

## APPENDIX 9 TREASURY MANAGEMENT STRATEGY AND PRUDENTIAL INDICATORS

### Prudential Code Indicators, Minimum Revenue Policy, Treasury Management and Investment Strategy Statements 2018/19

#### Introduction

In June 2009 the Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* (the CIPFA Code) which requires the Authority to approve a treasury management strategy before the start of each financial year. CIPFA consulted on changes to the Code in 2017, but has yet to publish the full detail required for the revised Code in time for this Strategy.

In addition, the Welsh Government (WG) issued revised *Guidance on Local Authority Investments* in March 2010 that requires the Authority to approve an investment strategy before the start of each financial year.

This report fulfils the Authority's legal obligation under the *Local Government Act 2003* to have regard to both the CIPFA Code and the WG Guidance.

The Authority has borrowed and invested substantial sums of money and is therefore exposed to financial risks including the loss of invested funds and the revenue effect of changing interest rates. The successful identification, monitoring and control of risk are therefore central to the Authority's treasury management strategy.

**Revised strategy:** In accordance with the WG Guidance, the Authority will be asked to approve a revised Treasury Management Strategy Statement should the assumptions on which this report is based change significantly. Such circumstances would include, for example, a large unexpected change in interest rates, in the Authority's capital programme or in the level of its investment balance.

#### External Context

**Economic background:** The major external influence on the Authority's treasury management strategy for 2018/19 will be the UK's progress in negotiating its exit from the European Union and agreeing future trading arrangements. The domestic economy has remained relatively robust since the surprise outcome of the 2016 referendum, but there are indications that uncertainty over the future is now weighing on growth. Transitional arrangements may prevent a cliff-edge, but will also extend the period of uncertainty for several years. Economic growth is therefore forecast to remain sluggish throughout 2018/19.

Consumer price inflation reached 3.0% in September 2017 as the post-referendum devaluation of sterling continued to feed through to imports. Unemployment continued to fall and the Bank of England's Monetary Policy Committee judged that the extent of spare capacity in the economy seemed limited and the pace at which the economy can grow without generating inflationary pressure had fallen over recent years. With its inflation-control mandate in mind, the Bank of England's Monetary Policy Committee raised official interest rates to 0.5% in November 2017.

In contrast, the US economy is performing well and the Federal Reserve is raising interest rates in regular steps to remove some of the emergency monetary stimulus it has provided for the past decade. The European Central Bank is yet to raise rates, but has started to taper its quantitative easing programme, signalling some confidence in the Eurozone economy.

**Credit outlook:** High profile bank failures in Italy and Portugal have reinforced concerns over the health of the European banking sector. Sluggish economies and fines for pre-crisis behaviour continue to weigh on bank profits, and any future economic slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. In addition, the largest UK banks will ringfence their retail banking functions into separate legal entities during 2018. There remains some uncertainty over how these changes will impact upon the credit strength of the residual legal entities.

The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however remain very low.

**Interest rate forecast:** The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.50% during 2018/19, following the rise from the historic low of 0.25%. The Monetary Policy Committee re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.

Future expectations for higher short term interest rates are subdued and on-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions. The risks to Arlingclose's forecast are broadly balanced on both sides. The Arlingclose central case is for gilt yields to remain broadly stable across the medium term. Upward movement will be limited, although the UK government's seemingly deteriorating fiscal stance is an upside risk.

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

For the purpose of setting the budget, it has been assumed that new investments will be made at an average rate of 0.4%, and that new long-term loans will be borrowed at an average rate of 3.5%.

### **Local Context**

On 31st December 2017, the Authority held £156m of borrowing and £34m of investments. This is set out in further detail at **Appendix B**. Forecast changes in these sums are shown in the balance sheet analysis in table 1 below.

