Treasury Management Strategy 2017/18

Background

1 The County Council is required by the Chartered Institute of Public Finance and Accountancy (CIPFA) to approve a Treasury Management Strategy Statement for 2017/18 before 1 April 2017 (**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 in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel.

2 The Council's treasury management activities expose it to a variety of financial risks, the key risks are:

- **Credit Risk**: The possibility that other parties might fail to pay amounts due to the Council;
- **Liquidity Risk**: The possibility that the Council might not have funds available to meet its commitments to make payments;
- **Re-Financing Risk**: The possibility that the Council might be requiring to renew a financial instrument on maturity at disadvantageous interest rates;
- **Market Risk**: The possibility that financial loss might arise for the Council as a result of changes in such measures as interest rate movements.

3 The Council's overall risk management procedures focus on the unpredictability of financial markets, and implementing restrictions to minimise these risks. The procedures for risk management are set out through a legal framework in the Local Government Act 2003 and the associated regulations (including CIPFA Codes of Practice). Financial risks, relating to both borrowings and investments, are minimised through the annual Treasury Management Strategy, which incorporates the recommended Prudential Indicators as set out in the 2017/18 Budget Report.

Borrowing:

4 The Council's long-term external borrowing (excluding PFI, finance leases and the loan undertaken on behalf of the Littlehampton Harbour Board) amounted to £402.6m at 31 December 2016, sourced entirely from the Public Works Loan Board (PWLB) at fixed interest rates of between 5.125% and 3.77%, with a weighted average rate of 4.53%. The Director of Finance, Performance and Procurement forecasts that the cost of this PWLB borrowing (interest charge) in 2017/18 will be £18.1m (£18.3m in 2016/17).

5 Capital plans highlight that a borrowing requirement of up to £65.4m for the core programme along with £73.6m relating to income generating initiatives (IGIs) is required to finance the Council's capital programme in 2017/18. An analysis of the Council's usable reserves show these continue to be sufficient to avoid external borrowing during 2017/18 for the core programme, but there may be a need to externally borrow for the IGIs.

6 £7m (plus interest) will however be repaid to the PWLB during 2017/18, as per the terms and conditions of the £70m borrowing taken during April 2011.

When external borrowing is required the strategy has been developed to include a combination of short and long-term (fixed and variable rate) borrowing within a framework that considers cost, certainty, flexibility and need for cash.

7 Additionally, the Council is developing long-term plans in respect of its future debt requirements. The affordability of external debt is the Council's primary consideration, ensuring that the resulting revenue impact when arranging new debt arising from additional capital financing costs (including annual MRP costs and actual interest paid on outstanding debt) remains within prudent levels. The Council is also reviewing the repayment of external debt via the use of future capital receipts or as per the agreed terms and conditions of any new debt arrangements. Given the Council is a going concern, it will have the ability to continue to repay debt liabilities in the future and have the ability to arrange future debt from the money markets (including the Public Works Loan Board) as and when required.

Investments:

8 The Cabinet Member for Finance recommends a continuation of the diversification approach adopted in the 2016/17 strategy, given the risks and continued low returns from short-term unsecured bank deposits. This approach aims to diversify investments through the use of bail-in exempt and non-bank financial instruments and to extend duration periods for investments where appropriate. Unsecured bank deposits (including money market funds) will however remain part of the Council's short-term (up to one year) investment strategy, along with the use of enhanced cash funds which provide an alternative to short-term money market funds in the management of cash-flow liquidity with the potential of increasing investment returns.

9 Given the continuing period of low interest rates, the returns generated from local authority investments remain stubbornly low. The 2017/18 investment income budget has been set at £1.603m, which includes a budget reduction of £0.261m from the 2016/17 investment income budget to reflect the reduction in returns following the Bank of England's Base Rate cut in August 2016.

Recommended

(1) That the Treasury Management Strategy 2017/18, as set out at the Annex, be approved; and

(2) That the investment policies approved for 2017/18 be implemented with immediate effect for the remainder of 2016/17.

Jeremy Hunt
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Background Papers: None

(see paragraph 1, page 1)

Treasury Management Strategy Statement (2017/18)

1 Background

1.1 Treasury management is defined as: 'The management of the local authority's investments and cash flows, its banking, money market and capital market transactions; the effective control of the risks associated with those activities; and the pursuit of optimum performance consistent with those risks'. All treasury management activity will comply with relevant statute, guidance and accounting standards.

1.2 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.

1.3 The Council is required to operate a balanced revenue budget, which broadly means that cash raised during the year will meet cash expenditure. Part of the treasury management operation ensures that cash flow liquidity is adequately planned, with cash being available when it is needed. Surplus monies are then invested in low risk counterparties and instruments commensurate with the Council's risk appetite, thereby providing adequate liquidity before the consideration of investment return. Additionally the management of the Council's long-term cash, including forecasts for its usable reserves, may provide the potential for diversifying investments into asset classes other than cash that give rise to the possibility of enhancing returns over the longer-term.

1.4 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 that the Council can meet its capital spending obligations. This management of longer-term cash may involve the arrangement of long or short term external debt as a temporary method of financing the Council's borrowing requirement; or may use longer-term cash surpluses as another temporary form of finance (internal borrowing). On occasion any external debt previously undertaken may be restructured to meet the Council's risk or cost objectives

1.5 The treasury management strategy therefore takes into account the impact of the Council's revenue budget and capital programme on its Balance Sheet position, the current treasury position (**Appendix A**), the outlook for interest rates (**Appendix B**) and the Prudential Indicators (**Appendix C**).

2 Governance

2.1 In accordance with CIPFA's "Treasury Management Code of Practice" the Council will report on risk, compliance and performance against the approved treasury management strategy throughout the year.

2.2 The Council maintains a Treasury Management Panel comprising the Cabinet Member for Finance and four other elected members. The Panel functions as a formal consultative body supporting the Director of Finance, Performance and Procurement, along with the Cabinet Member for Finance, in implementing the Council's treasury management strategy and widening Members' involvement in treasury management decisions.

2.3 The Performance and Finance Select Committee is responsible for the scrutiny of treasury management policies and annual strategy, and reviews performance of delivering the strategy against planned objectives. A mid-year report detailing borrowing and investment activity during the first half of the year, together with an update of the capital position, is made available to this Committee. Regarding Council investments, the mid-year report further benchmarks security and liquidity in addition to the actual yield achieved by the Council during the period. The Regulation, Audit and Accounts Committee receive quarterly reports on compliance with the treasury management strategy.

2.4 In accordance with the CIPFA Treasury Management Code and the Department for Communities and Local Government's (DCLG) Investment Guidance, a revised Treasury Management Strategy Statement can be approved by the County Council and implemented at any time during the financial year. County Council delegates the power to amend specific areas of the treasury management strategy between annual reviews to the Director of Finance, Performance and Procurement, in consultation with the Cabinet Member for Finance. Such changes will be subject to a full risk appraisal and will be reported within the quarterly compliance reports and may include:

- The types of financial instruments used
- Selection of counterparties (within the creditworthiness parameters as approved by County Council)
- Duration periods for fixed-term deposits
- Country, sector and group limits

3 Treasury Management Advisors

3.1 Following a procurement exercise undertaken in 2016/17, the Director of Finance, Performance and Procurement has appointed Capita Asset Services (formerly Sector Treasury Services) as the Council's new treasury management advisor in favour of the previous provider, Arlingclose. Capita Asset Services were appointed on the basis that they would remain supportive of the Council's existing investment and borrowing strategies, whilst delivering a cost saving over the contract period through lower advisory fees. The new contract 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)*.

3.2 The Council will receive specific advice on a wide range of areas including:

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

3.3 The Council recognises that the responsibility for all treasury management decisions remains with the organisation at all times and will ensure that undue reliance is not placed upon the external advice received. The Council further recognises however that there is value in employing external providers of treasury management services in order to acquire access to their specialist skills and resources. For investments in particular, advice is provided on the nature and appropriateness of different counterparties, the types of financial instruments employed, the duration of deposits and the merits of employing external fund managers. The Council also benefits from regular seminars, workshops and training as provided by Capita Asset Services.

