	1,890,500	0	0
Resources & Reputation	2,950,000	150,000	2,650,000
Equipment Replacement	150,000	150,000	150,000
Development Bids	0	100,000	100,000
Total Capital Expenditure	**8,374,000**	**1,889,000**	**4,005,000**

The table below summarises the above capital expenditure plans and how these are being financed by capital or revenue resources. Any shortfall of resources results in a borrowing need.

Financing of Capital Expenditure:	2018/19 Est Estimate £	2019/20 Estimate £	2020/21 Estimate £
Capital Exp £m (above)	**8,374,000**	**1,889,000**	**4,005,000**
Financed by:			
Capital receipts	1,010,000	710,000	605,000
Capital grants & contributions	2,815,100	900,000	900,000
Direct Revenue Financing	0	0	0
Net Borrowing Need	**4,548,900**	**279,000**	**2,500,000**

2.1.2 The Council's borrowing need – the Capital Financing Requirement (CFR)

The CFR represents the total historic outstanding capital expenditure which has not yet been paid for, from either revenue or capital resources. It is essentially a measure of the Council's "underlying borrowing need". Any capital expenditure in the tables above, which has not immediately been paid for by way of capital receipts, grants or contributions, will increase the Council's CFR.

The CFR does not increase indefinitely, as the minimum revenue provision (MRP) is a statutory annual revenue charge which broadly reduces the borrowing need in line with each asset's life, and so charges the economic consumption of capital assets as they are used.

The CFR can include any other long term liabilities, for example finance leases and PFI schemes. Whilst these would increase the CFR, and therefore the borrowing requirement, such schemes would include their own borrowing facilities and the Council would not be required to separately borrow for them. The Council has no such schemes within its CFR.

Capital Financing Requirement (CFR):	**2018/19 Estimate £**	**2019/20 Estimate £**	**2020/21 Estimate £**
Closing CFR	15,086,500	14,592,200	16,354,800
Movement in CFR in year	**+2,953,200**	**-494,300**	**+1,762,600**
The movement in the CFR is represented by:			
Net financing need for the year (borrowing)	4,548,900	279,000	2,500,000
Application of Local Authority Mortgage Scheme (LAMS) capital receipt (LAMS 2)	-1,000,000	0	0
Less Gross MRP	-595,700	-773,300	-737,400
Movement in CFR in year	**+2,953,200**	**-494,300**	**+1,762,600**

2.1.3 Minimum Revenue Provision (MRP) Policy Statement

The Council is required to pay off an element of the accumulated General Fund capital spending (CFR) each year by way of a minimum revenue provision (MRP). It is also allowed to make an additional voluntary revenue provision if it wishes (VRP).

CLG regulations require the full Council to approve an MRP Statement in advance of each year. A variety of options is provided to councils, but there must be "prudent provision". The guidance does not, however, define

"prudent", instead making recommendations on the interpretation of the term. It is the responsibility of each authority to decide upon the most appropriate method of making a prudent MRP, having had regard to the guidance and its own circumstances, the broad aim being to ensure that borrowing is repaid over a period that reflects the useful lives of the assets acquired. The Council is obliged to have regard to the CLG guidance, but it is not prescriptive.

CLG has consulted on changes to the guidance for investments and MRP, with the aim of ensuring that local authorities continue to make borrowing and investment decisions in a way that is commensurate with their statutory responsibilities, and their best value duty. The primary issues raised in the consultation relate to investment in non-core functions; the principles of prioritising security and liquidity over yield in respect of investment in non-financial assets, eg, property; the ability to borrow to finance any investment that does not deliver statutory or strategic objectives, and changes to MRP guidance to ensure that prudent provision is made for the repayment of debt. The outcome of the consultation, and the new guidance, is still awaited so the full impact is not yet known, however the proposals in respect of MRP are considered to be prudent and have been applied in the preparation of the 2018/19 budget. The main area of uncertainty relates to potential controls on borrowing to finance the acquisition of investments that are not in delivery of core functions, eg. investment property outside the borough, however there are currently no proposals for this type of investment.