Table 1: Balance sheet summary and forecast

	<b>31.3.17 Actual</b>	<b>31.3.18 Estimate</b>	<b>31.3.19 Forecast</b>	<b>31.3.20 Forecast</b>	<b>31.3.21 Forecast</b>

	£m	£m	£m	£m	£m
General Fund CFR	279.1	281.8	292.0	294.2	295.2
Less: Other debt liabilities *	(47.2)	(45.1)	(43.1)	(42.3)	(41.3)
<b>Borrowing CFR</b>	<b>231.9</b>	<b>236.7</b>	<b>248.9</b>	<b>251.9</b>	<b>253.9</b>
Less: External borrowing **	(211.7)	(146.1)	(144.7)	(103.2)	(100.9)
<b>Internal borrowing</b>	<b>20.2</b>	<b>90.6</b>	<b>104.2</b>	<b>148.7</b>	<b>153.0</b>
Less: Usable reserves	(107.2)	(86.3)	(76.9)	(73.2)	(70.6)
Less: Working capital	84.7	4.6	4.6	4.6	4.6
<b>Investments (or New borrowing)</b>	<b>2.3</b>	<b>(8.8)</b>	<b>(31.9)</b>	<b>(80.1)</b>	<b>(87.0)</b>

\* finance leases, PFI liabilities and transferred debt that form part of the Authority's total debt

\*\* shows only loans to which the Authority is committed and excludes optional refinancing

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

The Authority has an increasing CFR due to the capital programme, but intends to maintain minimal investments and will therefore be required to borrow up to £87m over the forecast period. This will contain new borrowing for re-financing of maturing loans, of which there is a significant value in 2019/20 due to the stock issue.

CIPFA's *Prudential Code for Capital Finance in Local Authorities* recommends that the Authority's total debt should be lower than its highest forecast CFR over the next three years. Table 1 shows that the Authority expects to comply with this recommendation during 2018/19.

### **Borrowing Strategy**

The Authority currently holds £156million of loans, a decrease of £53 million on the previous year, as part of its strategy for funding previous years' capital programmes, and the maturity of loans relating to the Queensberry Ltd borrowing. The balance sheet forecast in table 1 shows that the Authority will need to borrow further in 2018/19, this will mainly be to cover the expected capital loan and the reduction in earmarked reserves. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the authorised limit for borrowing of £263 million.

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

**Strategy:** Given the significant cuts to public expenditure and in particular to local government funding, the Authority's borrowing strategy continues to address the key issue of affordability without compromising the longer-term stability of the debt portfolio. With short-term interest rates currently much lower than long-term rates, it is likely to be more cost

effective in the short-term to either use internal resources, or to borrow short-term loans instead.

By doing so, the Authority is able to reduce net borrowing costs (despite foregone investment income) and reduce overall treasury risk. The benefits of internal borrowing will be monitored regularly against the potential for incurring additional costs by deferring borrowing into future years when long-term borrowing rates are forecast to rise modestly. Arlingclose will assist the Authority with this 'cost of carry' and breakeven analysis. Its output may determine whether the Authority borrows additional sums at long-term fixed rates in 2018/19 with a view to keeping future interest costs low, even if this causes additional cost in the short-term.

Alternatively, the Authority may arrange forward starting loans during 2018/19, where the interest rate is fixed in advance, but the cash is received in later years. This would enable certainty of cost to be achieved without suffering a cost of carry in the intervening period.

In addition, the Authority may borrow short-term loans to cover unplanned cash flow shortages.

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

- Public Works Loan Board (PWLB) and any successor body
- any institution approved for investments (see below)
- any other bank or building society authorised to operate in the UK
- capital market bond investors
- special purpose companies created to enable local authority bond issues

**Other sources of debt finance:** In addition, capital finance may be raised by the following methods that are not borrowing, but may be classed as other debt liabilities:

- operating and finance leases
- hire purchase
- Private Finance Initiative
- sale and leaseback

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

**LOBOs:** The Authority holds £30m of LOBO (Lender's Option Borrower's Option) loans where the lender has the option to propose an increase in the interest rate at set dates, following which the Authority has the option to either accept the new rate or to repay the loan at no additional cost. £30m of these LOBOS have options during 2018/19, and although the Authority understands that lenders are unlikely to exercise their options in the current low interest rate environment, there remains an element of refinancing risk. The Authority will

take the option to repay LOBO loans at no cost if it has the opportunity to do so. Total borrowing via LOBO loans will be limited to £30m.