4 Balance Sheet and Treasury Management Positions

4.1 In line with CIPFA's "Prudential Code for Capital Finance in Local Authorities" the Council approves the use of borrowing to finance part of its capital programme. Each year County Council approves its on-going capital programme as part of the annual budget meeting in February. Capital expenditure may be financed from a range of internal and external sources. Internal sources include capital receipts, revenue contributions and reserves. External sources include private sector contributions (such as s106 developer contributions) as well as government grants which may be ring-fenced for specific purposes or non-ring-fenced and available for general application by the Council.

4.2 Borrowing is required to meet the cost of any capital expenditure not financed by internal and/or external funding sources; external debt however is only a temporary form of finance as loans must be repaid or refinanced on maturity. The Council is therefore currently developing long-term plans in respect of its future debt requirements, including:

- Recognising that the Council is a going concern and as such has the ability to arrange future debt from the money markets (including the Public Works Loan Board) as and when required.
- The affordability of external debt; ensuring that the resulting revenue impact when arranging new debt arising from additional capital financing costs (including annual MRP costs and actual interest paid on outstanding debt) remains within prudent levels.
- Planning the repayment of external debt via the use of future capital receipts or as per the agreed terms and conditions of any new debt arrangements (including 'annuity' and 'equal instalments of principal' loan structures).

4.3 The Council's underlying need to borrow for capital purposes (including PFI schemes and finance lease liabilities) is measured by the Capital Financing

Requirement (CFR) and represents the total historic outstanding capital expenditure which has yet to be permanently financed. Usable reserves and working capital are the underlying resources available for investment. The CFR together with usable reserves are therefore key drivers of the Council's treasury management activity.

4.4 The Council's current level of external debt and investments is **set out at Appendix A**. Market conditions, interest rate expectations and credit risk considerations will influence the Council's strategy in determining the borrowing and investment activity against the underlying Balance Sheet position.

4.5 In December 2016, County Council reviewed an updated capital programme totalling £686.5m up to 2021/22, along with £264.2m for the Council's Income Generating Initiatives (IGIs) and Bold Ideas. Furthermore County Council gave approval for additional spending on Basic Need for 2017/18 and a change to the Minimum Revenue Provision (MRP) policy, the method by which the Council sets aside revenue funding to repay borrowing, to be implemented from 2016/17.

4.6 In order to finance the updated capital programme up to 2021/22 (excluding IGIs), County Council was asked to consider borrowing of up to a maximum £243.4m; subsequently lowered to £243.2m as detailed in the February 2017 Budget Report. As a consequence the planned capital expenditure (**excluding** IGIs and Bold Ideas) and expected financing up to 31 March 2022 is shown below:

	2017/18 Estimate £'m	**2018/19 Estimate £'m**	**2019/20 Estimate £'m**	**2020/21 Estimate £'m**	**2021/22 Estimate £'m**
Capital Expenditure	**145.3**	**146.6**	**108.8**	**81.6**	**93.9**
Financed By:					
Ringfenced Government Grant	-18.4	-15.6	-9.2	-20.0	-10.5
Non-Ringfenced Government Grant	-42.9	-49.0	-42.8	-31.2	-30.6
External Contributions	-12.1	-6.6	-4.1	-2.6	-16.6
Capital Receipts (including leasing)	-3.1	-1.0	-1.0	-3.0	-3.0
Revenue Funding	-3.4	-10.5	-0.5	-0.5	-0.6
Total Financing	**-79.9**	**-82.7**	**-57.6**	**-57.3**	**-61.3**
Borrowing	-65.4	-63.9	-51.2	-24.3	-32.6
Total	**-145.3**	**-146.6**	**-108.8**	**-81.6**	**-93.9**

4.7 The updated financial overview (Balance Sheet forecast) through to 31 March 2022 (**excluding** IGIs and Bold Ideas) is shown below:

	2017/18 Estimate £'m	**2018/19 Estimate £'m**	**2019/20 Estimate £'m**	**2020/21 Estimate £'m**	**2021/22 Estimate £'m**
Capital Financing Requirement	617.3	668.3	707.5	716.4	732.1
Less Other Debt Liabilities *(i)*	-110.4	-107.2	-105.9	-101.9	-97.1
Borrowing CFR	**506.9**	**561.1**	**601.6**	**614.5**	**635.0**
Existing Borrowing	-395.9	-388.9	-381.8	-374.8	-371.3

	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
Profile (PWLB)					
Short-Term Borrowing *(ii)*	-4.0	-4.0	-4.0	-4.0	-4.0
External Borrowing *(iii)*	**-399.9**	**-392.9**	**-385.8**	**-378.8**	**-375.3**
Usable Reserves	-173.5	-118.9	-105.5	-99.5	-82.3
Provisions & Working Capital	-64.3	-69.2	-69.7	-71.2	-72.7
Investment(-) / Borrowing	**-130.8**	**-19.9**	**40.6**	**65.0**	**104.7**

(i) The CFR includes any other long-term liabilities (including PFI schemes and finance leases) that form part of the Council's total borrowing requirement; such schemes however include a borrowing facility so that the Council is not required to borrow separately for them.

(ii) Money held on behalf of the Chichester Harbour Conservancy.

(iii) Loans to which the Council is committed to, excluding optional refinancing.

4.8 It is a requirement of the CIPFA Prudential Code to ensure that capital expenditure remains within sustainable limits, and in particular to consider the impact on Council Tax. The Prudential Code also requires local authorities to agree ratios and limits in respect of their borrowing and to demonstrate that their plans are prudent and affordable. Details of the proposed ratios and limits are summarised in the Council's Prudential Indicators (**Appendix C**).

4.9 The Prudential Indicators show that the impact of capital plans as outlined in the above financing table (paragraph 4.6) would add £29.23 to current Council Tax (Band D equivalent) levels over the five-year period ending 31 March 2022.

4.10 Income Generating Initiatives: As detailed in the Budget Report (February 2017) the planned capital expenditure relating to Income Generating Initiatives that is expected to be self-financing (no cost to the tax-payer) up to 31 March 2022, as supported by approved business cases, is shown below:

	2017/18 Estimate £'m	2018/19 Estimate £'m	2019/20 Estimate £'m	2020/21 Estimate £'m	2021/22 Estimate £'m
Income Generating Initiatives	**49.4**	**73.4**	**56.1**	**21.0**	**17.1**
Financed By:					
Capital Receipts (Propco)	0.0	-1.4	-5.1	-33.0	-32.1
Income Generating Grants	-0.6	-0.9	-0.6	-0.6	0.0
Borrowing for IGI's	-48.8	-72.5	-55.5	-20.4	-17.1
Borrowing Repayment	0.0	1.4	5.1	33.0	32.1
TOTAL	**-49.4**	**-73.4**	**-56.1**	**-21.0**	**-17.1**

5 Minimum Revenue Provision (MRP)

5.1 The Council is required to set an annual policy on the way it calculates the prudent provision for the charge to the revenue account for borrowing (MRP). The MRP policy (as approved by the County Council in December 2016) is attached at **Appendix D**.

6 Borrowing Strategy

6.1 The Council is required to approve a strategy that sets-out the borrowing required to meet the cost of any unfinanced expenditure as contained within its capital programme; whilst ensuring that such borrowing remains within prudent, affordable and sustainable limits. 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.

6.2 The Council is currently developing long-term plans in respect of its future debt and debt refinancing/repayment requirements (paragraph 4.2) and the following issues will be considered prior to undertaking any external borrowing:

- Affordability within revenue budget constraints.
- Maturity profile of existing debt.
- Interest rate and refinancing risk.

6.3 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 continue to investigate all sources of funding that may be available at favourable borrowing rates.

6.4 During 2017/18, the Director of Finance, Performance and Procurement may arrange new external debt up to the Council's "Authorised Borrowing Limit" as detailed within the Prudential Indicators (**Appendix C**); whilst ensuring that the resulting revenue impact of such new debt remains within affordable levels. The Director of Finance, Performance and Procurement will therefore 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:

- 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).
- Borrowing from the UK Municipal Bond Agency plc and other special purpose companies created to enable local authority bond issue.

