Treasury Management Strategy 2018/19

Background

1 The Council is required by the Chartered Institute of Public Finance and Accountancy (CIPFA) to approve a Treasury Management Strategy Statement for 2018/19 before 1 April 2018 (**attached at the Annex**). In accordance with governance arrangements approved in February 2013 the Performance and Finance Select Committee has reviewed the annual strategy statement as recommended by the Cabinet Member for Finance and Resources in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel.

Borrowing

2 The Treasury Management Strategy sets out the continuation of an internal borrowing strategy in 2018/19, with the option of borrowing in advance of need to take advantage of favourable borrowing rates if such course of action is considered prudent and cost effective. In addition, the Borrowing and Repayment Strategy considers the long term repayment of debt and the requirement for new debt to finance ongoing capital plans (Section 6).

Investments

3 The Treasury Management Strategy sets out the continuation of the investment strategy approved in 2017/18, as set out in the attached Annual Investment Strategy (Section 7).

Amendments to CIPFA's Prudential and TM Codes of Practice

4 CIPFA is currently conducting a review of the "Prudential Code" and the "Treasury Management Code of Practice". This review is particularly focused on 'non-treasury' investments, especially the purchase of investment property and other commercial activities that aim to generate income; but may require external borrowing (or the use of existing cash balances) to raise the cash to finance such activities. The finalised codes are not expected until January 2018 and therefore the attached Treasury Management Strategy Statement (TMSS) has largely been prepared in accordance with the current Codes of Practice. The TMSS does however include the high-level principles the Council will follow when investing in commercial property (Section 9).

5 In accordance with the Council's Constitution the Director of Finance, Performance and Procurement, in consultation with the Treasury Management Panel, will amend the attached TMSS as appropriate to ensure the Council's Treasury Management Strategy 2018/19 remains compliant with the new CIPFA Codes. Any amendments will be reported to the Performance and Finance Select Committee in line with existing governance arrangements.

Recommended

That the Treasury Management Strategy Statement 2018/19, as set out at the Annex, be approved.

Jeremy Hunt
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Background Papers

None

(see paragraph 1, page 230)

Treasury Management Strategy Statement (2018/19)

1. Background

1.1 The Council is required to operate a balanced budget which broadly means cash raised during the year will meet its cash expenditure. Part of the treasury management operation is to ensure that this cash flow is adequately planned, with cash being available when it is needed. Surplus monies are invested in high credit quality counterparties, financial instruments or externally managed pooled funds commensurate with the Council's risk appetite, providing adequate liquidity initially before considering investment return.

1.2 The second main function of the treasury management service is the funding of the Council's capital plans. These capital plans provide a guide to the borrowing need of the Council, essentially the longer term cash flow planning, to ensure the Council can meet its capital spending obligations. The management of longer term cash may involve the arrangement of long and/or short term loans (external borrowing) or may use longer term cash flow surpluses in lieu of external borrowing (internal borrowing). On occasion, when it is prudent and economic, any external debt previously drawn may be repaid and/or restructured to meet the Council's risk or cost objectives.

1.3 Accordingly, the Chartered Institute of Public Finance and Accountancy (CIPFA) defines treasury management as:

> *"The management of the Council's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks".*

1.4 The Council is responsible for all its treasury management decisions and activity and as a consequence has borrowed and invests substantial sums of money, which exposes the Council to potentially large financial risks including the loss of invested funds and the revenue effect of changing interest rates. No treasury management activity is without risk; accordingly the successful identification, control and monitoring of risk are integral elements to treasury management activities and include credit and counterparty risk, liquidity risk, market or interest rate risk, refinancing risk and legal and regulatory risk.

2. Reporting Requirements

2.1 In accordance with CIPFA's "Treasury Management Code of Practice" the Council is required to receive and approve, as a minimum, three main reports each year, which incorporates a variety of policies, estimates and actuals, including:

(a) The Treasury Management Strategy Statement (TMSS) - Including Prudential and Treasury Indicators; and the Annual Investment

Strategy which approves the parameters on how investments are to be managed.

(b) A Mid-Year Treasury Management Report – Updating the Council with the progress of the capital position, treasury management activity and performance, and whether any policies and/or prudential and treasury indicators require revision; delegated to the Performance and Finance Select Committee in accordance with governance arrangements approved in February 2014. Additionally, the Regulation, Audit and Accounts Committee receive quarterly reports on compliance with the treasury management strategy.

(c) An Annual Treasury Management Report – Providing details of actual treasury operation as compared to the estimates within the strategy, together with a selection of actual prudential and treasury indicators.

2.2 The above reports are required to be adequately scrutinised before being recommended to County Council. For the TMSS this role is undertaken by the Performance and Finance Select Committee. In addition, the Council maintains a Treasury Management Panel comprising the Cabinet Member for Finance and Resources and four other elected members. The Panel functions as a formal consultative body supporting the Director of Finance, Performance and Procurement in implementing the Council's treasury management strategy and scrutinising all treasury management reports.

2.3 Treasury management issues reported within the attached 2018/19 TMSS include the Council's:

<u>Capital Issues</u>:
- Capital plans and the prudential indicators; and
- Minimum Revenue Provision (MRP) policy (**Appendix A**).
- Borrowing and Repayment Strategy (**Appendix B**)

<u>Treasury Management Issues</u>:
- Current treasury position (**Appendix C**);
- Treasury indicators which limit the treasury risk and activities of the Council;
- Prospects for interest rates as provided by the Council's treasury management advisor (**Appendix D**);
- The borrowing strategy;
- Policy on borrowing in advance of need;
- Debt rescheduling;
- The investment strategy;
- Creditworthiness policy; and
- Policy on the use of external service providers.

2.4 These elements cover the requirements of the Local Government Act 2013; CIPFA's Prudential and Treasury Management Codes; and the Department for Communities and Local Government's (DCLG) MRP and Investment Guidance.

3. Training

3.1 CIPFA's Code of Practice requires the Director of Finance, Performance and Procurement to ensure that members with responsibility for treasury management receive adequate training in treasury management; this especially applying to members responsible for scrutiny. Following County Council elections in May 2017 training of new Treasury Management Panel members was provided by the Council's treasury management advisor in June 2017. Further training will be arranged as required.

3.2 Additionally, the training needs of treasury management officers are periodically reviewed as part of staff appraisals and personal development plans. Training options available to officers include professional qualifications from CIPFA and other appropriate organisations; attendance at workshops and seminars run by the Council's appointed treasury management advisor; and on the job training in line with the approved Treasury Management Practices (TMPs) as provided by the Treasury Management Officer.

4. Treasury Management Advisors

4.1 The Council uses Link Asset Services (Link Treasury Services Ltd; formerly Capita Asset Services) as its external treasury management advisor. The Council recognises that responsibility for treasury management decisions remains with the organisation at all times and therefore will ensure that undue reliance is not placed upon its external service providers. The Council recognises however that there is value in employing external providers of treasury management services in order to acquire access to a wide range of specialist skills and resources including:

- Credit advice;
- Investment advice;
- Debt management advice;
- Capital and financial accounting advice; and
- Economic and interest rate forecasting.

4.2 The Council will ensure that the terms of the appointment of external treasury management advisors and the methods by which their value will be assessed are properly agreed and documented, and subject to regular review. The new contract with Link Asset Services commenced on 1 November 2016 and is subject to triennial reviews, with the next review scheduled during 2019/20 *(to include an option to extend for an additional two years following a review of the service received across the period)*.

5. Capital Programme (2017/18 to 2022/23)

5.1 The Council's capital expenditure and financing plans as contained within the approved Capital Programme are the key drivers of treasury management activity. The output of the Capital Programme is reflected in the Council's prudential indicators, which are designed to provide members with an overview and confirm such expenditure and financing plans.

5.2 The table below is a summary of the Council's capital expenditure plans, both those agreed previously and those forming part of the current budget cycle for approval by County Council in December 2017:

Capital Expenditure by Service	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m
Adults and Health	0.2	0.7	1.1	1.4	0.7	0.5
Education/Children & Young People	52.1	46.4	35.4	32.1	29.7	23.7
Environment	1.3	4.6	5.4	0.0	0.0	0.0
Finance and Resources	4.5	4.4	11.6	23.7	38.4	40.9
Highways and Infrastructure	37.1	34.6	32.8	37.1	51.3	36.6
Leader	1.0	8.8	13.1	13.1	4.0	14.0
Safer, Stronger Communities	5.3	4.9	7.3	5.4	3.5	5.3
Core Programme	**101.5**	**104.4**	**106.7**	**112.8**	**127.6**	**121.0**
Income Generating Initiatives	14.6	31.6	40.2	49.4	45.0	61.8
Total Capital Expenditure	**116.1**	**136.0**	**146.9**	**162.2**	**172.6**	**182.8**

2022/23 estimate includes subsequent years spend

5.3 Capital expenditure as reported above may be financed from a range of external and internal sources. External sources include private sector contributions (such as s106 developer contributions) as well as government grants; internal sources include capital receipts, revenue contributions and reserves set aside for capital purposes.