The Council is recommended to approve the following MRP Statement for 2018/19:

a. *The Council will assess MRP in accordance with the recommendations within the guidance issued under section 21(1A) of the Local Government Act 2003.*

b. *The CFR method, will be used for calculating MRP in respect of all capital expenditure incurred up to and including 31 March 2008. This is the simplest approach available, being calculated as a straightforward 4% of the relevant element of the CFR at the end of the previous year. In the current economic climate the Chief Financial Officer considers that use of the CFR Method is prudent.*

c. *The Asset Life Method, will be used for calculating MRP in respect of all capital expenditure incurred on and after 1 April 2008. An equal instalment approach will be adopted.*

d. *The Chief Financial Officer will determine estimated asset lives. Where expenditure of different types is involved, it will be grouped together in a manner which best reflects the nature of the main component of expenditure. It will only be divided up in cases where there are two or more major components, with significantly different asset lives.*

e. *The Council currently operates a cash-backed Local Authority Mortgage Scheme (LAMS), based on a five-year advance to Lloyds TSB to match the five-year life of the indemnity. Lloyds TSB terminated all active LAMS schemes on 31 July 2016 and no further applications have been accepted since that date, however the Council's advance with Lloyds remains in place pending its maturity in June 2018. The advance provides an integral part of the mortgage lending under the LAMS scheme, and is treated as capital expenditure and a loan to a third party, therefore the Capital Financing Requirement (CFR) increases by the amount of the advance. When the advance is returned at maturity in June 2018, the funds will be classed as a capital receipt, and the CFR will reduce accordingly. As the advance is a temporary (5-year) arrangement, there is no need to set aside prudent provision to repay the debt liability in the interim period, and there is accordingly no MRP application.*

f. *In view of the economic climate and significant budgetary pressures, the Council will not provide for an additional voluntary contribution to MRP in 2018/19.*

g. *Based on the above policy, the net MRP charge for 2018/19 has been calculated as £595,700 as detailed below, and this sum has been included in the Council's 2018/19 budget proposals. The exact amount of MRP will be subject to change should capital financing decisions alter during the year.*

Minimum Revenue Provision (MRP)	**2018/19 £**
CFR Method	230,300
Asset Life Method	365,400
Gross MRP	**595,700**

2.1.4 Other Capital Affordability Prudential Indicators

Sections 2.1.1 and 2.1.2 above cover the Prudential Indicators for overall "capital" and "control of borrowing", but within the Prudential framework additional indicators are required to further assess the affordability of the Council's capital investment plans. These provide an indication of the impact of the capital investment plans on the Council's overall finances and are detailed below. The indicators can be found at Appendix 1.

- Ratio of financing costs to net revenue stream - This indicator identifies the trend in the cost of capital (borrowing and other long term obligation costs, net of investment income) against the net revenue stream. Estimates of financing costs include current commitments and the proposals included in the Gedling Plan report elsewhere on this agenda. As detailed in the Capital Programme report elsewhere on this agenda, no

contributions from the revenue budget are available to finance the 2018/19 capital programme.

- Incremental Impact of capital investment decisions on Council Tax

  Following the December 2017 revision of the Prudential Code, this indicator has been removed to allow focus on a longer term, and more informed, view of affordability, rather than placing reliance on a specific indicator.

- Maximum Gross Debt

  The Council must ensure that its gross debt does not, except in the short term, exceed the total of the opening capital financing requirement, plus estimates of any additional CFR for the year in question and the following two financial years (reductions are ignored). This allows flexibility for early borrowing for future years, but ensures that borrowing is not undertaken for revenue purposes. Please see 2.2.1 below.

  The 2018/19 Capital Programme and Capital Investment Strategy report provides full details of the proposed capital programme, including non-treasury investments, ie. commercial property investment. All the capital prudential indicators can be found at Appendix 1, and represent capital investment plans that have been fully factored into the Council's Medium Term Financial Plan, and are assessed as affordable, prudent and sustainable, subject to securing the commitment to delivering an efficiency programme in the medium term, as proposed in the Gedling Plan report.

2.2 Treasury Strategy 2018/19 - Borrowing and Investment

The capital expenditure plans set out above provide details of the Council's service activity. The treasury management function ensures that the Council's cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this activity. This will involve both the organisation of the cash flow and, where necessary, the organisation of approporiate borrowing facilities. The Treasury Strategy covers the relevant treasury indicators, the current and projected debt positions and the annual investment strategy.