6.5 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)
- Leasing (including hire purchase)

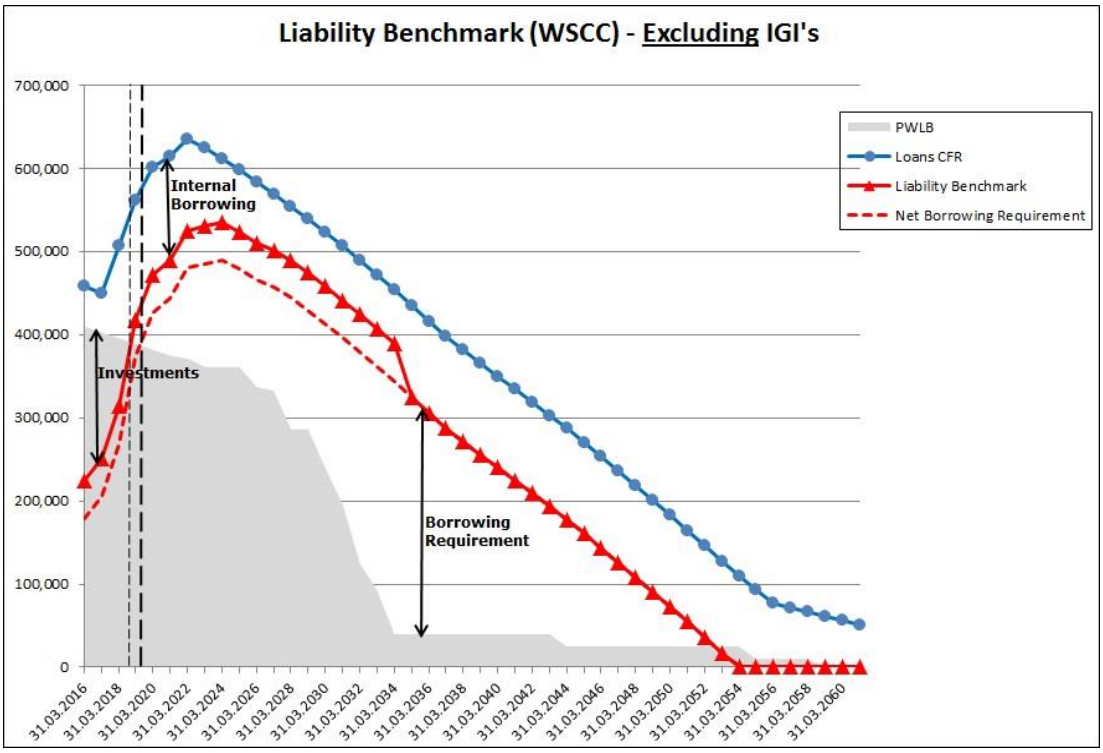
6.6 Internal Borrowing: In accordance with CIPFA's Prudential Code the Council may borrow up to its Capital Financing Requirement (CFR). At any point in time the Council can be in a position whereby actual debt exceeds its CFR ("borrowing in advance of need") or remains lower than its CFR ("under-borrowed"). In December 2010, County Council took a decision to introduce an internal borrowing strategy whereby the Council's capital borrowing need (the CFR) is not fully funded by external debt and cash supporting the Council's usable reserves and working capital is used as a temporary funding measure in lieu of external borrowing. As a result the Council currently remains under-borrowed against its CFR (£44.7m as at 31 March 2016).

6.7 The cost of new long-term external borrowing is calculated with reference to UK gilt yields. During periods when short-term interest rates are lower than long-term rates, the resulting differential creates a 'cost of carry' in the Council's revenue budget where the proceeds of any new long-term borrowing are temporarily held in lower yielding investments. The Council's internal borrowing strategy has remained prudent against the continual backdrop of low investment returns and heightened investment counterparty risk. With official interest rates forecast to remain below long-term gilt yields (**Appendix B**) an internal borrowing strategy will likely continue to be beneficial in 2017/18.

6.8 The benefits of internal borrowing will be regularly monitored against the potential for incurring additional costs through deferring new external borrowing into future years when long-term borrowing rates are forecast to rise. The Council's treasury management advisor (Capita Asset Services) will assist in determining whether the Council should consider borrowing additional sums now, with the view of minimising future borrowing costs, even if this causes additional costs in the short-term.

6.9 Liability Benchmark: To further assist the long-term borrowing strategy the Director of Finance, Performance and Procurement has created a liability benchmark (as introduced within the CIPFA "Risk Management Toolkit") which forecasts the minimum amount of debt the Council could hold if its internal resources are used in lieu of external borrowing, assuming £45m is maintained for strategic long-term investment (for instance the investment of usable long-term PFI reserves).

6.10 Extending the medium-term 'Balance Sheet and Treasury Management Position' forecasts (paragraph 4.7) the liability benchmark can be used to project the Council's need to borrow over a longer-term period. The resulting liability benchmark that includes planned capital expenditure up to March 2022 (**excluding** the income generating initiatives) is shown below:



6.11 The graphical presentation above shows the profile of the Council's maturing PWLB debt, the forecast for its "Borrowing CFR" (Capital Financing Requirement excluding long-term PFI/finance lease liabilities) and the liability benchmark over a forty-five year period. The Director of Finance, Performance and Procurement currently forecasts that under the current capital programme (excluding income generating initiatives), usable reserves and working capital (cash-flow liquidity) assumptions, the Council will be required to reintroduce external borrowing in 2018/19. The Council's "net borrowing requirement" is also included to demonstrate the minimum amount of debt the Council could hold if 100% of its internal resources are used in lieu of borrowing (no assumed strategic long-term investment); under this scenario external borrowing could be delayed until 2019/20.

6.12 Borrowing for Capital Purposes: At 31 December 2016, the Council's long-term external borrowing (excluding PFI liabilities, finance leases and the 20-year loan taken on behalf of the Littlehampton Harbour Board) amounted to £402.6m (£520.6m including other debt liabilities) as part of its strategy for funding previous year's capital programmes; the Council's total assets as reported at 31 March 2016 amounting to £1.7bn. The £402.6m debt has been sourced entirely from the Public Works Loan Board (PWLB) at fixed interest rates of between 5.125% and 3.77%, with a weighted average rate of 4.53%.

6.13 Capital plans highlight that a borrowing requirement of up to £65.4m (paragraph 4.6), together with additional borrowing of up to £73.6m relating to Income Generating Initiatives (which includes £24.8m relating to 2016/17), is required to finance the Council's overall capital programme in 2017/18. An analysis of the Council's IGIs (and Bold Ideas) shows such possible capital expenditure increasing to an extent whereby the potential reintroduction of external borrowing for IGIs will be required in 2017/18; but only where schemes are supported by approved business cases.

6.14 With regards to capital plans excluding IGIs, it is likely the Council will continue to maintain an internal borrowing strategy throughout 2017/18, thereby minimising external borrowing costs and overall treasury risk by reducing the level of external investments (despite forgoing investment income).

6.15 The Council's IGI borrowing requirement in 2017/18, together with the repayment of existing debt (including £70m being repaid to the PWLB over a 10-year period; £7m per year and a final repayment of £3.5m in April 2022) and plans for externalising new debt over the five year period ending 31 March 2022 (**including** IGIs and Bold Ideas) are set out below:

	2017/18 Estimate £'m	**2018/19 Estimate £'m**	**2019/20 Estimate £'m**	**2020/21 Estimate £'m**	**2021/22 Estimate £'m**
Gross Debt at 1 April	**520.6**	**583.9**	**674.0**	**774.7**	**774.3**
Repayment of Existing Debt	-7.0	-7.0	-7.0	-7.0	-3.5
External Debt (Core Borrowing)	0.0	30.0	60.0	25.0	40.0
Potential External Debt (IGIs)	73.6	70.3	49.1	-14.4	-17.0
PFI/Finance Lease Repayment	-3.3	-3.2	-1.4	-4.0	-4.8
Gross Debt at 31 March	**583.9**	**674.0**	**774.7**	**774.3**	**789.0**
Internal Borrowing	103.7	135.0	122.7	117.7	101.8
Capital Financing Requirement	**687.6**	**809.0**	**897.4**	**892.0**	**890.8**

6.16 Gross debt (as reported in the above table) is used to measure the "Operational Borrowing Limit" as reported within the Council's Prudential Indicators (**Appendix C**). To ensure the continual affordability and suitability of the Council's total borrowing for capital purposes, the Director of Finance, Performance and Procurement will appraise available borrowing options (as set out in paragraph 6.4) when arranging potential external debt relating to the Council's Income Generating Initiatives and Bold Ideas in 2017/18.