5.4 Borrowing is required to meet the cost of any capital expenditure not financed by internal and/or external funding sources. The table below summarises how the Council's capital expenditure plans will be financed across the period through to 2022/23, with any funding shortfall resulting in a borrowing requirement:

Financing the Capital Programme	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m
Capital Expenditure	**116.1**	**136.0**	**146.9**	**162.2**	**172.6**	**182.8**
Financed By:						
Government Grants	-53.7	-69.8	-78.8	-54.4	-41.6	-39.6
External Contributions	-8.2	-9.7	-5.8	-6.4	-16.6	-1.9
Capital Receipts	-1.0	-1.0	-2.0	-6.1	-20.4	-81.0
Revenue Funding	-2.4	-2.3	-5.3	-0.5	-0.5	-10.5
Financing (Excl. Borrowing)	**-65.3**	**-82.8**	**-91.9**	**-67.4**	**-79.1**	**-133.0**
Borrowing (Core)	-37.4	-25.2	-18.0	-46.6	-63.9	-28.9
Borrowing (IGIs and Bold Ideas)	-13.4	-28.0	-37.0	-48.2	-29.6	-20.9
Total Financing	**-116.1**	**-136.0**	**-146.9**	**-162.2**	**-172.6**	**-182.8**

5.5 The above financing table excludes other long-term liabilities, such as existing PFI schemes (Crawley Schools; Street Lighting and Waste Management) and leasing arrangements which already include borrowing instruments within their contractual terms; and so the Council is not required to separately borrow for them.

6. Borrowing and Repayment Strategy

6.1 The capital expenditure plans set out in Section 5 provide details of the service activity of the Council. The treasury management function ensures that the cash is organised in accordance with the relevant professional codes, so that sufficient cash is available to meet this service

activity and the Council's capital strategy. This will involve both the organisation of the Council's cash flow and, where capital plans require, the organisation of appropriate borrowing facilities.

6.2 The borrowing strategy covers the relevant prudential and treasury indicators, and the current and projected debt positions. The key objectives of the Council's current borrowing strategy are:

(1) Ensure that future external debt is affordable within revenue budget constraints; with the timing of when to arrange new debt governed by the Council's long-term cash flow forecasts (as per the requirements of the capital plans through to 2022/23);

(2) Potentially borrowing in advance of need so that external debt (fixed-rate funding) is arranged whilst interest rates are lower than they are projected to be over the next few years; and

(3) All existing debt sourced from the Public Works Loan Board (PWLB) to be repaid on loan maturities.

6.3 For all new external debt arrangements, the Council will first ensure that due diligence is given to both the affordability of such debt in the revenue budget and the future plans regarding the repayment of the debt; including the possible use of capital receipts or as per the agreed terms and conditions of any new debt arrangements (including 'annuity' and 'equal instalments of principal' loan structures).

6.4 Approved Funding Sources: The Council's primary objective when borrowing money is to strike an appropriately low risk balance between securing low interest borrowing costs whilst achieving cost certainty over the period for which funds are required. The flexibility to renegotiate loans should the Council's long-term capital plans change is a secondary objective.

6.5 There is no counterparty risk associated with borrowing, except that associated with money laundering. In conjunction with advice received from its treasury management advisor the Council will keep under review the following fixed or variable rate long-term and short-term (in lieu of long-term) borrowing options as sources of finance for the approved capital programme, including:

- Borrowing against internal resources held by the Council (including usable reserves and working capital) in lieu of external borrowing;
- Public Works Loan Board (PWLB) and any successor body;
- Borrowing from other UK local authorities (particularly with regard to borrowing for Income Generating Initiatives on a short-term basis);
- Borrowing from the money markets (financial institutions authorised by the Prudential Regulation Authority to operate in the UK);
- Borrowing from multilateral development banks (including the European Investment Bank); and
- Borrowing from the UK Municipal Bond Agency plc and/or other special

purpose companies created to enable local authority bond issue.

6.6 Additionally capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- Private Partnerships (PFI/PPP); and
- Leasing (including hire purchase)

6.7 The Council may additionally consider arranging forward starting loans in 2018/19, where the interest rate is agreed in advance (fixed in context with current rates) but the cash is received in later years. The arrangement of such debt would enable certainty of cost to be achieved without suffering an investment "cost of carry" in the intervening period.

6.8 Current Portfolio Position: In December 2010, County Council took a decision to introduce an internal borrowing strategy whereby the Council's capital borrowing need is not fully funded by external debt, but rather cash supporting the Council's usable reserves and working capital have been used as a temporary funding measure in lieu of external borrowing. The Council's internal borrowing at the end of 2016/17 amounted to £41.3m.

6.9 Capital plans (paragraph 5.4) highlight that a borrowing requirement of £104m is required to finance the Council's capital expenditure plans through to 31 March 2019, including:

- Borrowing of up to £62.6m relating to the core programme; and
- Additional borrowing of up to £41.4m relating to Income Generating Initiatives.

6.10 In accordance with CIPFA's Prudential Code, the Council's underlying borrowing need (the total historic outstanding capital expenditure which has not yet been financed) is represented by its Capital Financing Requirement (CFR). Capital expenditure financed through debt is subject to a minimum revenue provision charge as set out in the Minimum Revenue Policy in Appendix A.

6.11 An analysis of the Council's levels of usable reserves, provisions and working balances show these are likely to be sufficient to maintain an internal borrowing strategy throughout 2018/19, with the need to externally borrow from 2019/20 onwards for the capital programme. The table below details the estimates of these year-end balances through to 2022/23, assuming no new external debt or optional refinancing of existing debt is arranged:

Balance Sheet Projections (at 31 March)	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m
Capital Financing Requirement	598.9	639.4	682.7	762.4	839.6	915.8
Less: PFI Schemes and Leases	-108.3	-105.6	-105.1	-102.0	-98.0	-93.3
Borrowing CFR *(i)*	**490.6**	**533.8**	**577.6**	**660.4**	**741.6**	**822.5**
Existing Borrowing Profile (PWLB)	-395.9	-388.8	-381.8	-374.8	-371.3	-361.3
Short-Term Borrowing *(ii)*	-4.5	-4.5	-4.5	-4.5	-4.5	-4.5
Over(-) / Under Borrowing	**90.2**	**140.5**	**191.3**	**281.1**	**365.8**	**456.7**
Usable Reserves	-180.1	-166.9	-156.1	-153.8	-151.5	-140.5
Provisions	-12.0	-11.0	-10.0	-10.0	-10.0	-10.0
Working Balances	-56.8	-58.2	-59.6	-61.1	-62.7	-64.2
Investment(-) / Borrowing	**-158.7**	**-95.6**	**-34.4**	**56.2**	**141.6**	**242.0**

(i) The "Borrowing CFR" excludes other long-term liabilities (PFI schemes and finance leases) that form part of the Council's total borrowing requirement but include a borrowing facility so that the Council is not required to borrow separately for them.

(ii) Money held and invested on behalf of the Chichester Harbour Conservancy (CHC) and its associated charities; repayable to CHC on any given notice.

6.12 The Council has previously approved that a proportion of its usable reserves are held in long-term strategic investments (including PFI/MRMC reserve balances); as a result the Council's external debt and internal borrowing projections (including CFR forecasts; and internal borrowing as a percentage of the CFR) are summarised below:

Debt Projections	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m
Gross External Debt (1- Apr)	**517.1**	**508.7**	**498.9**	**507.0**	**582.6**	**660.5**
Repayment of Existing Debt	-6.7	-7.1	-7.0	-7.0	-3.5	-10.0
External Debt (Core Borrowing)	0.0	0.0	0.0	0.0	29.7	35.3
External Debt (IGIs)	0.0	0.0	15.6	85.7	55.7	65.0
PFI/Finance Lease Movement	-1.8	-2.7	-0.5	-3.1	-4.0	-4.7
Gross External Debt (31- Mar)	**508.6**	**498.9**	**507.0**	**582.6**	**660.5**	**746.1**
Internal Borrowing (at 31 March)	90.2	140.5	175.7	179.8	179.1	169.7
Capital Financing Requirement	**598.8**	**639.4**	**682.7**	**762.4**	**839.6**	**915.8**
Internal Borrowing (%)	**15.1%**	**22.0%**	**25.7%**	**23.6%**	**21.3%**	**18.5%**

6.13 The benefits of internal borrowing will be regularly monitored against the potential for incurring additional costs through deferring external borrowing into future years when long-term borrowing rates are forecast to rise. Whilst this strategy has remained prudent against a continual backdrop of low investment returns and heightened counterparty risk, there will be a future point in time when internal borrowing will have to be externalised. As shown in the table above, under the Council's current capital plans, usable reserves and long-term strategic investment assumptions, it is forecast that the Council will be required to reintroduce external borrowing in 2019/20 (paragraph 6.11 and Appendix B).