2.2.1 Projected portfolio position

The Council's forward projection on its treasury portfolio position is summarised below. This shows the projected external debt, ie. the treasury management operations, against the underlying capital borrowing need, ie. the Capital Financing Requirement (CFR), highlighting any expected over or under borrowing.

Projected Gross Debt compared to CFR	2018/19 Estimate £000s	2019/20 Estimate £000s	2020/21 Estimate £000s
Estimated Debt 1 April	7,812	10,312	11,312
Estimated change in debt	2,500	1,000	2,500
Other long term liabilities	0	0	0
Estimated Gross Debt 31 March	**10,312**	**11,312**	**13,812**
Estimated Closing CFR	15,086	14,592	16,355
Under/(over) borrowing	**4,774**	**3,280**	**2,543**

Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. As detailed at 2.1.4 above, to comply with the "gross debt" indicator, the Council must ensure that its gross debt does not, except in the short term, exceed the total of the closing CFR in the preceding year plus the estimates of any **additional** CFR for 2018/19 and the following two financial years. This allows some flexibility for limited early borrowing for future years, but ensures that borrowing is not undertaken for revenue, or for speculative purposes.

The Chief Financial Officer can report that the Council has complied with this prudential indicator during the current year, 2017/18, and does not envisage difficulties for the future. This view takes into account current commitments, existing plans, and the proposals in this budget report.

Maximum Gross Debt	2018/19 Estimate £000s	2019/20 Estimate £000s	2020/21 Estimate £000s
Opening CFR (ie. closing CFR in preceding year)	12,133	15,086	14,592
Additions (only) in-year + following 2 years	4,716	1,912	1,912
Maximum Gross Debt	**16,849**	**16,998**	**16,504**
Estimated GBC debt at 31 March	10,312	11,312	13,812
Under/(over) borrowing	**6,537**	**5,686**	**2,692**

2.2.2 Treasury indicators – affordability limits to borrowing (Appendix 1)

a. The Operational Boundary for external debt

This is the limit which external debt is not "normally" expected to exceed. In most cases, this would be a similar figure to the CFR, but it may be lower or higher depending on the levels of actual debt.

b. The Authorised Limit for external debt

This limit represents a control on the “maximum” level of borrowing. It is the statutory limit determined under s3 (1) of the Local Government Act 2003 and represents the limit beyond which external debt is prohibited. The Authorised Limit must be set, and revised if necessary, by Full Council. It reflects a level of external debt which, while not desirable, could be afforded in the short term, but is not sustainable in the longer term. The Government retains an option to control either the total of all Councils’ plans, or those of a specific Council, although this power has not yet been exercised.

2.2.3 Prospects for Interest Rates

The Council has appointed Link Asset Services (LAS) as its treasury advisor and part of their service is to assist the Council to formulate a view on interest rates. The following table gives the LAS central view as at 22 January 2018 and further information on interest rates can be found at Appendix 2.

Link Asset Services Interest Rate View													
	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Jun-20	Sep-20	Dec-20	Mar-21
Bank Rate	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.00%	1.25%	1.25%	1.25%
5yr PWLB rate	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.10%	2.20%	2.30%	2.30%
10yr PWLB rate	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	2.80%	2.90%	2.90%	3.00%
25yr PWLB rate	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.50%	3.50%	3.60%	3.60%
50yr PWLB rate	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.30%	3.30%	3.40%	3.40%

The Monetary Policy Committee (MPC) increased Bank Rate from 0.25% to 0.5% in November 2017 reversing the emergency cut in August 2016 following the EU referendum result. It also gave forward guidance that two further increases in Bank Rate were expected, and the LAS forecast above includes increases of 0.25% in November 2018 and 0.25% in November 2019.

The overall long run trend is for gilt yields and PWLB rates to rise gently. A protracted move from bonds to equities has long been expected, after a 25 year trend of falling bond yields. The action of central banks since the financial crash of 2008 in implementing substantial Quantitative Easing (QE), has added further impetus to the downward trend in bond yields and rising bond prices. QE has also led directly to a rise in equity values as investors search for higher returns, and take on riskier assets.

Until 2015, monetary policy was focused on stimulating economic growth but has since started to refocus on countering the threat of rising inflationary pressures. The US Federal Reserve (The Fed) has started raising interest rates and this trend is expected to continue during 2018 and 2019.

Gilt yields, and therefore PWLB rates, are subject to exceptional levels of

volatility due to geopolitical, sovereign debt crises and emerging market developments. Such volatility could occur at any time during the forecast period.