6.17 CIPFA's Prudential Code sets out limited flexibility for early borrowing for future years, including ensuring borrowing is not undertaken for revenue purposes. The Director of Finance, Performance and Procurement will therefore ensure that the Council will not borrow more than, or in advance of its need, purely to profit from the investment of the extra sums borrowed. Any decision to borrow in advance of capital need will be within forward approved Capital Financing Requirement estimates and will be carefully considered to ensure that value for money and the security of such funds held in temporary investments can be demonstrated. The Council's "Authorised Borrowing Limit" (as reported within the Prudential Indicators; **Appendix C**) has therefore been increased to allow external borrowing in advance of its borrowing need for up to a maximum of two years forward (period ending 31 March 2020). It is therefore not expected, except in the short-term, that gross debt will exceed CFR over the five year capital programme.

6.18 The Director of Finance, Performance and Procurement may additionally consider arranging forward starting loans in 2017/18, 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 a cost of carry in the intervening period.

6.19 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:

	2017/18 Estimate £'m	**2018/19 Estimate £'m**	**2019/20 Estimate £'m**	**2020/21 Estimate £'m**	**2021/22 Estimate £'m**
Net Revenue Expenditure	532.0	531.7	551.8	570.1	570.1
Capital Financing Charges – ***Excluding*** *IGIs, PFI and Finance Leases*	26.9	28.5	31.0	32.3	34.2
% Ratio	**5.1%**	**5.4%**	**5.6%**	**5.7%**	**6.0%**

6.20 In accordance with this recommended borrowing strategy, the Director of Finance, Performance and Procurement forecasts that the costs of external borrowing (interest charges) in 2017/18 will be:

- Core Programme: £18.1m (£18.3m in 2016/17)
- IGIs and Bold Ideas: Up to a maximum of £2.0m (nil in 2016/17)
- PFI schemes and finance leases: £9.7m (9.8m in 2016/17)

6.21 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).

6.22 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.

6.23 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 forecast; paragraph 4.7) 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)

6.24 The PWLB allows local authorities to repay loans early and either pay a premium or obtain a discount according to a formula based on current interest rates. Rescheduling opportunities within the Council's debt portfolio, whilst remaining very limited in the current economic climate, will be reviewed throughout 2017/18; such opportunities being constrained by the relatively expensive premium charge incurred regarding the early repayment of PWLB loans in the Council's portfolio.

6.25 Reporting: All new external 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.

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 31 December 2016 the Council's investments amounted to £256.3m (**Appendix A**), £4.4m less than 31 December 2015. In the past twelve months the Council's average investment balance was £280.7m and is forecast to average around £230m throughout the forthcoming calendar year given the continuation of internal borrowing and capital expenditure plans.

7.2 Both CIPFA's "Treasury Management Code of Practice" and DCLG's "Guidance on Local Government Investments" require the Council to invest its funds prudently and to have regard to the security and liquidity of its investments before seeking the highest rate of return ("SLY" investment principles). As a consequence, the Council's primary objective when investing money is to strike an appropriate balance between risk and return; minimising the risk of incurring losses from defaults against the risk of receiving unsuitably low investment income.

7.3 Risks associated with the generation of investment income will be continually monitored throughout the year. Provided that proper levels of security and liquidity are achieved then the Director of Finance, Performance and Procurement may consider it reasonable to seek the highest yield consistent with these priorities. The Council however 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.

7.4 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 UK plc)
- ICAP Securities Limited
- Institutional Cash Distributors (ICD) Ltd
- King and Shaxson Limited
- Tradition (UK) Limited
- Tullett Prebon Group Limited

7.5 Investment Strategy (including 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).
- 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 for greater than one year.

7.6 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 increased risks and low returns from short-term unsecured bank investments, the Council aims to further diversify investments into more secure and/or higher yielding asset classes during 2017/18; this is especially the case for an estimated £45m (inclusive of existing long-term investments totalling £24.1m; paragraph 8.4) that is available for strategic long-term investment.

7.7 At 31 December 2016, 73% 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 2016/17 treasury management strategy. The Director of Finance, Performance and Procurement confirms that the Council will not be holding any investment at 31 March 2017 that will be in breach of the recommended 2017/18 strategy.

7.8 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 364 days
- Not defined as capital expenditure by legislation; and
- Invested with one of:

- The UK Government
- A local authority in England, Wales, Scotland or Northern Ireland
- An institution or investment scheme of 'high credit quality'.

7.9 For investments to be regarded as specified, the Council defines 'high credit quality' as institutions and securities having a long-term credit rating of **A-** or higher that are domiciled in the UK or a foreign country with a sovereign rating of **AA+** or higher (non-UK banks holding a credit rating of A+ or higher). For money market funds 'high credit quality' is defined as those having a **AAA** credit rating having the aim of maintaining a constant net asset valuation (or very low daily volatility) and assets exceeding £1bn. For externally managed pooled funds 'high credit quality' is defined as those having a **AAA** credit rating.

7.10 In assessing credit ratings (as provided by Capita Asset Services) the Director of Finance, Performance and Procurement 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. Specific institutions (or individual securities) and short-term money market funds must be rated by at least two out of the three rating agencies to be regarded as a specified investment; externally managed pooled funds to be rated AAA by at least one of the rating agencies to be regarded as a specified investment. Any investment not meeting the specified investment criteria or any counterparty holding only one credit rating will be treated as if it were unrated (non-specified investment). For secured investments the credit rating relevant to the specific investment (covered bonds) or underlying collateral (reverse repurchase agreements) is used. For other investments (including bank unsecured and non-bank deposits) the counterparty credit rating is used.

7.11 DCLG Investment Guidance requires the Council to consider other means of assessing the credit-worthiness of countries and institutions, over and above sole reliance on credit ratings. It is therefore important to continually assess and monitor the financial sector on both a micro and macro basis in relation to both the economic and political environments in which institutions operate; such assessments will also take account of information that reflects the opinion of the markets. To meet this objective the Director of Finance, Performance and Procurement will engage with Capita Asset Services to establish a robust scrutiny process on the suitability of potential investment counterparties through the consideration of a range of criteria over and above credit ratings, including:

- Credit Default Swap prices (where quoted)
- Share prices
- Financial statements for specific institutions
- Corporate developments, news articles, market sentiment

7.12 The Director of Finance, Performance and Procurement and the Council's treasury management advisor 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 7.9 and 7.14).

7.13 In response to advice received from the Council's treasury management advisor (Capita Asset Services) and having the aim of increasing investment diversification, including the avoidance of concentration risks arising from bank unsecured deposits held within individual banks and building societies, the Cabinet Member for Finance, in consultation with the Treasury Management Panel and the Director of Finance, Performance and Procurement recommends the following investment strategy changes be adopted in 2017/18:

(1) An increase to **unsecured** bank deposit duration limits (up to a maximum of 364 days) as set out below:

- Australian Banks rated AA- (including Australia & New Zealand Banking Group, Commonwealth Bank of Australia, National Australia Bank, and Westpac Banking Corporation): 364 Days (increased from 6 months in 2016/17).
- Goldman Sachs International Bank (UK Bank; long-term rating A): 6 months (increased from 100 days in 2016/17); in line with other UK banks holding an equivalent long-term credit rating and approved for Council investment (including Coventry Building Society, Close Brothers Ltd, Lloyds Bank Group and Nationwide Building Society).