**Short-term and variable rate loans:** These loans leave the Authority exposed to the risk of short-term interest rate rises and are therefore subject to the limit on the net exposure to variable interest rates in the treasury management indicators below.

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

### **Investment Strategy**

The Authority holds significant invested funds, representing income received in advance of expenditure plus balances and reserves held, this is due to the receipt from the sale of Friars Walk. In the past 12 months, the Authority's investment balance has ranged between £0 and £35 million, however, the level of investments is expected to reduce over the forthcoming year as funding is required and there is a move back towards holding minimal investments.

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

**Negative interest rates:** If the UK enters into a recession in 2018/19, there is a small chance that the Bank of England could set its Bank Rate at or below zero, which is likely to feed through to negative interest rates on all low risk, short-term investment options. This situation already exists in many other European countries. In this event, security will be measured as receiving the contractually agreed amount at maturity, even though this may be less than the amount originally invested.

**Strategy:** The majority of the Authority's surplus cash is currently invested in local authorities or short-term unsecured bank deposits. It is expected that the authority will look to diversify its investments into other approved counterparties where it is felt there is the correct balance between security and yield.

**Approved counterparties:** The Authority may invest its surplus funds with any of the counterparty types in table 2 below, subject to the cash limits (per counterparty) and the time limits shown.

### **Table 2: Approved investment counterparties and limits**

Credit Rating	Banks Unsecured	Banks Secured	Government	Corporates	Registered Providers
UK Govt	Not applicable	Not applicable	£ Unlimited 50 years	Not applicable	Not applicable
AAA	£5m 2 years	£10m 2 years	£10m 2 years	£5m 2 years	£5m 2 years
AA+	£5m 2 years	£10m 2 years	£10m 2 years	£5m 2 years	£5m 2 years
AA	£5m 2 years	£10m 2 years	£10m 2 years	£5m 2 years	£5m 2 years
AA-	£5m 2 years	£10m 2 years	£10m 2 years	£5m 2 years	£5m 2 years
A+	£5m 2 years	£10m 2 years	£5m 2 years	£5m 2 years	£5m 2 years
A	£5m 13 months	£10m 2 years	£5m 2 years	£5m 2 years	£5m 2 years
A-	£5m 6 months	£10m 13 months	£5m 2 years	£5m 13 months	£5m 2 years
BBB+	£2.5m 100 days	£5m 6 months	£2.5m 2 years	£2.5m 6 months	£2.5m 2 years
BBB	£2.5m overnight	£5.0m 100 days	Not applicable	Not applicable	Not applicable
None	£1m 6 months	Not applicable	£10m 25 years	Not applicable	Not applicable
Pooled funds	Not applicable				

This table must be read in conjunction with the notes below

**Credit rating:** Investment limits are set by reference to the lowest published long-term credit rating from Fitch, Moody's or Standard & Poor's. Where available, the credit rating relevant to the specific investment or class of investment is used, otherwise the counterparty credit rating is used. However, investment decisions are never made solely based on credit ratings, and all other relevant factors including external advice will be taken into account.

**Banks unsecured:** Accounts, deposits, certificates of deposit and senior unsecured bonds with banks and building societies, other than multilateral development banks. These investments are subject to the risk of credit loss via a bail-in should the regulator determine that the bank is failing or likely to fail. See below for arrangements relating to operational bank accounts.

**Banks secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and

means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the higher of the collateral credit rating and the counterparty credit rating will be used to determine cash and time limits. The combined secured and unsecured investments in any one bank will not exceed the cash limit for secured investments.

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

**Corporates:** Loans, bonds and commercial paper issued by companies other than banks and registered providers. These investments are not subject to bail-in, but are exposed to the risk of the company going insolvent. Loans to unrated companies will only be made either following an external credit assessment or to a maximum of £5,000,000 per company as part of a diversified pool in order to spread the risk widely.