Economic and interest rate forecasting remains difficult with many external influences weighing on the UK. The LAS forecasts above (and MPC decisions) may change depending how economic data and developments in the financial markets play out over the next year. Geopolitical developments, especially in the EU, could also have a major impact. Forecasts for average investment earnings beyond the three-year time horizon will be heavily dependent on economic and political developments. The overall balance of risk to economic recovery in the UK is to the downside (ie. recovery is slower than anticipated), particularly with the current level of uncertainty over the final terms of Brexit.

Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Bank of England monetary policy takes action too quickly over the next three years to raise Bank Rate and causes UK economic growth, and increases in inflation, to be weaker than currently anticipated;
- Geopolitical risks, especially North Korea, but also in Europe and the Middle East, which could lead to increasing safe haven flows;
- A resurgence of the Eurozone sovereign debt crisis, possibly in Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system;
- The weak capitalisation of some European banks;
- The result of the October 2017 Austrian general election is likely to result in a strongly anti-immigrant coalition government. In addition, the expected new Czech prime minister is strongly against EU migrant quotas and refugee policies. Both these developments could provide impetus to other countries to unite and create a major block to progress on EU integration and the centralisation of EU policy. This, in turn, could impact on the Euro, EU financial policy and financial markets;
- Rising protectionism under President Trump;
- A sharp Chinese downturn and its impact on emerging market countries.

The potential for upside risks to current forecasts for UK gilt yields and PWLB rates, especially for longer term PWLB rates include:

- The Bank of England is too slow in its pace and strength of increases in Bank Rate and therefore allows inflationary pressures to build up too strongly within the UK economy, which then necessitates a more rapid series of increases in Bank Rate;
- UK inflation returning to sustained significantly higher levels causing an increase in the inflation premium inherent to gilt yields;
- The Fed causing a sudden shock in financial markets by misjudging the pace and strength of increases in its own rate, and in the pace and strength of

reversal of QE, which then leads to a fundamental reassessment by investors of the relative risks of holding bonds, as opposed to equities. This could lead to a major flight from bonds to equities and a sharp increase in bond yields in the US, which could then spill over into impacting bond yields around the world.

Investment returns are likely to remain low during 2018/19 but then to be on a gently rising trend over the following few years.

Borrowing rates increased sharply after the General Election in June 2017, and again after the September MPC meeting when financial markets accelerated their expectations of the timing of Bank Rate increases. Otherwise there has been little general trend in rates during the current financial year. The policy of postponing new borrowing by using spare cash balances has served well, however this will need to be reviewed to avoid higher borrowing costs in the future when borrowing to finance capital expenditure or refinance maturing debt may become unavoidable.

There will remain a revenue cost of carry to any new longer term borrowing that causes a temporary increase in cash balances, ie the difference between the borrowing cost and the investment return.

2.2.4 Borrowing Strategy

The Strategy

The Council is currently maintaining an under-borrowed position (see 2.2.1 above). This means that the capital borrowing need (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 represents "internal borrowing". This strategy is prudent since investment returns remain low, and counterparty risk is still an issue that needs to be considered.

However, against this background and the risks within the economic forecast outlined above, and the potential cost of carry (see 2.2.5 below), caution will be adopted with the 2018/19 treasury operations. The Chief Financial Officer will monitor interest rates in financial markets and adopt a pragmatic approach to changing circumstances:

- If it was felt that there was a significant risk of a sharp FALL in long and short term rates (e.g. due to a marked increase of risks around a relapse into recession, or of risks of deflation), then long term borrowing will be postponed, and potential rescheduling from fixed rate funding into short term borrowing will be considered.

- If it was felt that there was a significant risk of a much sharper RISE in long and short term rates than that currently forecast, perhaps arising from

an acceleration in the rate of increase in central rates in the UK and US, an increase in world economic activity or a sudden rise in inflation risk, then the portfolio position will be re-appraised with the likely action that fixed rate funding will be drawn whilst interest rates are still lower than they are projected to be in the next few years.

Any new borrowing will be discussed with LAS, and any decisions will be reported to Cabinet at the next available opportunity.