(2) The inclusion and/or reintroduction of additional financial institutions approved as suitable for **unsecured** bank deposits including:

<u>UK Banks</u>:

- Santander UK plc (long-term rating A) up to a maximum duration of 6 months.
- Standard Chartered Bank (long-term rating A) and Yorkshire Building Society (long-term rating A-) up to a maximum duration of 100 days.
- The Royal Bank of Scotland, including NatWest Bank (long-term rating BBB+) up to a maximum duration of 364 days given the part nationalised status of the banking group (no approval if the bank loses this status).

<u>Non-UK Banks</u>:

- Multilateral development banks (long-term rating AAA), including the European Investment Bank up to a maximum duration of 2 years (364 days in 2016/17).
- Sweden: Skandinasviska Enskilda Banken (long-term rating A+) and Swedbank (long-term rating AA-) up to a maximum duration of 364 days; as per other approved Swedish Banks.
- Switzerland: UBS Bank (long-term rating A+) up to a maximum duration of 364 days.
- US: The Bank of New York Mellon and Wells Fargo Bank (both holding a AA- long-term rating) up to a maximum duration of 364 days.

(3) The inclusion of specific investment criteria regarding the use of externally managed pooled funds (including enhanced cash, strategic bond, equity and property funds).

(4) The maximum limit for the total invested greater than one year to be lowered to £45m, based on long-term usable reserve (including PFI and MRMC reserves) forecasts up to March 2022.

7.14 The Director of Finance, Performance and Procurement, under delegated powers, will undertake the most appropriate form of investments in keeping with the Cabinet Member for Finance's recommended strategy objectives, income and risk management requirements and the Council's approved Prudential Indicators (**Appendix C**). 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 (per counterparty) 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	364 Days	£25m	5 Years
AA	£15m	364 Days	£25m	4 Years
AA-	£15m	364 Days	£25m	3 Years
A+	£15m	364 Days	£15m	2 Years
A	£15m	6 Months	£15m	364 Days
A-	£15m	100 Days	£15m	6 Months
BBB+			£10m	100 Days
RBS (Nationalised)	£15m	364 Days	(Limits as above)	
Money Market Funds	£25m *(i)*	Overnight	£25m *(ii)*	Overnight
Registered Providers (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)*	To Be Agreed

(iii) Maximum monetary limits for externally managed pooled funds (including enhanced cash, strategic bond, equity 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.

7.15 Banks Unsecured: Includes 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.

7.16 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 prime 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.

7.17 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 7.14) 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).

7.18 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 7.14). The combined secured and unsecured investments in any one bank will not exceed the monetary limit approved for secured investments.

7.19 Government Backed: Loans, bonds and bills issued or guaranteed by national governments, regional and local authorities and multilateral development banks. These investments are not subject to bail-in and there is an insignificant risk of insolvency. Investments with 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.

7.20 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. The rates of interest offered through short-term DMO/local authority deposits are below equivalent money market rates thereby reducing the

levels of investment income earnings, but the returns are an acceptable trade-off for the guarantee that the Council's capital is secure.

7.21 Corporates: Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in but are exposed to the risk of the company going insolvent. The Cabinet Member for Finance approves the use of investments issued by corporates that hold a credit rating (as set out in paragraph 7.14) by at least two of the three rating agencies, up to a maximum of £15m per company (£10m for corporates rated BBB+).

7.22 Registered Providers: Loans and bonds issued by, guaranteed by or secured against the assets of Registered Providers of Social Housing (formerly known as Housing Associations). These bodies are tightly regulated by the Homes and Communities Agency and as providers of public services they retain a high likelihood of receiving government support if needed.

7.23 Money Market Funds: Pooled investment vehicles consisting of unsecured money market deposits and similar instruments, unless the fund consists of government securities only (paragraph 7.25). 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.

7.24 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 under management), whichever lower. Such funds must hold a AAA credit rating by at least two of the three rating agencies and hold underlying assets in excess of £1bn to be considered appropriate for Council investments.

7.25 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 DMO deposits, up to a limit per fund of £25m or 2% of the fund's total assets under management, whichever lower. Such funds will be treated as a separate counterparty to a standard cash money market fund provided by the same sponsor.

7.26 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).

7.27 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 for money market funds.

Strategic bond, equity 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 funds may experience times of displaying capital losses when viewed over a short-term horizon, contravening "SLY" investment principles.

7.28 Recommendations of pooled funds considered appropriate for Council investments will be made following a full credit risk appraisal of potential funds by Council Officers, with support of its treasury advisor. Selection of funds will be undertaken by the Director of Finance, Performance and Procurement and will be reported to the Cabinet Member for Finance and the Treasury Management Panel. The Council's current investments in such funds are listed in **Appendix A**. 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.

7.29 Investment Limits: All limits including duration, monetary, country, sector and banking group are subject to the explicit approval by the Cabinet Member for Finance, in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel. 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 registered provider, rated A- or above	£15m
Any single corporate, rated BBB+	£10m
Maximum % invested in UK domiciled institutions/organisations	100%
Maximum investment amount per banking group	£25m
Maximum corporate exposure	£50m
Maximum registered provider exposure	£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

7.30 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.

8 Non-Specified Investments

8.1 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- (or unrated)
- Investments in externally managed pooled funds (not rated AAA)
- Investments denominated in foreign currencies (Euros)
- Investments that are defined by legislation as capital expenditure

8.2 The Cabinet Member for Finance, in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel approves the following monetary limits for non-specified investments:

Investment Type	**Cash Limit £'m**
Total long-term investments (greater than one year)	45.0
Total investments with corporates rated below A-	30.0
Total investments within externally managed pooled funds, including enhanced cash funds (not rated AAA);	60.0
Total investments denominated in foreign currencies	2.8
Total investments defined as capital expenditure	5.2

8.3 Long-Term Investments: Limits on long-term investments, those that are due to mature twelve months or longer from the date of arrangement, are set by reference to the Council's Medium Term Financial Strategy (MTFS) and long-term usable reserve forecasts (including PFI/MRMC reserves as contained within the Council's total usable reserves; paragraph 4.7). As required by the Prudential Code, the Cabinet Member for Finance has placed a maximum limit for principal sums invested in 2017/18 for greater than one year as £45m. This limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested. No long-term investment will be arranged with any bank or building society on an unsecured basis.

8.4 Long-term investments including gilts, covered bonds, corporate bonds, supranational bank bonds, local authority loans, registered provider (housing association) loans, externally managed pooled funds and an equity investment with the UK Municipal Bond Agency are approved by the Cabinet Member for Finance. The maximum monetary limit for long-term investments with any one organisation is set at £15m (£25m for individual UK local authorities). At 31 December 2016 the Council had £24.1m invested for greater than one year including:

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

8.5 The existing long-term investments held with two local authorities are both expected to mature in 2019; and are yielding interest at 1.30%

(£6m) and 1.31% (£10m). The Nationwide Building Society covered bond (floating rate note) is due to mature in April 2019; interest resets quarterly at a margin over the prevailing 3-month LIBOR rate, expected 0.85% yield to maturity *(assuming 3-month LIBOR remains at current levels over the lifetime of the investment)*.

8.6 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 €3.4m (£2.8m equivalent based on a 1.2143 exchange rate).

8.7 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 Cabinet Member for Finance, in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel. In 2017/18 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).
- 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.

9 Monitoring Credit Ratings

9.1 The Council uses long-term credit ratings from the three main rating agencies (Fitch Ratings, Moody's Investors Service and Standard & Poor's Financial Services) to assess the risk of investment default. The lowest published counterparty credit rating will be used to determine credit quality, unless an investment-specific rating is available.

9.2 Credit ratings will be monitored by both Council Officers, together with our treasury management advisor (Capita Asset Services) who will notify the Council of any changes as soon as they occur. 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 Cabinet Member for Finance, Director of Finance, Performance and Procurement, Treasury Management Panel members and all authorised signatories.

9.3 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.