**Registered providers:** Loans and bonds issued by, guaranteed by or secured on the assets of registered providers of social housing, formerly known as housing associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services, they retain the likelihood of receiving government support if needed.

**Pooled funds:** Shares in diversified investment vehicles consisting of the any of the above investment types, plus equity shares and property. These funds have the advantage of providing wide diversification of investment risks, coupled with the services of a professional fund manager in return for a fee. Short-term Money Market Funds that offer same-day liquidity and very low or no volatility will be used as an alternative to instant access bank accounts, while pooled funds whose value changes with market prices and/or have a notice period will be used for longer investment periods.

Bond, equity and property funds offer enhanced returns over the longer term, but are more volatile in the short term. These allow the Authority to diversify into asset classes other than cash without the need to own and manage the underlying investments. Because these funds have no defined maturity date, but are available for withdrawal after a notice period, their performance and continued suitability in meeting the Authority's investment objectives will be monitored regularly.

**Operational bank accounts:** The Authority may incur operational exposures, for example through current accounts, collection accounts and merchant acquiring services, to any UK bank with credit ratings no lower than BBB- and with assets greater than £25 billion. These are not classed as investments, but are still subject to the risk of a bank bail-in, and balances will therefore be kept below £5,000,000] per bank. The Bank of England has stated that in the event of failure, banks with assets greater than £25 billion are more likely to be bailed-in than made insolvent, increasing the chance of the Authority maintaining operational continuity.

**Risk assessment and credit ratings:** Credit ratings are obtained and monitored by the Authority's treasury advisers, who will notify changes in ratings as they occur. Where an entity has its credit rating downgraded so that it fails to meet the approved investment criteria then:

- no new investments will be made,
- any existing investments that can be recalled or sold at no cost will be, and
- full consideration will be given to the recall or sale of all other existing investments with the affected counterparty.

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

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

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

**Specified investments:** The WG Guidance defines specified investments as those:

- denominated in pound sterling,
- due to be repaid within 12 months of arrangement,
- not defined as capital expenditure by legislation, and
- invested with one of:
  - the UK Government,
  - a UK local authority, parish council or community council, or
  - a body or investment scheme of “high credit quality”.

The Authority defines “high credit quality” organisations and securities as those having a credit rating of [A-] or higher that are domiciled in the UK or a foreign country with a



sovereign rating of [AA+] or higher. For money market funds and other pooled funds “high credit quality” is defined as those having a credit rating of [A-] or higher.

**Non-specified investments:** Any investment not meeting the definition of a specified investment is classed as non-specified. The Authority does not intend to make any investments denominated in foreign currencies. Non-specified investments will therefore be limited to long-term investments, i.e. those that are due to mature 12 months or longer from the date of arrangement, Money Market Funds and other pooled funds that are defined as capital expenditure, and investments with bodies and schemes not meeting the definition on high credit quality. Limits on non-specified investments are shown in table 3 below.

Table 3: Non-specified investment limits

	<b>Cash limit</b>
Total long-term investments	£50m
Total invested in other pooled funds	£5m
Total investments without credit ratings or rated below [A-] (except the UK Government and UK local authorities)	£20m
Total non-specified investments	£50m

**Investment limits:** The Authority’s revenue reserves available to cover investment losses are forecast to be £6.5 million on 31st March 2018. The maximum that will be lent to any one organisation (other than the UK Government) will be £5million. A group of banks under the same ownership will be treated as a single organisation for limit purposes. Limits will also be placed on fund managers, investments in brokers’ nominee accounts, foreign countries and industry sectors as below. Investments in pooled funds and multilateral development banks do not count against the limit for any single foreign country, since the risk is diversified over many countries.