6.14 Revenue Impact: The revenue impact (capital financing cost as a percentage of net revenue streams) of the recommended borrowing strategy relating to the Council's 'core' capital programme (excluding IGIs, Bold Ideas, PFI and Finance Leases) is outlined below:

	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m	2022/23 Estimate £'m
Net Revenue Expenditure *(i)*	533.7	552.8	571.0	589.8	600.0
Capital Financing Charges – ***Excluding*** *IGIs, PFI and Finance Leases*	27.3	27.7	28.0	29.8	32.1
% Ratio	**5.1%**	**5.0%**	**4.9%**	**5.1%**	**5.4%**

(i) Current estimates (October 2017); subject to change when Revenue Budget is approved by County Council in February 2018.

6.15 In accordance with this recommended borrowing strategy, the Council forecasts that the costs of external borrowing (interest charges) in 2018/19 will be:

- Core Programme: £17.8m (£18.1m in 2017/18)
- IGIs and Bold Ideas: Nil (unchanged from 2017/18)
- PFI schemes and finance leases: £11.0m (£11.2m in 2017/18)

6.16 Borrowing in Advance of Need: Any decision to borrow in advance will be within forward approved CFR estimates and arranged to take advantage of favourable borrowing rates (given such rates are forecast to rise in the future) thereby ensuring that value for money can be demonstrated and that the Council can ensure the security of such funds. Risks associated with any borrowing in advance activity will be subject to prior appraisal and subsequent reporting through quarterly compliance reports (and annual report to County Council).

6.17 The Authorised Borrowing Limit (paragraph 6.20) constraints borrowing in advance of future capital need by limiting such borrowing to within CFR estimates over a three year planning period, therefore confirming that it is not being taken for revenue profit (investment of the extra sums borrowed) or speculative purposes.

6.18 Limits to Borrowing Activity: Within the prudential indicators there are a number of key indicators to ensure that the Council operates its activities within well-defined limits. One of these is that the Council ensures that its gross external debt does not, except in the short-term, exceed the total of the CFR in the preceding year plus estimates for any additional CFR for 2018/19 and the following two financial years. Based on the gross external debt projections (paragraph 6.12) the Director of Finance, Performance and Procurement reports that the Council complied with this prudential indicator in 2017/18 and does not envisage difficulties over the period of the capital programme.

6.19 The "Operational Boundary" is the limit (Prudential Indicator) beyond which external debt is not normally expected to exceed, as set out below:

Operational Boundary	Estimate 2017/18 £'m	Estimate 2018/19 £'m	Estimate 2019/20 £'m	Estimate 2020/21 £'m	Estimate 2021/22 £'m	Estimate 2022/23 £'m
External Debt (including CHC)	400.4	393.3	401.9	480.6	562.5	652.8
PFI Schemes/ Finance Leases	108.3	105.6	105.1	102.0	98.0	93.3
Operational Boundary	**508.7**	**498.9**	**507.0**	**582.6**	**660.5**	**746.1**

6.20 The "Authorised Borrowing Limit" is a further key Prudential Indicator that reports the maximum level of borrowing. This represents the limit beyond which external debt (including overdrawn bank balances and short-term borrowing undertaken for unexpected cash flow movements) is prohibited, as approved by County Council. It reflects the level of external debt which, whilst not desired, could be afforded in the short-term (e.g. when borrowing in advance of capital need) but is not desirable in the long term.

6.21 This limit is a statutory limit determined under Section 3(1) of the Local Government Act 2003. The Government retains an option to control either the total of all councils' plans or those of a specific council; although to-date this power has not yet been exercised.

Authorised Borrowing Limit	Estimate 2017/18 £'m	Estimate 2018/19 £'m	Estimate 2019/20 £'m	Estimate 2020/21 £'m	Estimate 2021/22 £'m	Estimate 2022/23 £'m
Gross Debt *(i)*	440.4	517.0	595.4	684.1	688.1	692.8
PFI Schemes/ Finance Leases	108.3	105.6	105.1	102.0	98.0	93.3
Authorised Borrowing Limit	**548.7**	**622.6**	**700.5**	**786.1**	**786.1**	**786.1**

(i) Gross debt estimates allow for external borrowing in advance of need for up to a maximum of two years and includes additional headroom (£40m) for unexpected cash flow movements.

6.22 In addition, the 'Maturity Structure of Fixed Rate Borrowing' Treasury Indicator are limits that highlight the existence of any large concentrations of fixed rate debt needing to be replaced at times of uncertainty over interest rates, and is designed to protect against excessive exposures to interest rate changes in any one period, in particular over the course of the next ten years. It is calculated as the amount of projected fixed rate borrowing that is maturing in each period as a percentage of total projected fixed rate borrowing. The maturity period of borrowing is determined by reference to the earliest date on which the lender can require payment.

6.23 The upper and lower limits for the maturity structure of fixed rate borrowing in 2018/19 (with actual split as at 30 September 2017 included for comparison) are set out below:

Treasury Management	Actual 30/09/17	Lower Limit 2018/19	Upper Limit 2018/19
Debt Maturity:			
Over 30 Years	6%	0%	30%
Over 25 to 30 Years	3%	0%	30%
Over 20 to 25 Years	0%	0%	30%
Over 15 to 20 Years	19%	0%	30%
Over 10 to 15 Years	51%	0%	70%

Treasury Management	Actual 30/09/17	Lower Limit 2018/19	Upper Limit 2018/19
Over 5 to 10 Years	11%	0%	40%
Over 1 to 5 Years	8%	0%	35%
Under 12 Months	2%	0%	25%

6.24 Borrowing for Cash-flow Purposes: The Council continues to approve the use of short-term loans (normally for up to one month) to cover unexpected cash-flow shortages. Short-term borrowing for cash-flow purposes, up to a maximum of £40m, will be limited to the following external funding sources:

- Borrowing from other UK local authorities (excluding Police and Crime Commissioners, Fire Authorities and Local Authority Pension Funds);
- Borrowing from the money markets (financial institutions authorised by the Prudential Regulation Authority to operate in the UK).

6.25 Additionally, the Council holds and invests money on behalf of third parties including the Chichester Harbour Conservancy and its associated charities; and the Consortium of Local Education Authorities for the Provision of Science Services (CLEAPSS). The Council reports any such money as short-term borrowing given the requirement that it is available for repayment at any future point in time.

6.26 Debt Rescheduling: As short-term borrowing rates will be considerably cheaper than long-term fixed interest rates there may be opportunities to generate savings by switching from long-term debt to short-term debt. Any savings generated will need to be considered in light of the Council's current treasury position (Balance Sheet projections; paragraph 6.11) and the actual cost of debt repayment (premiums incurred). The rationale for undertaking any debt repayment or rescheduling would be one or more of the following:

- The generation of cash savings and/or discounted cash flow savings;
- Helping to fulfil the treasury management strategy;
- Enhancing the balance of the debt portfolio (amending the maturity profile and/or the balance of volatility).

6.27 Reporting: All borrowing (and rescheduling) activity will be reported quarterly to the Regulation, Audit and Accounts Committee and Treasury Management Panel meetings within the prescribed compliance reports.

6.28 As at 31 March 2017 the Council has external loans with the PWLB totalling £402.9m, with a maturity profile which stretches out to 2059. In preparation for the 2018/19 TMSS, the Council has undertaken a modelling exercise to develop a repayment strategy for these external loans, whereby the Council intends to repay any loan as it falls due; including the annual repayment of £7m in respect of the £70m PWLB loan taken out in April 2011. This can be demonstrated in Appendix B, which extends out to 2059 and assumes the Council has a core programme borrowing requirement of £20m each year and continues to hold useable reserves, provisions and working capital of £125m each year from 2023/24 onwards. The Council's external core programme debt at the

end of this period would be £312m, as at today's value, after utilising the internal cash balances relating to useable reserves, provisions and working capital. On a time value basis, taking into account the impact of inflation and other economic changes, the debt outstanding at 2059 is forecast to be around a quarter of its valuation at current prices.