9.4 If an institution is placed on negative rating watch and is at (or likely to fall below) the Council's minimum rating criteria then deposits, including time periods, will only be placed with the explicit approval of the Cabinet Member for Finance, in consultation with the Director of Finance, Performance and Procurement and the Treasury Management Panel, until the outcome of the review is announced. Again, this policy will not apply to negative 'outlooks'.

9.5 Any institution will be suspended or removed from the Council's approved counterparty list should any credit indicators give rise to concern, even though it may meet the minimum credit rating criteria.

10 The County Council's Banker

10.1 The Council currently banks with Lloyds Bank, the contract being effective from 1 October 2013 for an initial three year period, with the Council having opted to extend the contract in 2016 for an additional six years up to 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 7.9) the provider may continue to be used for short-term (overnight) liquidity requirements and business continuity arrangements.

10.2 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 7.14 and 7.29). Occasionally 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 Cabinet Member for Finance 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.

11 Policy on the use of Financial Derivatives

11.1 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 removes 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.

11.2 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.

12 Investment Income (2017/18)

12.1 The UK referendum vote on EU membership (Brexit) in June 2016 delivered an immediate shock fall in confidence indicators and business surveys at the beginning of August 2016, which was interpreted by the Bank of England in its August Inflation Report as pointing to an impending sharp slowdown in the UK economy. The Bank's August 2016 Monetary Policy Meeting (MPC) was therefore dominated by countering this expected sharp slowdown and resulted in a package of measures that included a cut in the Base Rate from 0.5% to 0.25%; together with the expectation that it may be cut further by the end of 2016. However, the following monthly surveys in September showed an equally sharp recovery in confidence and business surveys. As a consequence, markets now expect that the UK economy will post reasonably strong growth numbers throughout 2017, albeit at a slower pace than the first half of 2016 (pre-Brexit).

12.2 The Bank Rate is now forecast to remain flat during 2017/18 and 2018/19 before rising by 0.5% in 2019/20; as per the economic and interest rate outlook provided by the Council's treasury management advisor, Capita Asset Services (**Appendix B**). The overall balance of risks to interest rate forecasts are currently slightly skewed to the downside in view of the uncertainty over the final terms of Brexit. If UK growth expectations disappoint and inflationary pressures are minimal then the start of Bank Rate increases could be pushed back further than forecast. On the other hand however, should the pace of growth quicken and/or forecasts for inflation increases significantly rise, then Bank Rate increases may occur earlier or at a quicker pace than that forecast.

12.3 The Council is expected to have an average investment portfolio of £230m (including usable reserves) throughout 2017/18. Given the investment portfolio attracting an average interest rate of 0.77% (as per likely yields attainable on the Council's expected investment portfolio; assuming an increased use of short and long-term externally managed pooled funds), the Director of Finance, Performance and Procurement expects to receive gross investment income totalling £1.768m in 2017/18.

12.4 As declared within the Budget Report (February 2017) the 2017/18 investment income budget has been set at £1.603m, which includes a budget reduction of £0.261m from the 2016/17 investment income budget

to reflect the reduction in returns following the Bank of England's Base Rate cut in August 2016. Following £0.165m transfers to/from internal and external reserve balances held by the Council (including school accumulating funds, PFI/MRMC reserves and cash held on behalf of the Chichester Harbour Conservancy) the Director of Finance, Performance and Procurement forecasts that the budgeted investment income total (£1.603m) will be achieved – as set out below:

	Average Portfolio £'m	**Interest Rate**	**Interest £'000**
Liquidity Portfolio	70.0	0.28	200
Short-Term Investment Portfolio	115.0	0.57	660
Long-Term Investment Portfolio	45.0	2.02	908
Gross Interest	**230.0**	**0.77**	**1,768**
Less transfers to/from specific reserves			-165
Net Interest (2017/18 Budget)			**1,603**

12.5 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 2017/18 and report any changes to the above forecast within monthly Total Performance Monitors (TPMs).

13 Liquidity Management

13.1 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, to minimise the risk of the Council being forced to borrow on unfavourable terms to meet its financial commitments.

13.2 The Council operates a number of interest paying call (instant-access) accounts and money market funds where cash is deposited at competitive short-term interest rates and can be withdrawn without notice. These funds are therefore highly liquid. The Council also 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.

14 Training

14.1 CIPFA's Code of Practice requires the Cabinet Member for Finance and the Director of Finance, Performance and Procurement to ensure that all members and officers tasked with treasury management responsibilities, including scrutiny of the treasury management function, receive appropriate training relevant to their needs and understand fully their roles and responsibilities.

14.2 The Director of Finance, Performance and Procurement has addressed this important issue by:

- Reviewing the training requirements for the elected Treasury Management Panel and members, as appropriate.
- Officers dealing with treasury management matters will have their training needs assessed every six months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change. Various training options available to officers include:

  (a) Professional qualifications from CIPFA, the Association of Corporate Treasurers (ACT) and other appropriate organisations
  (b) Training, workshops and seminars run by the Council's appointed treasury management advisors
  (c) Attendance at CIPFA treasury management seminars, and
  (d) On the job training in line with the approved Treasury Management Practices (TMPs), as provided by the Treasury Management Officer.

15 Balance Sheet Reporting

15.1 To comply with IFRS and in particular International Accounting Standard (IAS) 7, the Director of Finance, Performance and Procurement has adopted the following accounting policy for 'cash' and 'cash equivalents' with regard to its investment portfolio:

- Cash: Represented by cash in hand (Lloyds current accounts)
- Cash Equivalents: Deposits with financial institutions held for purposes of cash management and repayable without penalty on notice of not more than 24 hours from date of acquisition
- Short Term: Investments made for purposes of securing an investment gain with maturities up to 364 days
- Long Term: Investments with a maturity date greater than 1 year

15.2 The accounting treatment may differ from the underlying cash transactions arising from investment decisions made by the Council. To ensure that the Council is protected from any adverse revenue impact which may arise from these differences, Capita Asset Services will review the accounting implications of new transactions before they are undertaken.

(see paragraph 1.5, page 3)

West Sussex County Council's Current Portfolio

	31/12/16 Portfolio £'000
External Borrowing:	
- Fixed Rate: Public Works Loan Board (PWLB)	402,599
- Fixed Rate: PWLB (on behalf of the Littlehampton Harbour Board)	290
- Variable Rate: Short-Term (inc. Chichester Harbour Conservancy)	4,000
Total External Borrowing	**406,889**
Other Long Term Liabilities *(*)*:	
- PFI	111,769
- Finance Leases	1,906
Total Gross External Debt	**520,564**
Internally Managed Investments:	
(i) Bank Unsecured *(Short Term)*	
- Cash Deposits (Fixed-Term)	80,000
- Cash Deposits (Notice Accounts)	24,543
- Certificate of Deposits	29,991
- Short Term Money Market Funds	52,611
(ii) Bank Secured	
- Short Term Covered Bonds	10,000
- Long Term Covered Bonds	7,865
(iii) Local Authority	
- Short Term Investments	15,000
- Long Term Investments	16,000
(iii) Non-Bank	
- UK Municipal Bond Agency: Long Term Equity	200
Externally Managed Investments:	
Enhanced Cash Funds	
- Payden Sterling Reserve Fund	20,062
Total Investments	**256,272**

(*) Other Long Term Liabilities: Expected position at 31 March 2017

(see paragraph 1.5, page 3)

1 Capita Asset Services - Economic and Interest Rate Forecast

1.1 The Council has appointed Capita Asset Services (CAS) 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 CAS central view:

	Dec-16	Mar-17	Jun-17	Sep-17	Dec-17	Mar-18	Jun-18	Sep-18	Dec-18	Mar-19	Jun-19	Sep-19	Dec-19	Mar-20
Bank rate	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.25%	0.50%	0.50%	0.75%	0.75%
5yr PWLB rate	1.60%	1.60%	1.60%	1.60%	1.60%	1.70%	1.70%	1.70%	1.80%	1.80%	1.90%	1.90%	2.00%	2.00%
10yr PWLB rate	2.30%	2.30%	2.30%	2.30%	2.30%	2.30%	2.40%	2.40%	2.40%	2.50%	2.50%	2.60%	2.60%	2.70%
25yr PWLB rate	2.90%	2.90%	2.90%	2.90%	3.00%	3.00%	3.00%	3.10%	3.10%	3.20%	3.20%	3.30%	3.30%	3.40%
50yr PWLB rate	2.70%	2.70%	2.70%	2.70%	2.80%	2.80%	2.80%	2.90%	2.90%	3.00%	3.00%	3.10%	3.10%	3.20%

1.2 The Bank of England's Monetary Policy Committee (MPC) cut the Bank Rate from 0.50% to 0.25% on 4 August 2016 in order to counteract what it forecast was going to be a sharp slowdown in UK growth in the second half of 2016. It also gave a strong steer that it was likely to cut the Bank Rate again by the end of the 2016. However, UK economic data since August has indicated much stronger growth in the second half of 2016 than that forecast; also inflation forecasts have risen substantially as a result of a continuation of the sharp fall in the value of sterling since early August. Consequently the Bank Rate was not cut again in November 2016 and on current trends it now appears unlikely that there will be another cut, although that cannot be completely ruled out if there was a significant dip downwards in economic growth.