2.2.5 Policy on borrowing in advance of need

The Council will not borrow more than, or in advance of, its needs purely to profit from the investment of the extra sums borrowed, since this is unlawful. Any decision to borrow in advance of need will be within the forward-approved CFR estimates, and will be considered carefully to ensure value for money can be demonstrated, and that the Council can ensure the security of such funds.

In determining whether borrowing will be undertaken in advance of need, the Council will ensure that there is a clear link between the capital programme and the maturity profile of the existing debt portfolio which supports the need to take funding in advance of need. It will ensure that the on-going revenue liabilities created, and the implications for future plans and budgets have been considered, and evaluate the economic and market factors that might influence the manner and timing of any decision to borrow. The advantages and disadvantages of alternative forms of funding will be considered, together with the most appropriate periods over which to fund.

Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through the mid-year or annual reporting mechanism.

2.2.6 Debt rescheduling

As short term borrowing rates are expected to be considerably cheaper than longer term fixed interest rates, there may be potential opportunities to generate savings by switching from long term debt to short term debt. However, these savings will need to be considered in the light of the current treasury position and the size of the cost of debt repayment (premiums incurred).

The reasons for any rescheduling to take place will include:

- The generation of cash savings and / or discounted cash flow savings
- Helping to fulfil the Treasury Strategy;
- Enhance the balance of the portfolio (amend the maturity profile and/or the balance of volatility).

Consideration will also be given to identifying any residual potential for making savings by running down investment balances to repay debt prematurely as short term rates on investments are likely to be lower than rates paid on current debt.

All rescheduling will be reported to Cabinet at the earliest meeting following action.

2.2.7 Municipal Bond Agency

The Municipal Bond Agency may offer loans to local authorities for infrastructure and housing, at borrowing rates potentially lower than those offered by the Public Works Loan Board (PWLB). The Council may make use of this source of borrowing if appropriate, but only with advice from its advisers, LAS.

2.2.8 Annual Investment Strategy 2017/18

The intention of the Annual Investment Strategy is to provide security of investment and the minimisation of risk. The aim is to generate a list of highly creditworthy counterparties which will also enable diversification and thus the avoidance of concentration risk.

As discussed at 1.2.5 above, the revised Prudential Code will result in a review of the TMSS and Capital Programme and Capital Investment Strategy reports to ensure that both treasury and non-treasury investments are included. For 2018/19 these remain separate reports and the paragraphs below refer only to treasury investments.

a. Investment Policy

The Council's investment policy has regard to the CLG's guidance on Local Government Investments ("the guidance"), and the revised CIPFA Treasury Management in Public Services Code of Practice and Cross Sectoral Guidance Notes ("the CIPFA TM Code"). At the time of writing, the results of a CLG consultation on investment guidance which closed on 22 December 2017 were still awaited, however the consultation focussed particularly on non-treasury investments (investment property etc).

In accordance with the guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable criteria in order to generate a list of highly creditworthy counterparties. This also enables diversification and thus the avoidance of concentration risk. The Council has clearly stipulated below at 2.2.8 (c) the minimum acceptable credit quality of counterparties for inclusion on its lending list. The Council utilises the LAS creditworthiness methodology, whereby banks' ratings are monitored on a real time basis with knowledge of any changes notified electronically as the agencies notify modifications.

All investments will be made in sterling, and since the risk appetite of the Council with regard to its investments is very low, its general policy objective is the prudent investment of treasury balances. The Council's investment priorities are (in order of priority):

- The security of capital;
- The liquidity of its investments;
- The rate of return.

The borrowing of monies purely to invest or on-lend and make a return remains unlawful, and the Council will not engage in such activity.

Investment instruments identified for use during the financial year are listed at Appendix 3 under "Specified" and "Non-Specified" categories.

Specified Investments:

An investment is a specified investment if all of the following apply:

- The investment is denominated in sterling and the payment or repayment is only payable in sterling.
- The investment is not "long-term", ie. it is made for up to one year, ie. a maximum term of **365 days** (previously 364 days).
- The making of the investment is not defined as capital expenditure.
- The investment is made with a body of high credit quality, or with the UK government, a local authority or a parish council.

Only minimal reference need be given to specified investments in the Annual Investment Strategy, and they will generally be used for cash-flow management.