Table 4: Investment limits

	<b>Cash limit</b>
Any single organisation, except the UK Central Government	£10m each
UK Central Government	unlimited
Any group of organisations under the same ownership	£10m per group
Registered providers	£5m in total
Unsecured investments with building societies	£5m in total
Loans to unrated corporates	£5m in total

**Liquidity management:** The Authority uses purpose-built cash flow forecasting to determine the maximum period for which funds may prudently be committed. The forecast is compiled on a prudent basis to minimise the risk of the Authority being forced to borrow on

unfavourable terms to meet its financial commitments. Limits on long-term investments are set by reference to the Authority's medium term financial plan and cash flow forecast.

### **Non-Treasury Investments**

Although not classed as treasury management activities and therefore not covered by the CIPFA Code or the WG Guidance, the Authority may also purchase property for investment purposes and may also make loans and investments for service purposes, for example as loans to local businesses and landlords, or as equity investments and loans to the Authority's subsidiaries.

Such loans and investments will be subject to the Authority's normal approval processes for revenue and capital expenditure and need not comply with this treasury management strategy.

The Authority's existing non-treasury investments are listed in Appendix B.

### **Treasury Management Indicators**

The Authority measures and manages its exposures to treasury management risks using the following indicators.

**Interest rate exposures:** This indicator is set to control the Authority's exposure to interest rate risk. The upper limits on fixed and variable rate interest rate exposures, expressed as the proportion of interest payable will be:

	<b>2018/19</b>	<b>2019/20</b>	<b>2020/21</b>
Upper limit on fixed interest rate exposure	100%	100%	100%
Upper limit on variable interest rate exposure	50%	50%	50%

Fixed rate investments and borrowings are those where the rate of interest is fixed for at least 12 months, measured from the start of the financial year or the transaction date if later. All other instruments are classed as variable rate.

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

	<b>Upper</b>	<b>Lower</b>
Under 12 months	70%	0%
12 months and within 24 months	60%	0%
24 months and within 5 years	60%	0%
5 years and within 10 years	50%	0%
10 years and within 20 years	30%	0%
20 years and within 30 years	20%	0%
30 years and within 40 years	20%	0%
40 years and within 50 years	20%	0%

50 years and above	20%	0%
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Time periods start on the first day of each financial year. The maturity date of borrowing is the earliest date on which the lender can demand repayment.

**Principal sums invested for periods longer than 364 days:** The purpose of this indicator is to control the Authority's exposure to the risk of incurring losses by seeking early repayment of its investments. The limits on the long-term principal sum invested to final maturities beyond the period end will be:

	2018/19	2019/20	2020/21
Limit on principal invested beyond year end	£40m	£10m	£10m

### **Other Items**

There are a number of additional items that the Authority is obliged by CIPFA or WG to include in its Treasury Management Strategy.

**Policy on the use of financial derivatives:** In the absence of any explicit legal power to do so, the Authority will not use standalone financial derivatives (such as swaps, forwards, futures and options). Derivatives embedded into loans and investments, including pooled funds and forward starting transactions, may be used, and the risks that they present will be managed in line with the overall treasury risk management strategy.

**Investment training:** The needs of the Authority's treasury management staff for training in investment management are assessed every three months as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

Staff regularly attend training courses, seminars and conferences provided by Arlingclose and CIPFA. Relevant staff are also encouraged to study professional qualifications from CIPFA, the Association of Corporate Treasurers and other appropriate organisations.

**Investment advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues.

**Investment of money borrowed in advance of need:** The Authority may, from time to time, borrow in advance of need, where this is expected to provide the best long-term value for money. Since amounts borrowed will be invested until spent, the Authority is aware that it will be exposed to the risk of loss of the borrowed sums, and the risk that investment and borrowing interest rates may change in the intervening period. These risks will be managed as part of the Authority's overall management of its treasury risks.

The total amount borrowed will not exceed the authorised borrowing limit of £263 million. The maximum period between borrowing and expenditure is expected to be two years, although the Authority is not required to link particular loans with particular items of expenditure.

### **Financial Implications**

The budget for investment income in 2018/19 is £0.04 million. The budget for debt interest paid in 2018/19 is £9.1 million, based on an average debt portfolio of £150 million at an average interest rate of 4.5%. If actual levels of investments and borrowing, and actual interest rates differ from those forecast, performance against budget will be correspondingly different.