1.3 During the two-year period 2017 to 2019, when the UK is negotiating the terms for withdrawal from the EU, it is likely that the MPC will do nothing to dampen growth prospects (i.e. by raising Bank Rate) which will already be adversely impacted by the uncertainties of what form Brexit will eventually take. Accordingly, a first increase to 0.50% is not tentatively pencilled in until the second quarter of 2019 (as shown in the table above) after those negotiations have been concluded, although the period for negotiations could yet be extended. However, if strong domestically generated inflation, (e.g. from wage increases within the UK) were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

1.4 Economic and interest rate forecasting remains difficult with so many external influences weighing on the UK. The above forecasts (and MPC decisions) will be liable to further amendment depending on how economic data and developments in financial markets transpire 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.

1.5 The overall longer run trend is for gilt yields and PWLB rates to rise, albeit gently. It has long been expected that at some point there would be a start to a switch back from bonds to equities after a historic long-term trend over about the last twenty five years of falling bond yields. The action of central banks since the financial crash of 2008 in implementing substantial quantitative easing purchases of bonds, added further impetus to this downward trend in bond yields and rising prices of bonds. The opposite side of this coin has been a rise in equity values as investors searched for higher returns and took on riskier assets. The sharp rise in bond yields since the US Presidential election has called into question whether, or when, this trend has, or may, reverse especially when the US is likely to lead the way in reversing monetary policy.

1.6 Until 2015, US monetary policy was focused on providing stimulus to economic growth but has since started to refocus on countering the threat of rising inflationary pressures as strong economic growth becomes more firmly established. The expected substantial rise in the Fed Rate over the next few years may make holding US bonds much less attractive and cause their prices to fall, and therefore bond yields to rise. Rising bond yields in the US would be likely to exert some upward pressure on bond yields in other developed countries but the degree of that upward pressure is likely to be dampened by how strong, or weak, the prospects for economic growth and rising inflation are in each country, and on the degree of progress in the reversal of monetary policy away from quantitative easing and other credit stimulus measures.

1.7 PWLB rates and UK gilt yields have been experiencing exceptional levels of short-term volatility that have been highly correlated to geopolitical, sovereign debt crisis and emerging market developments. It is likely that these exceptional levels of volatility could continue to occur for the foreseeable future. The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

1.8 Apart from the above uncertainties, **downside risks to current forecasts** for UK gilt yields and PWLB rates currently include:

- If UK economic growth and increases in inflation are weaker than what Capita Asset Services currently anticipate.
- Weak growth or recession in the UK's main trading partners, namely the EU and US (if such scenarios materialise).
- A resurgence of the Eurozone sovereign debt crisis, with Greece being a particular problem, and stress arising from disagreement between EU countries on free movement of people and how to handle a huge influx of immigrants and terrorist threats.
- Weak capitalisation of some European banks, especially Italian.
- Geopolitical risks in Europe, the Middle East and Asia, causing a significant increase in safe haven flows.

- Monetary policy action by the central banks of major economies reaching its limit of effectiveness and failing to stimulate significant sustainable growth, combat the threat of deflation and reduce high levels of debt in some countries; combined with a lack of adequate action from national governments to promote growth through structural reforms, fiscal policy and investment expenditure.

- Major national polls, including:

  - Dutch general election (15 March 2017)
  - French presidential election (April/May 2017)
  - French National Assembly election (June 2017)
  - German Federal election (August to October 2017)
  - Spain currently has a minority government with only 137 seats out of 350 after already having had two inconclusive general elections in 2015 and 2016; this position is potentially highly unstable.

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

- UK inflation rising to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium in gilt yields.

- A rise in US Treasury yields as a result of Fed Rate increases and rising inflation expectations in the USA, dragging UK gilt yields upwards.

- The pace and timing of increases in the Fed Rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.

- A downward revision to the UK's sovereign credit rating undermining investor confidence in holding sovereign debt (gilts).

Investment and borrowing rates

1.10 Investment returns are likely to remain low during 2017/18 and beyond; the suggested budgeted investment earnings rates for returns on investments placed for periods up to 100 days during each financial year are as follows:

2016/17	0.25%
2017/18	0.25%
2018/19	0.25%
2019/20	0.50%
2020/21	0.75%
2021/22	1.00%
2022/23	1.50%
2023/24	1.75%
Later years	2.75%

1.11 Borrowing interest rates have been on a generally downward trend during most of 2016 up to mid-August; they fell sharply to historically phenomenally low levels after the referendum and then even further after the MPC meeting of 4th August when a new package of quantitative easing purchasing of gilts was announced. Gilt yields have since risen sharply due to a rise in concerns around a 'hard Brexit', the fall in the value of sterling, and an increase in inflation expectations. The policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times when authorities will not be able to avoid new borrowing to finance capital expenditure and/or to refinance maturing debt.

1.12 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.

(see paragraph 1.5, page 3)

Prudential Indicators – 2016/17 to 2021/22

1 Background

1.1 There is a requirement under the Local Government Act 2003 for local authorities to have regard to CIPFA's Prudential Code for Capital Finance in Local Authorities (the "CIPFA Prudential Code") when setting and reviewing their Prudential Indicators.

1.2 The Council is asked to approve the following Prudential Indicators.

2 Gross Debt and the Capital Financing Requirement

2.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the Capital Financing Requirement is taken from the amounts held in the Balance Sheet relating to capital expenditure and financing. Proposed levels of capital expenditure remain within sustainable limits and are detailed for the period 2017/18 to 2021/22, together with the associated financing, within Section 4 of the main strategy report (paragraph 4.6).

2.2 In order to ensure that over the medium term debt will only be for a capital purpose, the Council should ensure that gross external debt does not, except in the short term, exceed the total of Capital Financing Requirement in the preceding year plus the estimates of any additional Capital Financing Requirement for the current and the next two financial years.

2.3 The Director of Finance, Performance and Procurement confirms that gross external debt held by the Council has not exceeded the Capital Financing Requirement in 2016/17 (to date). Following review of the Council's capital programme up to 2021/22 in December 2016, the Capital Financing Requirement has been recalculated to include the annual profile of borrowing (up to a maximum of £243.2m) that is required to finance capital expenditure over the period (excluding Income Generating Initiatives). On the assumption that this borrowing requirement continues in-part to be met from internal resources, gross external debt is not expected to exceed the revised Capital Financing Requirement during the period ending 2021/22 (except in the short-term if borrowing is arranged in advance of capital need; as governed by the Council's "Authorised Borrowing" limit).

	Actual 31.03.16 £'000	**Estimate 2016/17 £'000**	**Estimate 2017/18 £'000**	**Estimate 2018/19 £'000**	**Estimate 2019/20 £'000**	**Estimate 2020/21 £'000**	**Estimate 2021/22 £'000**
Capital Expenditure (Including IGIs/PFI)	135,350	126,016	194,868	220,358	168,049	103,322	111,225
Capital Financing Requirement (CFR)	572,329	585,610	687,647	809,044	897,424	891,990	890,775
Gross External Debt (including short/ long-Term Borrowing, PFI and Finance Leases)	527,650	520,557	583,910	674,008	774,693	774,324	788,999

3 Incremental Impact of Capital Investment Decisions

3.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax (Band D equivalent) levels.