6.29 Within the IGI borrowing figures, the borrowing need gradually reduces to zero over the period to 2059 due to both the application of capital receipts generated by some of the IGI projects, along with other projects generating revenue returns to reduce the associated borrowing need.

7. Annual Investment Strategy

7.1 The Council's main treasury management activity continues to be the investment of its surplus funds, representing income received in advance of expenditure plus balances and reserves held. At 30 September 2017 the Council's investments amounted to £268.9m (Appendix C). In the past twelve months the Council's average investment balance was £293.6m and is forecast to average around £270m throughout the forthcoming calendar year given the continuation of internal borrowing and capital expenditure plans.

7.2 The Council's investment policy has regard to the CIPFA Treasury Management Code of Practice and DCLG's Guidance on Local Government Investments. The Council's investment priorities will be the security first, liquidity second and then investment return ("SLY" investment principles). Accordingly the Council will look to strike an appropriate balance between risks and return; minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income.

7.3 In accordance with the CIPFA and DCLG guidance, and in order to minimise the risk to investments, the Council applies minimum acceptable credit criteria in order to generate a list of high creditworthy counterparties which also enables diversification and thus avoidance of concentration risks. In assessing credit ratings (as provided by Link Asset Services) the Council employs the 'Lowest Common Denominator (LCD)' approach, meaning that it uses the lowest rating of those published by Fitch Ratings Ltd, Moody's Investors Service Ltd or Standard & Poor's.

7.4 Ratings will not be the sole determinant of the quality of an institution; it is important to continually assess and monitor the financial sector in relation to the economic and political environments in which institutions operate. The assessment will also take account of information that reflects the opinion of markets. To achieve this consideration the Council will engage with its treasury management advisors to maintain a monitor on market pricing such as "credit default swaps" and overlay that information on top of credit ratings.

7.5 Other information sources used will include the financial press, share price and other such information pertaining to institutions (banks, corporates etc.) in order to establish the most robust scrutiny process on the suitability of potential investment counterparties. The Council continues

to remain alert for any signs of credit or market distress that might adversely affect its treasury management activities and corrective action will be taken when deemed appropriate to ensure the security of the total investment portfolio.

7.6 Accordingly, the Director of Finance, Performance and Procurement will comply with the following strategy when investing funds, whether directly or via the London money market. Investments arranged via the London money market will be made through approved brokers. The current list of approved brokers comprises:

- BGC Partners (including Martin Brokers)
- Institutional Cash Distributors (ICD) Ltd
- King and Shaxson Limited
- Tradition (UK) Limited
- Tullett Prebon Group (including ICAP)

7.7 Creditworthiness Policy: The primary objective governing the Council's investment criteria is the security of its investments, although the yield or investment return is also a key consideration (paragraph 7.2). After this objective the Council will ensure that:

- It maintains a policy covering both the categories of investment types it will invest in and the criteria for choosing investment counterparties with adequate security (including monitoring their security); and

- It has sufficient liquidity in its investments; for this purpose it will set out procedures for determining maximum periods for which funds may prudently be committed. These procedures also apply to the Council's prudential indicators covering the maximum principal sums invested.

7.8 The credit risks associated with making unsecured bank deposits remain evident (due to bail-in legislation) relative to the risks of other investment options available to the Council (including bank secured, local authority and non-bank corporate deposits). Given the risks and low returns from short-term unsecured bank investments, the Council aims to diversify investments into more secure and/or higher yielding asset classes during 2018/19; this is especially the case for an estimated £75m (inclusive of existing long-term investments totalling £33.3m; paragraph 7.43) that is available for strategic long-term investment.

7.9 At 30 September 2017, 66.6% of the Council's investment portfolio is invested in short-term unsecured bank deposits and short-term money market funds (excluding externally managed pooled funds) in accordance with the policies as contained within the 2017/18 TMSS. The Director of Finance, Performance and Procurement confirms that the Council will not be holding any investment at 31 March 2018 that will be in breach of the recommended 2018/19 strategy.

7.10 Investments are categorised as either 'Specified' or 'Non Specified' (both categories being approved as suitable for Council investment) based on

the criteria in the DCLG Investment Guidance. Specified investments are designed to offer high liquidity and high security, with the minimum of formalities. The DCLG Guidance defines specified investments as those:

- Denominated in Sterling;
- With a maximum maturity of one year (365 days);
- Not defined as capital expenditure by legislation; and
- Invested with one of:

  - The UK Government (including Gilts, Treasury Bills and DMADF).
  - A local authority in England, Wales, Scotland or Northern Ireland.
  - An institution or investment scheme of 'high credit quality'.
  - Supranational Institutions (e.g. The European Investment Bank).

7.11 For investments to be regarded as specified, the Council defines 'high credit quality' as institutions and securities meeting the following criteria:

(a) UK Institutions (Banks, Building Societies and Corporates): Minimum long-term credit rating of **A-**; rated by at least two of the three rating agencies; Fitch, Moody's and Standard & Poor's (S&P).

(b) Non-UK Banks: Minimum long-term credit rating of **A+**; rated by at least two of the three rating agencies (Country holding a sovereign rating of at least **AA+**).

(c) Non-UK Corporates: Minimum long-term credit rating of **A-**; rated by at least two of the three rating agencies (Country holding a sovereign rating of at least **AA+**).

(d) Money Market Funds: Holding a **AAA** credit rating; rated by at least two of the three rating agencies and holding assets exceeding £1bn. New EU regulations to be implemented in 2018/19 will change fund valuation methodology from only Constant Net Asset Valuation (CNAV) to both Low Volatility Net Asset Valuation (LVNAV) and CNAV. As a consequence the Council approves the use of Money Market Funds that operate under a CNAV (funds that invest exclusively in government securities) or operate under a LVNAV (all other liquidity funds).

(e) UK Local Authorities: Assumed **AA-** rating (unless actual rating exists from any of the three rating agencies).

(f) UK Registered Social Landlords (formerly Housing Associations): Minimum long-term credit rating of **A-;** rated by at least one of the three rating agencies.

(g) Externally Managed Pooled Funds: Holding a **AAA** credit rating; rated by at least one of the three rating agencies.

7.12 Any investment not meeting the 'Specified' investment criteria listed above will be treated as if it were unrated ('Non-Specified' investment;

paragraph 7.41). For secured investments the credit rating relevant to the specific investment (covered bonds) or underlying collateral (reverse repurchase agreements) will be used as opposed to the individual rating of the bank/building society issuing the security.

7.13 Monitoring Credit Quality: Credit rating information is supplied by Link Asset Services (the Council's treasury advisor) on all active counterparties that comply with the criteria listed above. Any counterparty falling to meet the criteria will be omitted from the counterparty (dealing) list. Any rating changes, rating 'watches' (notification of a likely change) or rating 'outlooks' (notification of the longer term bias outside the central rating view) are provided to officers almost immediately they occur and this information is considered before actual dealing arrangements. Where an institution has its credit rating downgraded so that it fails to meet any of the approved investment criteria then:

- No new investments will be made after the date of notification;
- Any existing investments that can be immediately recalled or sold at no cost (financial penalty) will be;
- Full consideration will be given to the recall or sale of all other existing investments with the affected counterparty; and
- Details will be reported to the Director of Finance, Performance and Procurement, the Cabinet Member for Finance and Resources and Treasury Management Panel members (and all authorised signatories).

7.14 Where an institution is placed on negative rating watch (notification of a possible rating downgrade) the reasons for the rating action will be evaluated. Unless there is sufficient cushion to absorb a two-notch downgrade to the long-term credit rating (to remain at or above the Council's minimum approved rating criteria) then decisions on new investments will be subject to approval by the Director of Finance, Performance and Procurement. This policy will not apply to negative 'outlooks', which indicate a longer term view rather than an imminent change to an institution's rating.

7.15 If an institution is placed on negative rating watch and is at (or likely to fall below) the Council's minimum rating criteria then no investments will be arranged until the outcome of the review is announced. Again, this policy will not apply to negative 'outlooks'.