Non Specified Investments:

Non-specified investments are all those not meeting the criteria for specified investments above. Accordingly, they may be simple investments made with the same counterparties as specified investments, being "non-specified" only by way of the maturity period being over one year (ie. over 365 days). Alternatively they may be more complex instruments, or those offering slightly higher risk or lower liquidity, for example a property fund. If used at all, non-specified investments will tend only to be used for the longer-term investment of core-balances.

Appendix 3 also sets out:

- The advantages and associated risk of investments under the non-specified category.
- The upper limit to be invested in each non-specified category.

- Those instruments best used only after consultation with the Council's treasury advisers.

b. Investment Limits:

Investment counterparty limits for 2018/19 will generally be **£3m** per individual counterparty, however a higher limit of **£4m** per Money Market Fund is considered prudent since such funds are already by definition highly diversified investment vehicles. The CFO has delegated authority to amend investment limits as he sees fit, and will report any such amendments to Cabinet for information as part of the next quarterly Treasury Management Report following the change.

With regard to the Council's own banker, HSBC, for transactional purposes if the bank was to fall below the standard creditworthiness criteria below, cash balances would be minimised both in monetary size and in duration of deposit.

c. Creditworthiness policy

To reiterate, the primary principles governing the Council's creditworthiness criteria are:

- Security of capital
- Liquidity of capital
- Return on investment

With regard to security, policies are maintained for "categories" of investment to be used, and these are set out at Appendix 3, ie. Specified and Non-Specified investments (see above). For the purpose of liquidity, policies are in place for determining the maximum periods for which funds may prudently be committed with counterparties.

The Chief Financial Officer maintains a "counterparty list" and this is monitored constantly. The CFO has delegated authority to amend the minimum criteria as he sees fit, and will report any such amendments to Cabinet for information as part of the next quarterly Treasury Management Report following the change.

The Council applies the creditworthiness methodology provided by LAS for the selection of investment counterparties. This employs a sophisticated modelling approach utilising credit ratings from the three main credit rating agencies (Fitch, Moody's and Standard & Poor's). The credit ratings of counterparties are supplemented with overlays for:

- Credit watches and credit outlooks from rating agencies.
- Credit default swap (CDS) spreads to give early warnings of likely changes in credit ratings.

- Sovereign ratings to select counterparties from only the most creditworthy countries.

The LAS modelling approach combines credit ratings, credit watches and credit outlooks in a weighted scoring system which is then combined with an overlay of CDS spreads for which the output is a series of colour coded bands which indicate the relative creditworthiness of counterparties. These colour codes are used by the Council to determine the suggested maximum duration of investments with a given counterparty. The colour bandings used by the Council are as follows:

- Yellow 5 years (UK government debt or its equivalent)
- Purple 2 years
- Blue 1 year (nationalised or semi nationalised UK banks only)
- Orange 1 year
- Red 6 months
- Green 100 days
- No colour not to be used

The LAS creditworthiness service uses a wider array of information than just "primary" ratings. Furthermore, by using a risk weighted scoring system it does not place undue reliance on one agency's rating. All credit ratings are monitored weekly and the Council is also alerted to interim changes via its use of the LAS creditworthiness service. If a downgrade deems counterparties no longer acceptable, their use for new investments will be withdrawn immediately.

Ratings under the LAS methodology will not necessarily be the sole determinant for the use of a counterparty. Other information sources used will include market data, the financial press, share price and other such information pertaining to the banking sector in order to establish the most robust scrutiny process on the suitability of potential investment counterparties.

The Council will use approved UK counterparties subject to their individual credit ratings under the LAS methodology. The Council may also use approved counterparties from countries with a minimum sovereign credit rating of **AA**. No more than £3m will be placed with each non-UK country at any time. The list of countries that currently qualify is shown at Appendix 4, however this list will be adjusted by officers in accordance with this policy should ratings change. The CFO has delegated authority to amend the minimum sovereign credit rating as he sees fit, and will report any such amendment to Cabinet for information as part of the next quarterly Treasury Management Report following the change.

The ultimate decision on what is prudent and manageable for the Council will be taken by the Chief Financial Officer under the approved scheme of delegation.

Under the cash-backed Local Authority Mortgage Scheme, launched in April 2012, the Council made two advances of £1m each to Lloyds Banking Group, each for a period of five years, to match the life of the indemnities. The first advance matured in April 2017 but the other remains active. This advance is classified as a "service investment", rather than a treasury management investment, and is therefore outside the Specified/Non specified categories discussed above.

d. Investment Strategy

The Council's in-house managed funds are mainly cash-flow derived however, there has for some time been a core balance available for investment over a longer period, if appropriate. In addition, any borrowing undertaken in advance of need at favourable interest rates may add to the funds available for investment (see 2.2.5 above).