Impact of Capital Plans on Council Tax (Band D Equivalent)	Base 2016/17	Increase from Base 2017/18	Increase from Base 2018/19	Increase from Base 2019/20	Increase from Base 2020/21	Increase from Base 2021/22
Gross Impact on Capital Plans (excluding IGI's and Bold Ideas)	1,207.89	£8.05	£15.46	£21.67	£24.90	£29.23
Gross Impact on Capital Plans (including IGI's and Bold Ideas)	1,207.89	£13.67	£28.94	£41.10	£43.49	£46.63

3.2 The Prudential Indicator shows that current capital plans will add £29.23 (£46.63 including Income Generating Initiatives and Bold Ideas) over the period to current Band D Council Tax levels.

4 Authorised Limit and Operational Boundary for External Debt

4.1 The Council has an integrated treasury management strategy and manages its treasury position in accordance with its approved strategy and practice. Overall borrowing may arise as a consequence of all its financial transactions and not just those arising from capital spending as reflected in the Capital Financial Requirement.

4.2 The Authorised Borrowing Limit is a statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the "Affordable Limit"). This limit sets the maximum level of external debt on a gross basis (excluding all investments) for the County Council. It is measured on a daily basis against all external debt items on the Council's Balance Sheet, including:

- Long-term borrowing
- Short-term borrowing
- Overdrawn bank balances
- Other long-term liabilities (PFI / Finance Leases)

	Estimate 2016/17 £'000	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000	Estimate 2021/22 £'000
External Borrowing	446,882	704,270	707,470	708,820	727,096	731,866
PFI Schemes and Finance Leases	113,675	110,423	107,223	105,873	101,903	97,133
Authorised Borrowing Limit	560,557	814,693	814,693	814,693	828,999	828,999

4.3 The Operational Boundary (borrowing limit) links directly to the Council's estimates of the Capital Financing Requirement. This indicator is based on the same estimates as the Council's Authorised Borrowing Limit and reflects the maximum borrowing required to meet capital spending plans, without the additional headroom included within the Authorised Limit required to meet unusual cash-flow movements and borrowing in advance of capital need requirements.

	Estimate 2016/17 £'000	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000	Estimate 2021/22 £'000
External Borrowing	406,882	473,487	566,785	668,820	672,421	691,866
PFI Schemes and Finance Leases	113,675	110,423	107,223	105,873	101,903	97,133
Operational Borrowing Limit	520,557	583,910	674,008	774,693	774,324	788,999

5 Ratio of Capital Financing Costs to Net Revenue Stream

5.1 This indicator highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet capital financing charges (including income generating initiatives) as defined in the Prudential Code.

	Actual 31.03.16 £'000	Estimate 2016/17 £'000	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000	Estimate 2021/22 £'000
Net Expenditure	528,886	534,953	531,957	531,679	551,835	570,053	570,053
Capital Financing Charges (Revenue) – ***Excluding*** *IGIs, PFI and Finance Leases*	35,959	29,545	26,870	28,523	30,984	32,352	34,195
% Ratio (1)	6.80%	5.52%	5.05%	5.36%	5.61%	5.68%	6.00%
Capital Financing Charges (Revenue) – ***Including*** *IGIs, PFI and Finance Leases*	46,746	40,927	40,276	44,439	49,386	50,394	51,823
% Ratio (2)	8.84%	7.65%	7.57%	8.36%	8.95%	8.84%	9.09%

Treasury Management Indicators

6 Adoption of the CIPFA Treasury Management Code

6.1 The County Council approved the adoption of the CIPFA Treasury Management Code of Practice (2009) into the Treasury Management Policy Statement as detailed within the Council's Financial Regulations at its meeting dated 11 February 2011. Subsequent amendments to the CIPFA Treasury Management Code of Practice have been adopted by the County Council as required.

7 Upper Limits for Fixed and Variable Interest Rate Exposure

7.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates (and levels of internal borrowing). The Council calculates these limits on the principal outstanding sums as compared with the respective total borrowing and investment levels.

	Actual 31.03.16 £'000	Estimate 2016/17 £'000	Estimate 2017/18 £'000	Estimate 2018/19 £'000	Estimate 2019/20 £'000	Estimate 2020/21 £'000	Estimate 2021/22 £'000
Internal Borrowing	44,679	65,053	103,737	135,036	122,731	117,666	101,776
Capital Financing Requirement	572,329	585,610	687,647	809,044	897,424	891,990	890,775
Internal Borrowing %	8%	11%	15%	17%	14%	13%	11%

7.2 The upper limits for variable interest rate exposure has been set with regard to current economic forecasts, to ensure that the County Council is not exposed to interest rate rises which could adversely impact the revenue budget.

	Actual 31.03.16	Upper Limit 2016/17	Upper Limit 2017/18	Upper Limit 2018/19	Upper Limit 2019/20	Upper Limit 2020/21	Upper Limit 2021/22
Maximum % Borrowing at Fixed Rates	99%	100%	100%	100%	100%	100%	100%
Maximum % Borrowing at Variable Rates	1%	25%	25%	25%	25%	25%	25%
Maximum % Investments at Fixed Rates	53%	100%	100%	100%	100%	100%	100%
Maximum % Investments at Variable Rates	47%	85%	85%	85%	85%	85%	85%

7.3 The limits above provide the necessary flexibility within which decisions will be made for drawing down new loans on a fixed or variable rate basis; the decisions will ultimately be determined by expectations of anticipated interest rate movements as set out in the Council's Treasury Management Strategy.

8 Maturity Structure of Fixed Rate Borrowing

8.1 This indicator highlights 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.

8.2 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.

8.3 The upper and lower limits for the maturity structure of fixed rate borrowing in 2017/18 (with actual split as at 31 March 2016 and 2016/17 limits included for comparison) are set out below:

Treasury Management	**Actual 31.03.16**	**Lower Limit 2016/17**	**Upper Limit 2016/17**	**Lower Limit 2017/18**	**Upper Limit 2017/18**
Debt Maturity:					
Over 30 Years	6%	0%	10%	0%	30%
Over 25 to 30 Years	3%	0%	10%	0%	20%
Over 20 to 25 Years	0%	0%	10%	0%	15%
Over 15 to 20 Years	38%	0%	50%	0%	50%
Over 10 to 15 Years	34%	0%	60%	0%	60%
Over 5 to 10 Years	9%	0%	20%	0%	40%
Over 1 to 5 Years	7%	0%	20%	0%	35%
Under 12 Months	3%	0%	15%	0%	25%

8.4 The limits above provide the necessary flexibility within which decisions will be made for undertaking new external borrowing in accordance with the Council's capital programme. Should opportunities arise to redeem or restructure existing long-term borrowing, approval is delegated to the Director of Finance, Performance and Procurement to revise these upper limits during the course of 2017/18 as required.

9 Upper Limit for Principal Sums Invested over 364 Days

9.1 The purpose of this limit is to contain exposure to the possibility of loss that may arise as a result of the Council having to seek early repayment of the sums invested.

	Actual 31.03.16	**Upper Limit 2016/17**	**Upper Limit 2017/18**	**Upper Limit 2018/19**	**Upper Limit 2019/20**	**Upper Limit 2020/21**	**Upper Limit 2021/22**
Maximum Invested for a Year or longer (£)	£42.2m	£75m	£45m	£45m	£45m	£45m	£45m

(see paragraph 5.1, page 8)

Minimum Revenue Provision (MRP) Statement – 2017/18

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.

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.

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 at 1 April 2016 is made on a 2% annuity basis over a 40 year period from that date.

4 As part of the MRP policy review undertaken in 2016/17, the adoption of a revised policy for unsupported borrowing (from an equal instalments basis to an annuity basis over the estimated useful asset life) has resulted in a historic overprovision of MRP which is being recovered over a period equal to the number of years of repayment outstanding (per asset).

5 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.