### **Other Options Considered**

The WG Guidance and the CIPFA Code do not prescribe any particular treasury management strategy for local authorities to adopt. The Chief Financial Officer believes that the above strategy represents an appropriate balance between risk management and cost effectiveness. Some alternative strategies, with their financial and risk management implications, are listed below.

<b>Alternative</b>	<b>Impact on income and expenditure</b>	<b>Impact on risk management</b>
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Lower chance of losses from credit related defaults, but any such losses may be greater
Invest in a wider range of counterparties and/or for longer times	Interest income will be higher	Increased risk of losses from credit related defaults, but any such losses may be smaller
Borrow additional sums at long-term fixed interest rates	Debt interest costs will rise; this is unlikely to be offset by higher investment income	Higher investment balance leading to a higher impact in the event of a default; however long-term interest costs may be more certain
Borrow short-term or variable loans instead of long-term fixed rates	Debt interest costs will initially be lower	Increases in debt interest costs will be broadly offset by rising investment income in the medium term, but long-term costs may be less certain
Reduce level of borrowing	Saving on debt interest is likely to exceed lost investment income	Reduced investment balance leading to a lower impact in the event of a default; however long-term interest costs may be less certain

## **Appendix A – Arlingclose Economic & Interest Rate Forecast November 2017**

### **Underlying assumptions:**

- In a 7-2 vote, the MPC increased Bank Rate in line with market expectations to 0.5%. Dovish accompanying rhetoric prompted investors to lower the expected future path for interest rates. The minutes re-emphasised that any prospective increases in Bank Rate would be expected to be at a gradual pace and to a limited extent.
- Further potential movement in Bank Rate is reliant on economic data and the likely outcome of the EU negotiations. Policymakers have downwardly assessed the supply capacity of the UK economy, suggesting inflationary growth is more likely. However, the MPC will be wary of raising rates much further amid low business and household confidence.
- The UK economy faces a challenging outlook as the minority government continues to negotiate the country's exit from the European Union. While recent economic data has improved, it has done so from a low base: UK Q3 2017 GDP growth was 0.4%, after a 0.3% expansion in Q2.
- Household consumption growth, the driver of recent UK GDP growth, has softened following a contraction in real wages, despite both saving rates and consumer credit volumes indicating that some households continue to spend in the absence of wage growth. Policymakers have expressed concern about the continued expansion of consumer credit; any action taken will further dampen household spending.
- Some data has held up better than expected, with unemployment continuing to decline and house prices remaining relatively resilient. However, both of these factors can also be seen in a negative light, displaying the structural lack of investment in the UK economy post financial crisis. Weaker long term growth may prompt deterioration in the UK's fiscal position.
- The depreciation in sterling may assist the economy to rebalance away from spending. Export volumes will increase, helped by a stronger Eurozone economic expansion.
- Near-term global growth prospects have continued to improve and broaden, and expectations of inflation are subdued. Central banks are moving to reduce the level of monetary stimulus.
- Geo-political risks remains elevated and helps to anchor safe-haven flows into the UK government bond (gilt) market.

### **Forecast:**

- The MPC has increased Bank Rate, largely to meet expectations they themselves created. Future expectations for higher short term interest rates are subdued. On-going decisions remain data dependant and negotiations on exiting the EU cast a shadow over monetary policy decisions.
- Our central case for Bank Rate is 0.5% over the medium term. The risks to the forecast are broadly balanced on both sides.