Investments will be made with careful reference to any remaining core balance, to cash-flow requirements, and to the outlook for short-term interest rates (ie. for investments up to 365 days).

Bank Rate is forecast to remain unchanged at 0.50% until Q4 of 2018, and not to rise above 1.25% by Q1 of 2021. Bank Rate forecasts for financial year ends (31 March) are:

- 2018/19 0.75%
- 2019/20 1.00%
- 2020/21 1.25%

LAS have suggested the following budgeted investment earnings rates for investments up to 100 days for the next four years:

- 2018/19 0.60%
- 2019/20 0.90%
- 2020/21 1.25%
- 2021/22 1.50%

The overall balance of risk to these forecasts is currently to the upside but they are dependent on how strong GDP growth turns out, how quickly inflation pressures rise, and how quickly and positively the Brexit negotiations move forward.

In the light of the continuing low interest rate environment, Council approval was obtained in November 2017 to add the use of property funds to the schedule of instruments available for non-specified investments. Subsequently an investment of £1m was made on 1 December 2017 in the CCLA Local Authority Property Fund, which is a local government investment scheme approved by the Treasury under the Trustee Investments Act 1961 (section 11). This is deemed a long term

investment, as property is not a liquid asset and it may take time to realise the investment. Whilst the risks associated with such an investment are higher than those with simple term deposits, the returns are potentially significantly higher. The property fund investment purchased a number of units, determined by the unit price on the entry date and this valued the initial investment of £1m at £936,000, setting the entry fee at £64,000. As the property fund investment is for the long-term, it is expected that this will be recovered as the fund grows.

The inclusion of the property fund investment has resulted in an overall estimated equated rate for 2018/19 of 0.84%. The Council will use the average 7-day and 3-month LIBID rates to benchmark its equated investment rate.

Prior to the December 2017 revisions to the Treasury Management Code there was a requirement to set indicators for the Council's maximum exposure to fixed and variable interest rates for net borrowing (ie. external borrowing less investments). This requirement has now been removed in favour of a statement in the TMSS stating how interest rate exposure is managed and monitored, and this is given below:

The Council has a general preference for fixed rate borrowing in order to minimse uncertainty and ensure stability in the charge to revenue, however it is acknowledged that in certain circumstances, some variable rate borrowing may be prudent, for example if interest rates are expected to fall. The Council's investments are generally for cashflow purposes and accordingly a mix of fixed and variable rates will be used to maximise flexibility and liquidity. Interest rate exposure will be managed and monitored on a daily basis by the Chief Financial Officer.

An investment treasury indicator and limit must be set for the maximum principal funds invested for periods in excess of one year (365 days) in the forthcoming and two subsequent years (ie. new non-specified investments). The limit for each year is set with regard to the Council's liquidity requirements.

The treasury indicator and limit for new non-specified investments in each of 2018/19, 2019/20 and 2020/21 is £3m, as detailed at Appendix 1 (treasury indicators), but this is subject to an overall limit of £5m for the total non-specified investments held by the Council at any one time, as detailed at Appendix 3. The individual counterparty limit of £3m also applies.

e. Investments defined as capital expenditure

The acquisition of share capital or loan capital in a body corporate is defined as capital expenditure under regulation 25(1)(d) of the Local Authorities (Capital Finance and Accounting) (England) Regulations 2003. Such investments will have to be funded out of capital or revenue

resources, and will be classified as non-specified investments.

A loan or grant or financial assistance by this Council to another body for capital expenditure by that body will be treated as capital expenditure.

Investments in "money market funds", which are collective investment schemes, and bonds issued by "multilateral development banks", both defined in SI 2004 No 534, will not be treated as capital expenditure.

f. Provision for credit-related loss

If any of the Council's investments appear to be at risk of loss due to default, this is a "credit-related loss" and not a loss resulting from a fall in price due to movements in interest rates. In such an instance, the Council will make revenue provision of an appropriate amount.

g. End of Year Investment Report

At the end of the year, the Council will report on its investment activity as part of its Annual Treasury Report.

h. Policy on the use of external service providers

The Council uses LAS as its external Treasury Management advisers, however it recognises that responsibility for Treasury Management decisions remains with the organisation at all times, and will ensure that undue reliance is not placed upon external service providers.