7.16 Additionally requirements under the CIPFA Treasury Management Code require the Council to supplement credit rating information. Whilst the above policies rely primarily on the application of credit ratings to provide a pool of appropriate counterparties for officers to use; additional market information (see paragraphs 7.4 and 7.5) will be applied before making any specific investment decisions from the approved pool of counterparties. This additional market information will be applied to compare the relative security of differing investment counterparties.

7.17 The Director of Finance, Performance and Procurement and the Council's treasury management advisor will continue to analyse and monitor market

indicators and credit developments on a regular basis and respond as necessary to ensure the security of the capital sums invested. No investments will be made with an organisation if there are substantive concerns about its credit quality, even though it may meet the approved minimum credit rating criteria (as set out in paragraphs 7.11 and 7.21).

7.18 Liquidity Management: The Council uses purpose-built short-term cash flow forecasting software (SAP Treasury Management Module) to determine the maximum period for which funds may prudently be invested. The forecast is entered on a prudent basis with income under-estimated and expenditure over-estimated. Additionally, the Council seeks to maintain a smooth profile of maturing investments, allowing it to cover unexpected items of expenditure and to react to favourable market conditions as they arise. Monetary limits on long-term investments are set by reference to the Council's Medium Term Financial Strategy (MTFS) and cash flow forecasts.

7.19 To assist liquidity management the Council operates a number of interest paying bank call (instant-access) accounts and money market funds where cash is deposited at competitive overnight interest rates and can be withdrawn without notice; these funds are therefore highly liquid.

7.20 Investment Policy: In response to advice received from the Council's treasury management advisor and having the aim of increasing investment diversification, the Director of Finance, Performance and Procurement, in consultation with the Cabinet Member for Finance and Resources and the Treasury Management Panel, recommends the following investment strategy changes be adopted in 2018/19:

(1) An increase to **unsecured** bank deposit duration limits (up to a maximum of one year) as set out below:

- Barclays Bank (UK Bank) – Long term rating A *(following a recent upgrade from S&P)*: Six months (increased from 100 days in 2017/18) in line with other UK banks holding an equivalent long-term credit rating and approved for Council investment (including Lloyds Bank Group and Nationwide Building Society).

- Standard Chartered Bank (UK Bank) – Long term rating A: Six months (increased from 100 days in 2017/18); following a review of other market indicators *(including its credit default swap price falling to levels in line with its banking peers)*.

- OP Corporate Bank (Finland; formerly Pohjola Bank) - Long term rating AA-: One Year (increased from six months in 2017/18); in line with other non-UK banks holding an equivalent long-term credit rating and approved for Council investment (including approved Swedish banks).

(2) Based on the Council's usable reserve forecasts (paragraph 6.11), the maximum limit for the investments greater than one year to be

increased from £45m to £75m in 2018/19 (and the remainder 2017/18). The increased limit is recommended to allow additional investments up to three year duration periods; this limit will be reviewed annually within the Council's need to externally borrow and in relation to prevailing investment rates. It is expected to reduce back to £45m by March 2021 in line with forecast long-term PFI/MRMC reserve balances.

7.21 The Director of Finance, Performance and Procurement will undertake the most appropriate form of investments in keeping with the approved strategy objectives, income and risk management requirements and the Council's Treasury Indicators. Accordingly the Council may invest its surplus funds over a range of maturity periods with any of the approved counterparty types listed below, subject to maximum monetary and duration limits (covering both 'Specified' and 'Non-Specified' investments) as shown, to ensure that prudent diversification of the investment portfolio is achieved:

Institution/Issue Credit Rating	**Unsecured Bank Deposits**		**Secured Bank, Government Issues, UK Local Authorities and Non-Bank**	
	Cash Limit	**Time Limit**	**Cash Limit**	**Time Limit**
UK Government			Unlimited	50 Years
Local Authorities			£25m	20 Years
AAA	£15m	2 Years	£25m	10 Years
AA+	£15m	1 Year	£25m	5 Years
AA	£15m	1 Year	£25m	4 Years
AA-	£15m	1 Year	£25m	3 Years
A+	£15m	1 Year	£15m	2 Years
A	£15m	6 Months	£15m	1 Year
A-	£15m	100 Days	£15m	6 Months
BBB+ (Excluding RBS)			£10m	100 Days
RBS (Part Nationalised)	£15m	1 Year	(as AAA rating above)	
Money Market Funds	£25m *(i)*	Overnight	£25m *(ii)*	Overnight
Housing Associations (rated A- or higher)			£15m	5 Years

(i) Maximum monetary limits per fund approved as £25m or 0.5% of the fund's total assets under management (AUM), whichever is lower.

(ii) Maximum monetary limits per fund that invest in government securities only approved as £25m or 2% of the fund's total assets under management (AUM), whichever is lower.

Externally Managed	**Cash Limit**	**Time Limit**
Pooled Funds	See Note *(iii)*	No Defined Maturity. Withdrawals made on: -Liquidity requirements -Fund performance

(iii) Maximum monetary limits for externally managed pooled funds (including ultra-short dated bond, equity, multi-asset and property funds) will be approved as £25m (AAA rated funds), £15m (all other funds) or 5% of the fund's total assets under management (AUM), whichever is lower.

7.22 Banks Unsecured: Includes bank current accounts, call (instant-access) accounts, notice accounts, fixed-term deposits, certificate of deposits and senior unsecured bonds with banks and building societies, other than multilateral development banks (for example the European Investment Bank). 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.

7.23 Banks Secured: Includes covered bonds, reverse repurchase agreements (repos) and other collateralised arrangements with banks and building societies. These investment types are secured against the bank's assets, which consequently limits the potential losses in the unlikely event of insolvency and means that they are exempt from bail-in. Covered bonds will be considered when secured against a 'pool' of residential and/or low loan-to-value mortgages held by the issuing bank. Covered bonds differ from mortgage or asset-backed securities because the bank which issues the bond remains responsible at all times for paying dividends and repaying capital. The Council's investments are therefore protected firstly by having a direct call on the 'pool' and secondly by a call on the general assets of the issuer.

7.24 The Council accepts repo/reverse repo as a form of collateralised lending and will be based on the GMRA 2000 ("Global Master Repo Agreement"). Should any investment counterparty not meet the Council's senior unsecured rating (as set out in paragraph 7.21) then a 102% collateralisation will be required. Acceptable collateral will include index linked gilts, conventional gilts, UK treasury bills, delivery by value (a basket of gilts covering differing maturity periods) and corporate bonds (subject to a minimum A- bond issue rating).

7.25 For secured bank deposits, where there is no investment specific credit rating but the collateral upon which the investment is secured has a credit rating, then the higher of the collateral credit rating or the counterparty credit rating will be used in determining monetary and duration limits (as set out in paragraph 7.21). The combined secured and unsecured investments in any one bank will not exceed the monetary limit approved for secured investments.

7.26 Government Backed: Loans, deposits, bonds and/or 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 UK local authorities can be made for up to twenty years (and may include early repayment conditions for both lender and borrower). The Director of Finance, Performance and Procurement will approve a local authority as suitable for long-term investment (greater than one year) before the investment is placed.

7.27 In any future period of significant market stress the Council will maintain required levels of security by restricting new investments to those organisations of high credit quality only and reducing maximum duration limits in accordance with the prevailing market conditions. If there are

insufficient financial institutions of high credit quality then the Council's surplus cash will be deposited with the UK Government, via the Debt Management Office (DMO) and UK treasury bills, or other local authorities.

7.28 Registered Social Landlords (RSLs): Loans, deposits and/or bonds either issued on an unsecured basis, or guaranteed by or secured against the assets of the RSL (formerly known as Housing Associations). These bodies are tightly regulated by the Homes and Communities Agency and as providers of public services they retain a high likelihood of receiving government support if needed.

7.29 Corporates: Bonds and/or commercial paper issued by companies other than banks, building societies and RSLs. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent. The Council approves the use of investments issued by corporates that hold credit ratings in accordance with the approved investment policy (as set out in paragraphs 7.11 and 7.21) up to a maximum of £15m per company (£10m for corporates rated BBB+).

7.30 Money Market Funds: Pooled investment vehicles consisting of unsecured money market deposits and similar instruments, unless the fund consists of government securities only (paragraph 7.32). Such funds have the advantage of providing wide diversification of investment risks and high liquidity, coupled with the services of a professional fund manager. Fees of between 0.10% and 0.20% per annum are deducted from the interest paid to the Council.

7.31 The Council continues to use short-term money market funds that offer same-day liquidity and aim for no (or very low) asset value volatility as an alternative to instant access bank accounts, subject to approved monetary limits per fund set as £25m or 0.5% of the fund's total assets under management (calculated against the previous working day's closing assets total) whichever is lower.