## Appendix B – Existing Investment & Debt Portfolio Position

	<b>31 December 2017 Actual Portfolio £'000</b>	<b>31 December 2017 Average Rate %</b>
<b>External borrowing:</b>		
Public Works Loan Board	70,488	4.47
Local authorities	10,500	0.41
LOBO loans from banks	30,000	4.33
Other loans	5,000	3.77
Stock Issue	40,000	8.88
<b>Total external borrowing</b>	<b>155,988</b>	<b>5.30</b>
<b>Other long-term liabilities:</b>		
Private Finance Initiative	47,300	
Finance Leases	87	
<b>Total other long-term liabilities</b>	<b>47,387</b>	
<b>Total gross external debt</b>	<b>203,375</b>	
<b>Treasury investments:</b>		
Banks & building societies (unsecured)	2,480	0.30
Government (incl. local authorities)	32,000	0.40
<b>Total treasury investments</b>	<b>34,480</b>	<b>0.40</b>
<b>Net debt</b>	<b>168,895</b>	

<b>Non-treasury investments:</b>		
Investment property	10,396	
Shares in subsidiaries	251	
<b>Total non-treasury investments</b>	<b>10,647</b>	
<b>Total investments</b>	<b>45,127</b>	

## Appendix C – Operational Investment Counterparties List

### COUNTERPARTY LIMITS FOR BANKING – UK INSTITUTIONS

	Unsecured Investments		Secured Investments	
<b>Counterparty - Banking UK Institutions</b>	<b>Maximum Counterparty Limit and Group Limit (if applicable)</b>	<b>Maximum Lending Period</b>	<b>Maximum Counterparty Limit and Group Limit (if applicable)</b>	<b>Maximum Lending Period</b>
Bank of Scotland	£5,000,000	13 Months	£10,000,000	2 years
Barclays Bank Plc.	£5,000,000	100 Days	£10,000,000	2 years
Close Brothers Ltd	£5,000,000	6 Months	£10,000,000	2 years
Goldman Sachs International Bank	£5,000,000	100 Days	£10,000,000	2 years
HSBC Bank Plc.	£5,000,000	13 Months	£10,000,000	2 years
Lloyds Bank Plc.	£5,000,000	13 Months	£10,000,000	2 years
National Westminster Bank Plc.	£2,500,000	35 Days	£10,000,000	2 years
Nationwide Building Society	£5,000,000	6 Months	£10,000,000	2 years
Royal Bank of Scotland	£2,500,000	35 Days	£10,000,000	2 years
Santander UK Plc. (Banco Santander Group)	£5,000,000	6 Months	£10,000,000	2 years
Standard Chartered Bank	Suspended		£10,000,000	2 years



## Appendix 9(2) - Prudential Indicators 2018/19

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

**Estimates of Capital Expenditure:** The Authority's planned capital expenditure and financing may be summarised as follows. Further detail will be provided in the capital programme report for the budget strategy.

<b>Capital Expenditure and Financing</b>	<b>2017/18 Revised</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
<b>Total Capital Expenditure</b>	<b>39.6</b>	<b>35.8</b>	<b>24.9</b>	<b>23.3</b>
Capital Receipts	7.7	3.1	0.0	0.0
Government Grants	14.7	7.6	13.6	13.3
Reserves	1.3	1.4	0.0	0.0
Revenue	1.9	0.1	0.2	0.1
Borrowing	13.8	23.6	10.9	9.9
Leasing and PFI	0.2	0.0	0.2	0.0
<b>Total Financing</b>	<b>39.6</b>	<b>35.8</b>	<b>24.9</b>	<b>23.3</b>

**Estimates of Capital Financing Requirement:** The Capital Financing Requirement (CFR) measures the Authority's underlying need to borrow for a capital purpose.

<b>Capital Financing Requirement</b>	<b>31.03.18 Revised</b>	<b>31.03.19 Estimate</b>	<b>31.03.20 Estimate</b>	<b>31.03.21 Estimate</b>
	<b>£m</b>	<b>£m</b>	<b>£m</b>	<b>£m</b>
General Fund CFR	281.8	298.0	300.8	302.0

The CFR is forecast to rise by £21m over the next three years as capital expenditure financed by debt is outweighed by resources put aside for debt repayment in those years, however this is mainly due to the expected capital loan of £12m, which will be repaid in 2022/23 this will reduce the CFR to close to current levels.