The Council also recognises that there is value in employing external providers of Treasury Management services in order to acquire access to specialist skills and resources. The Council will ensure that the terms of their appointment and the methods by which their value will be assessed are properly agreed and documented, and subjected to regular review.

2.2.9 Gedling Borough Council scheme of delegation

Full Council is responsible for:

- Receiving and reviewing reports on Treasury Management policies, practices and activities;
- Approval of the annual Strategy (TMSS);
- Annual budget approval.

Cabinet is responsible for:

- Approval of, and amendments to, the Council's adopted clauses, Treasury Management Policy Statement and Treasury Management Practices;
- Budget consideration and virement approval;

- Approval of the division of responsibilities;
- Receiving and reviewing regular Treasury Management monitoring reports, and acting on recommendations;
- Approving the selection of external service providers and agreeing terms of appointment.

Audit Committee is responsible for:

- Reviewing the Treasury Management policy and procedures, and making recommendations to the responsible body through the Internal Audit process.

2.2.10 The role of the section 151 officer

The Deputy Chief Executive and Director of Resources (the Chief Financial Officer) is the Council's nominated S151 Officer. The role of the S151 (responsible) officer includes the following:

- Recommending clauses, Treasury Management Policy and Practices for approval, reviewing these regularly, and monitoring compliance;
- Submitting regular Treasury Management policy reports;
- Submitting budgets and budget variations;
- Receiving and reviewing management information reports;
- Reviewing the performance of the Treasury Management function;
- Ensuring the adequacy of Treasury Management resources and skills, and the effective division of responsibilities within the Treasury Management function;
- Ensuring the adequacy of internal audit, and liaising with external audit;
- The appointment of external service providers.

Implicit in the December 2017 changes to the Prudential and Treasury Management Codes is a major extension of the function of the S151 role, especially in respect of non-financial investments (which Cipfa has defined as being part of treasury management). The S151 officer role is also now responsible for:

- Preparation of a capital strategy to include capital expenditure, capital financing, non-financial investments and treasury management over a significant timeframe;
- Ensuring that the capital strategy is prudent, sustainable and affordable in the long term, and provides value for money;
- Ensuring that due diligence has been carried out on all treasury and non-financial investments, and is in accordance with the risk appetite of the authority;
- Ensuring that the authority has appropriate legal powers to undertake expenditure on non-financial assets and their financing;
- Ensuring the proportionality of all investments so that the authority does not undertake a level of investment which exposes it to an excessive level

of risk compared to its financial resources;

- Ensuring that an adequate governance process is in place for the approval, monitoring and ongoing risk management of all non-financial investments and long-term liabilities;
- Provision to Members of a schedule of all non-financial investments including material investments in subsidiaries, joint ventures, loans and financial guarantees;
- Ensuring that Members are adequately informed and understand the risk exposure taken on by the authority;
- Ensuring that the authority has adequate expertise, either in-house or externally provided, to carry out any non-financial investments;
- The creation of Treasury Management Practices which specifically deal with how non-financial investments will be carried out and managed.

Alternative Options

There are no alternative options, this report being a statutory requirement.

Financial Implications

No specific financial implications are attributable to this report.

Appendices

1. Prudential and Treasury indicators for 2018/19 to 2020/21
2. Interest rate forecasts
3. Specified and non-specified investments
4. Approved countries for investment

Background Papers

None identified.

Recommendation

That:

Members approve the Prudential and Treasury Indicators and Treasury Management Strategy Statement 2018/19, which includes the key elements below, and refer it to Full Council for approval as required by the Regulations.

1. The Minimum Revenue Provision (MRP) Policy Statement (2.1.3);
2. The Borrowing Strategy (2.2.4);
3. The Annual Investment Strategy (2.2.8);

4. Capital Affordability Prudential Indicators (Appendix 1);
5. Treasury Indicators including affordability limits to borrowing (Appendix 1).

Reasons for Recommendations

To comply with the requirements of the Local Government Act 2003, the CIPFA Prudential Code, CLG MRP guidance, the CIPFA Treasury Management Code and CLG investment guidance.

For more information, please contact:

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