7.32 In times of significant market stress the Council may consider the use of money market funds that invest in government securities only as an alternative to Debt Management Office (DMO) deposits, up to a limit per fund of £25m or 2% of the fund's total assets under management, whichever lower (calculated as per paragraph 7.31). Such funds will be treated as a separate counterparty to a standard cash money market fund provided by the same sponsor.

7.33 Externally Managed Pooled Funds: Shares in diversified investment vehicles which may consist any of the investment types listed above, plus equity shares and property. These funds allow the Council to diversify its investment portfolio into asset classes other than cash without the need to own and manage the underlying investments (undertaken by a professional fund manager in return for a fee).

7.34 Ultra-short dated bond funds (enhanced cash funds) provide an alternative to short-term money market funds in the management of

cash-flow liquidity (up to 12 months) with the potential of increasing investment returns; whilst introducing the potential for short-term capital volatility not evident in money market funds. Equity, multi-asset and property funds provide the potential for enhanced returns over the longer-term, but are significantly more volatile when viewed in the short-term. Consequently all externally managed pooled funds may experience times of displaying capital losses when viewed over a short-term horizon, contravening "SLY" investment principles.

7.35 Selection of funds will be subject to credit risk appraisal undertaken by the Director of Finance, Performance and Procurement and will be reported to the Cabinet Member for Finance and Resources and the Treasury Management Panel. The Council's current investments in such funds are listed in Appendix C.

7.36 Because these funds have no defined maturity date and may be subject to experiencing periods of capital loss, their performance and continued suitability in meeting the Council's investment objectives will be regularly monitored by the Director of Finance, Performance and Procurement. Any compliance issues arising from pooled fund investments (for instance periods of capital loss) will be reported within quarterly compliance reports to the Regulation, Audit and Accounts Committee.

7.37 The Council's Main Provider of Banking Services: The Council currently banks with Lloyds Bank, the contract being effective up to 30 September 2022. Lloyds currently meets the Council's minimum credit criteria, however should its credit rating fall below the minimum rating criteria as prescribed in this strategy report (paragraph 7.11) the provider may continue to be used for short-term (overnight) liquidity requirements and business continuity arrangements.

7.38 Balances held within current accounts will be aggregated together with investments held with the Council's banker on a daily basis, and should remain within set counterparty monetary limits as prescribed within this strategy report (paragraphs 7.21 and 7.39). Occasionally however, the Council is in receipt of 'large' amounts of income which cannot be deposited into separate investment counterparties due to intra-day dealing deadlines. In such instances the Council approves that an operational breach of the Council's main banker's set monetary limits may occur for a maximum period of one working day, with corrective action being taken on the next available working day as appropriate.

7.39 Country, Group and Sector Limits: Due care will be taken to consider the county, group and sector exposure (in addition to duration and monetary exposure). Specific limits for which investments may be placed are set out below:

	Cash Limit
UK Central Government	Unlimited
Any single UK Local Authority (excluding individual Fire Authorities and Police and Crime Commissioners)	£25m
Any single financial institution, including UK building societies	£25m
Any single corporate or RSL: Rated A- or above	£15m
Any single corporate (including RSLs): Rated BBB+	£10m
Maximum % invested in UK domiciled institutions/organisations	100%
Maximum investment amount per banking group	£25m
Maximum corporate exposure	£50m
Maximum RSL exposure (rated above A-)	£25m
Maximum money market fund exposure (excluding pooled funds)	£115m
Maximum externally managed pooled fund exposure	£100m
Maximum investment total for non-UK countries	£90m
Maximum investment per individual non-UK country	£30m
Maximum invested in negotiable instruments held in a broker's (including King & Shaxson) nominee account	£100m

7.40 Investments in multilateral development banks, short-term money market funds and externally managed pooled funds do not count against the limit for any single non-UK country as shown above (£30m), since the risk is diversified across many countries.

7.41 Non-Specified Investments: Any investment not meeting the DCLG definition of a 'Specified' investment is classified as 'Non-Specified'. Having considered the rationale and risks associated with non-specified investments, the following have been determined appropriate for the Council's use:

- Long-term (greater than one year) investments
- Investments with credit ratings below A- (including RBS)
- Investments in externally managed pooled funds (not rated AAA)
- Investments denominated in foreign currencies (Euros)
- Investments that are defined by legislation as capital expenditure

7.42 The following monetary limits will be applied to Non-Specified investments in 2018/19:

Investment Type	**Cash Limit £'m**
Total long-term investments (greater than one year)	75.0
Total investments with corporates rated below A-	30.0
Total investments with RBS on an unsecured basis	15.0
Total investments within externally managed pooled funds, including ultra-short dated bond funds (not rated AAA);	60.0
Total investments denominated in foreign currencies	2.8
Total investments defined as capital expenditure	5.2

7.43 Long-Term Investments: Long-term investments including gilts, covered bonds, corporate bonds, supranational bank bonds, local authority loans, RSLs deposits/bonds, externally managed pooled funds and an equity investment with the UK Municipal Bond Agency are approved by the

Council. The maximum monetary limit for long-term investments with any one organisation is set at £15m (£25m for individual UK local authorities). At 31 March 2017 the Council had £33.3m invested for greater than one year including:

- £16m invested with two UK local authorities;
- £7.9 invested in a Nationwide Building Society covered bond;
- £9.2m invested in the CCLA Property Fund
- £0.2m equity held with the UK Municipal Bond Agency

7.44 As required by the Prudential Code, the Council is required to set limits for total principal funds invested for greater than 365 days. These limits are set with regard to the Council's liquidity requirements and to reduce the need for the early sale of an investment (potentially incurring additional costs) and are based on the availability of funds after each year-end (as detailed in the Council's Balance Sheet Projections; paragraph 6.11). The resulting treasury indicator is shown below:

	Original Limit 2017/18	**Revised Limit 2017/18**	**Upper Limit 2018/19**	**Upper Limit 2019/20**	**Upper Limit 2020/21**	**Upper Limit 2022/22**	**Upper Limit 2022/23**
Maximum Invested for a Year or longer (£)	£45m	£75m	£75m	£50m	£45m	£45m	£45m

7.45 No long-term investment will be arranged with any bank or building society on an unsecured basis.

7.46 Non-Sterling Investments: Occasionally the Council may receive grant funding denominated in Euros and subsequently incurs expenditure in Euros. To remove the exchange rate risk associated with converting such funds into Sterling, these can be held in a Euro current account. The Director of Finance, Performance and Procurement may therefore make investments denominated in Euros up to a maximum limit of €3.2m (£2.8m equivalent based on a 1.1428 exchange rate).

7.47 Investments Defined as Capital Expenditure: Investments defined by legislation as capital expenditure, such as company shares, are only arranged on the explicit approval of the Director of Finance, Performance and Procurement, in consultation with the Cabinet Member for Finance and Resources and the Treasury Management Panel. In 2018/19 this is limited to the following equity investments:

- £0.2m investment in the UK Municipal Bond Agency, a capital finance company established in 2014 by the Local Government Association with the aim of providing local authorities a borrowing alternative to the Public Works Loan Board (PWLB); and

- Share capital (up to a maximum in total of £5m) in companies associated with the Council's Income Generating Initiatives when supported by approved business cases, included within the Council's capital programme and subject to obtaining assurance regarding the security of capital.

7.48 Policy on Financial Derivatives: The Council has previously made use of financial derivatives that are embedded into investments, to reduce interest rate risks through the use of forward dated deals and to increase income through the use of callable deposits. The 'General Power of Competence' in Section 1 of the Localism Act 2011 removed much of the uncertainty over local authorities' use of standalone financial derivatives (those not embedded into an investment), including swaps and options. The CIPFA Treasury Management Code of Practice requires the Council to clearly state their policy on the use of financial derivatives in the annual strategy.

7.49 The Council does not intend to use standalone financial derivatives unless they can be clearly demonstrated to reduce the overall level of financial risks the Council is exposed to. Embedded derivatives, including those present in externally managed pooled funds and forward starting investments, will not be subject to this policy; however the risks they present will be managed in line with the overall treasury risk management strategy. Should this position change the Director of Finance, Performance and Procurement, after seeking a legal opinion on the use of standalone financial derivatives, will develop a detailed and robust risk management framework governing their use and will ensure that treasury management officers have the appropriate training.

8. Investment Income (2018/19)

8.1 The Council forecasts that the Bank of England's Bank Rate will remain 0.50% throughout 2018/19 following the 0.25% rate increase announced in November 2017; this increase reflecting a reversal of the Bank's emergency rate cut from August 2016.

8.2 The Council is expected to have an average investment portfolio of £270m throughout 2018/19; including additional LEP capital grant monies expected in April 2018 together with the Council's usable reserves and working capital balances. Given the investment portfolio attracting an average interest rate of 0.99% (as per likely yields attainable on the Council's expected investment portfolio; assuming the increased use of longer-term local authority investments and externally managed pooled funds) the Council expects to receive investment income totalling £1.9m in 2018/19 (as shown in the table below):

	Average Portfolio £'m	Interest Rate (%)	Interest £'000
Liquidity Portfolio	55.0	0.45	248
Short-Term Investment Portfolio	160.0	0.75	1,212
Long-Term Investment Portfolio	55.0	2.20	1,207
Gross Interest Return	**270.0**	**0.99**	**2,667**
Less transfers to specific reserves *(i)*			-767
Investment Income (2018/19)			**1,900**

(i) Includes interest payable on money held on behalf of the Chichester Harbour Conservancy.

8.3 If actual levels of investments and interest rates differ from the forecasts then performance against the budget will be correspondingly different. Given the constraints on the Council's 2017/18 revenue budget, the Director of Finance, Performance and Procurement will monitor the investment income budget throughout 2018/19 and report any changes to the above forecast within monthly Total Performance Monitors (TPMs).

9. Non-Treasury Investments (Commercial Property)

9.1 An updated Treasury Management Code of Practice is soon to be published and based on the recent consultation it is anticipated that the Council will be required to include non- treasury investments within the Treasury Management Strategy. Ahead of the final code being issued, high level details of the Council's future plans in relation to the purchase of investment properties are set out below.

9.2 As part of the Capital Programme which was approved by County Council in February 2017, the Council planned to invest in Commercial Property to establish a portfolio which is managed to generate a revenue return to the Council to support financial sustainability and to protect the provision of services to the residents of West Sussex, along with maintaining and growing the capital value of the investment. The approved £50m has now been re-profiled over the period 2018/19 to 2022/23. The principles of the Commercial Property strategy include:

(a) Ensuring the portfolio of assets is prudently balanced to minimise the risk of income fluctuation and loss of capital value. This will be achieved by investing in a range of assets and in a range of locations;

(b) Ensuring that the rate of return exceeds that which could be achieved through traditional sources of investments;

(c) Establishing a comprehensive due diligence process to minimise the risks in building an investment portfolio, to ensure both the quality of the asset and the incumbent tenant. This would include building and site specific surveys, estimates of future maintenance costs and estimates of any future capital refurbishment requirements; and

(d) Establishing appropriate governance arrangements to ensure decisions are made in a streamlined and efficient way, within a transparent and risk aware environment.

9.3 The Council will act prudently in making any investment, including a rigorous evaluation of potential opportunities against the principles outlined above.

(see paragraph 2.3, page 233)

Minimum Revenue Provision (MRP) Statement – 2018/19

1.1 In accordance with the Local Authorities (Capital and Accounting) (England) Regulations 2003, the Council is required to make an annual contribution from revenue to repay long-term borrowing, namely its "Minimum Revenue Provision (MRP)". The 2008 amendment to these regulations gives local authorities the flexibility to set MRP at a level it considers to be prudent.

1.2 The Department for Communities and Local Government (DCLG) has issued statutory guidance on determining a prudent level of MRP, which presents four ready-made options for the calculation, but makes clear that other methodologies are permissible. The guidance distinguishes between historic capital expenditure notionally supported by central government through the provision of Revenue Support Grant ("supported borrowing"), and self-financed "unsupported" borrowing. Transitory provisions of the DCLG guidance permit the treatment of any self-financed borrowing prior to 1 April 2008 as supported for the purposes of the MRP calculation.

1.3 The Council has adopted the Asset Life Annuity method (DCLG option 3b) for the calculation of MRP on unsupported borrowing. Under this approach the debt is repaid over a period equal to the useful life of the asset financed by the borrowing. Annuity rates are linked to rates published by the Public Works Loans Board. MRP on outstanding supported borrowing is made on a 2% annuity basis over a 40 year period.

1.4 Private Finance Initiatives and Finance Leases may be arranged to finance the acquisition of non-current assets as an alternative to borrowing where this is financially or operationally advantageous and is in accordance with the strategy for the capital programme. In line with DCLG guidance and to mitigate the impact of the move to International Financial Reporting Standards (IFRS) on the Council's revenue account, it is the policy of West Sussex County Council to make an annual MRP charge equal to the portion of the PFI unitary charge or lease payment taken to the Balance Sheet to reduce the liability.

(see paragraph 2.3, page 233)

Illustrative External Debt/Internal Borrowing Projections

Year Ending	Existing PWLB Debt £'m	Core Borrowing (New) £'m	IGI Borrowing (New) £'m	New Borrowing (Total) £'m	Internal Borrowing £'m
31 March 2018	395.9	0.0	0.0	0.0	90.2
31 March 2019	388.8	0.0	0.0	0.0	140.5
31 March 2020	381.8	0.0	15.6	15.6	175.7
31 March 2021	374.8	0.0	101.3	101.3	179.8
31 March 2022	371.3	29.7	157.0	186.7	179.1
31 March 2023	361.3	65.0	222.1	287.1	169.7
31 March 2024	361.3	55.4	208.2	263.6	185.4
31 March 2025	361.3	70.8	172.7	243.5	175.4
31 March 2026	337.2	109.5	168.7	278.2	165.4
31 March 2027	332.5	128.1	164.5	292.6	155.4
31 March 2028	286.4	187.3	160.3	347.6	145.4
31 March 2029	286.4	199.6	155.8	355.4	135.4
31 March 2030	239.2	258.1	151.2	409.3	125.4
31 March 2031	195.9	311.9	146.5	458.4	115.4
31 March 2032	124.8	392.6	141.5	534.1	105.4
31 March 2033	92.2	424.2	136.4	560.6	105.0
31 March 2034	40.0	474.0	131.2	605.2	105.0
31 March 2035	40.0	450.7	125.7	576.4	125.0
31 March 2036	40.0	446.2	120.1	566.3	125.0
31 March 2037	40.0	442.7	114.2	556.9	125.0
31 March 2038	40.0	439.8	108.2	548.0	125.0
31 March 2039	40.0	437.1	102.0	539.1	125.0
31 March 2040	40.0	435.0	95.5	530.5	125.0
31 March 2041	40.0	431.9	88.9	520.8	125.0
31 March 2042	40.0	427.9	82.1	510.0	125.0
31 March 2043	40.0	422.9	75.0	497.9	125.0
31 March 2044	25.0	432.4	68.5	500.9	125.0
31 March 2045	25.0	426.0	62.0	488.0	125.0
31 March 2046	25.0	418.5	55.8	474.3	125.0
31 March 2047	25.0	409.8	50.0	459.8	125.0
31 March 2048	25.0	399.9	44.6	444.5	125.0
31 March 2049	25.0	388.8	40.0	428.8	125.0
31 March 2050	25.0	377.8	35.1	412.9	125.0
31 March 2051	25.0	365.5	30.1	395.6	125.0
31 March 2052	25.0	351.9	24.9	376.8	125.0
31 March 2053	25.0	337.0	19.6	356.6	125.0
31 March 2054	25.0	322.5	14.0	336.5	125.0
31 March 2055	10.0	322.9	9.3	332.2	125.0
31 March 2059	10.0	307.7	5.3	313.0	125.0
31 March 2057	10.0	304.1	2.5	306.6	125.0
31 March 2058	10.0	302.5	0.8	303.3	125.0
31 March 2059	0.0	312.0	0.0	312.0	125.0

(see paragraph 2.3, page 233)

West Sussex County Council's Current Portfolio

	30/09/17 Portfolio £'000
External Borrowing:	
- Fixed Rate: Public Works Loan Board (PWLB)	399,099
- Fixed Rate: PWLB (on behalf of the Littlehampton Harbour Board)	275
- Variable Rate: Short-Term (Inc. Chichester Harbour Conservancy)	4,339
Total External Borrowing	**403,713**
Other Long Term Liabilities *(*)*:	
- PFI	106,466
- Finance Leases	1,821
Total Gross External Debt	**512,000**
Internally Managed Investments:	
(i) Bank Unsecured *(Short Term)*	
- Cash Deposits (Fixed-Term)	95,000
- Cash Deposits (Notice Accounts)	29,601
- Bond (Fixed Rate)	8,465
- Certificate of Deposits	14,999
- Short Term Money Market Funds	31,000
(ii) Bank Secured	
- Short Term Covered Bonds	10,445
- Long Term Covered Bonds	7,863
(iii) Local Authority	
- Short Term Investments	25,787
- Long Term Investments	16,000
(iv) Non-Bank	
- Corporate Bond	5,022
- UK Municipal Bond Agency: Long Term Equity	200
Externally Managed Investments:	
- CCLA (The Local Authorities' Property Fund)	9,455
- Payten Sterling Reserve Fund (Ultra-Short Dated Bond Fund)	15,053
Total Investments	**268,890**

(*) Other Long Term Liabilities: Expected position at 31 March 2018

(see paragraph 2.3, page 233)

Economic and Interest Rate Forecast (Link Asset Services)

1 Prospect for Interest Rates

1.1 The Council has appointed Link Asset Services (Link Treasury Services Ltd) as its treasury advisor and part of their service is to assist the Council in formulating a view on interest rates. The following table gives their central view (updated November 2017):

	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20	Mar-21
BANK RATE	0.50%	0.50%	0.50%	0.50%	0.75%	0.75%	0.75%	0.75%	1.00%	1.00%	1.25%
3 month LIBID	0.40%	0.40%	0.40%	0.40%	0.60%	0.60%	0.60%	0.70%	0.90%	0.90%	1.20%
6 month LIBID	0.50%	0.50%	0.50%	0.60%	0.80%	0.80%	0.80%	0.90%	1.00%	1.00%	1.40%
12 month LIBID	0.70%	0.80%	0.80%	0.90%	1.00%	1.00%	1.10%	1.10%	1.30%	1.30%	1.60%
5 year PWLB	1.50%	1.60%	1.60%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.10%	2.30%
10 year PWLB	2.10%	2.20%	2.30%	2.40%	2.40%	2.50%	2.60%	2.60%	2.70%	2.70%	3.00%
25 year PWLB	2.80%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.40%	3.60%
50 year PWLB	2.50%	2.60%	2.70%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.20%	3.40%

1.2 Interest rate forecasts have been updated following the Bank of England's Monetary Policy Committee (MPC) meeting in November 2017. In line with market expectations the MPC increased the UK Bank Rate from 0.25% to 0.50% by a vote of 7-2 with no change to levels of Quantitative Easing (QE); removing the post EU referendum emergency monetary stimulus implemented in August 2016. In view of the robust rate of growth in the second half of 2016 which confounded the Bank's August 2016 forecasts for a sharp slowdown, many commentators subsequently held the view that the Bank's emergency action was unnecessary.

1.3 Given this was the first increase in Bank Rate for a decade, the MPC also gave forward guidance that they expected to increase Bank Rate only twice more in the next three years to reach 1.0% by 2020. This was therefore not quite the 'one and done' scenario but is nevertheless a very relaxed rate of increase prediction in Bank Rate in line with previous statements that Bank Rate would only go up very gradually and to a limited extent.

1.4 Following the meeting, the MPC made some obvious comments around the fact that the UK is going through a period of heightened uncertainty due in particular to the unknowns around how the Brexit negotiations will proceed and the likely effect on households and companies. They will adjust their responses according to how these turn out and in the light of how the economy progresses over the next two to three years; if Brexit negotiations are very difficult and end up being disappointing this could put in jeopardy even two Bank Rate increases over the next three years.

1.5 Whilst there remains a wide spread of potential outcomes and heightened volatility during the forecast period, the previous link in western

economies between falling unemployment and rising inflation appears to be broken. This has led some commentators to raise the question as to whether we are now moving into a new trend of low unemployment at the same time as low inflation, where central bank policy targets of focusing primarily on inflation are beginning to be called into fundamental question. The example of Japan, which has struggled for some two decades to get inflation up to 2% despite massive repeated rounds of QE, being just one example.

1.6 Wage inflation therefore remains a key issue over the next two to three years; if it continues to remain very subdued this will act as a significant headwind to the MPC justifying further increases in Bank Rate due to other inflationary threats building up. The MPC could therefore be flexible in implementing its policy mandate of focusing primarily on inflation. Alternatively, they could justify increases in Bank Rate as being primarily due to the need to simply remove monetary policy stimulus as this has caused massive distortions in the economy with asset prices (equities and house prices) being the main beneficiaries whilst savers have been the major losers through low interest rates.

1.7 Link Asset Services forecasts remain cautious and in line with a subdued path for increases in Bank Rate; with inflation not considered a significant threat over the next three years. Changes to the Bank Rate are forecast as an increase to 0.75% in November 2018, to 1.0% in November 2019 and to 1.25% in August 2020 (as shown in paragraph 1.1). The central assumption underpinning forecasts is that the UK will make progress with concluding a satisfactory outcome over the Brexit negotiations with the EU by March 2019, although the UK finance sector is likely to be an area of particular concern and difficulty.

2 Link Asset Services' Forward View

2.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Interest rate forecasts (and future MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next few years. Forecasts for average earnings beyond the three year time horizon will be heavily dependent on economic and political developments.

2.2 Short-term volatility in bond yields is likely to continue as investor fears and confidence ebb and flow between favouring relatively more "risky" assets (including equities) or the "safe haven" of government bonds. However, the longer trend will be for gilt yields and PWLB borrowing rates to rise (albeit gently) as global economic recovery likely results in investors switching from safe haven bonds to equities.

2.3 As currently seen, the US Federal Reserve (the Fed) Funds Rate is likely to continue to rise more quickly and more strongly than the UK Bank Rate. Whilst previously there has been a high degree of correlation between UK and US yields, it is expected that a growing decoupling between the two will likely become evident; meaning US yields will go up faster than UK yields.

Going forward, this and any resulting effect on PWLB rates will be closely monitored.

2.4 The overall balance of risks to economic recovery in the UK is probably to the downside, particularly with the current level of uncertainty over the final terms of Brexit. However, the balance of risks to increases in the UK Bank Rate and shorter term PWLB rates are probably to the upside, depending on how strong GDP growth turns out, how quickly inflation pressures rise and how quickly the Brexit negotiations move forward positively.

2.5 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 Italy, due to its high level of government debt, low rate of economic growth and vulnerable banking system.
- 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. Additionally, the new Czech prime minister is expected to be Andrej Babis who is strongly against EU migrant quotas and refugee policies. Both developments could provide major impetus to other, particularly former Communist bloc countries, to coalesce to create a major block to progress on EU integration and centralisation of EU policy. This, in turn, could spill over into impacting the Euro, EU financial policy and financial markets.
- Rising protectionism under President Trump.
- A sharp Chinese downturn and its impact on emerging market countries.

2.6 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 inflation pressures to build up too strongly within the UK economy, which then necessitates a later rapid series of increases in Bank Rate faster than we currently expect.
- 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 through misjudging the pace and strength of increases in its Funds Rate and in the pace and strength of reversal of Quantitative Easing, 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.

3 Investment and borrowing rates

3.1 Following the November 2017 UK Bank Rate rise, investment returns will be higher in 2018/19 (as compared with 2017/18) followed by a gently rising trend over the next few years. The suggested budgeted earnings rates for returns on investments placed for periods up to about three months during each financial year are as follows:

Average Earnings per Financial Year	Nov-17 Forecast	Previous Forecast
2017/18	0.40%	0.25%
2018/19	0.60%	0.25%
2019/20	0.90%	0.50%
2020/21	1.25%	0.75%
2021/22	1.50%	1.00%
2022/23	1.75%	1.50%
2023/24	2.00%	1.75%
Later years	2.75%	2.75%

3.2 Borrowing Advice: Although yields have risen from their low points, yields are still around historic lows and borrowing should only be considered when appropriate to individual borrowing strategies. Value is however evident in the 40 to 50 year range at present, but this view would be negated if the UK Bank Rate does not climb to at least 2.5% over the coming years (forecasts indicating that the Bank Rate may rise to only 1.25% by March 2021; paragraph 1.1). Accordingly, clients will need to review and assess their risk appetite in terms of any underlying borrowing requirement they may have together with forward projections of available cash backed resources.

3.3 The policy of avoiding new borrowing by running down spare cash balances has served local authorities well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in the future when authorities may not be able to avoid new borrowing to finance capital expenditure and/or the refinancing of maturing debt. There will however remain a cost of carry to any new long-term borrowing that causes a temporary increase in cash balances as this position will most likely incur a revenue cost, that being the difference between borrowing costs and investment returns.