**Gross Debt and the Capital Financing Requirement:** In order to ensure that over the medium term debt will only be for a capital purpose, the Authority should ensure that debt

does not, except in the short term, exceed the total of capital financing requirement in the preceding year plus the estimates of any additional capital financing requirement for the current and next two financial years. This is a key indicator of prudence.

<b>Debt</b>	<b>31.03.18 Revised £m</b>	<b>31.03.19 Estimate £m</b>	<b>31.03.20 Estimate £m</b>	<b>31.03.21 Estimate £m</b>
Borrowing	156.0	176.9	185.9	190.9
Finance leases	0.1	0.1	0.0	0.0
PFI liabilities	45.1	43.1	42.3	41.3
<b>Total Debt</b>	<b>201.1</b>	<b>220.0</b>	<b>228.3</b>	<b>232.3</b>

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

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

<b>Operational Boundary</b>	<b>2017/18 Revised £m</b>	<b>2018/19 Estimate £m</b>	<b>2019/20 Estimate £m</b>	<b>2020/21 Estimate £m</b>
Borrowing	288	197	206	211
Other long-term liabilities	46	46	44	43
<b>Total Debt</b>	<b>334</b>	<b>243</b>	<b>250</b>	<b>254</b>

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

<b>Authorised Limit</b>	<b>2017/18 Limit £m</b>	<b>2018/19 Limit £m</b>	<b>2019/20 Limit £m</b>	<b>2020/21 Limit £m</b>
Borrowing	308	217	226	231
Other long-term liabilities	46	46	44	43
<b>Total Debt</b>	<b>354</b>	<b>263</b>	<b>270</b>	<b>274</b>

**Ratio of Financing Costs to Net Revenue Stream:** This is an indicator of affordability and highlights the revenue implications of existing and proposed capital expenditure by identifying the proportion of the revenue budget required to meet financing costs, net of investment income.

<b>Ratio of Financing Costs to Net Revenue Stream</b>	<b>2017/18 Revised</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
	<b>%</b>	<b>%</b>	<b>%</b>	<b>%</b>
General Fund	7.6%	7.6%	7.0%	7.1%

**Incremental Impact of Capital Investment Decisions:** This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax levels. The incremental impact is the difference between the total revenue budget requirement of the current approved capital programme and the revenue budget requirement arising from the capital programme proposed.

<b>Incremental Impact of Capital Investment Decisions</b>	<b>2018/19 Estimate</b>	<b>2019/20 Estimate</b>	<b>2020/21 Estimate</b>
	<b>£</b>	<b>£</b>	<b>£</b>
General Fund - increase in annual band D Council Tax	<b>2.33</b>	<b>-2.97</b>	<b>3.92</b>

**Adoption of the CIPFA Treasury Management Code:** The Authority adopted the Chartered Institute of Public Finance and Accountancy's *Treasury Management in the Public Services: Code of Practice 2011 Edition* in June 2009. It fully complies with the Codes recommendations.

## Appendix D – Annual Minimum Revenue Provision Statement 2018/19

Where the Authority finances capital expenditure by debt, it must put aside resources to repay that debt in later years. The amount charged to the revenue budget for the repayment of debt is known as Minimum Revenue Provision (MRP), although there has been no statutory minimum since 2008. The Local Government Act 2003 requires the Authority to have regard to the Welsh Government's *Guidance on Minimum Revenue Provision* (the WG Guidance) most recently issued in 2010.

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

The WG Guidance requires the Authority to approve an Annual MRP Statement each year, and recommends a number of options for calculating a prudent amount of MRP. The following statement incorporates options recommended in the Guidance.

For supported capital expenditure incurred after 31<sup>st</sup> March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in equal instalments. For unsupported capital expenditure incurred after 31<sup>st</sup> March 2008, MRP will be determined by charging the expenditure over the expected useful life of the relevant asset in on an annuity basis with an annual interest rate equal to the average relevant PWLB rate for the year of expenditure, starting in the year after the asset becomes operational.

For capital expenditure loans to third parties that are repaid over a short time period or more frequent instalments of principal, the Council will make nil MRP, but will instead apply the capital receipts arising from principal repayments to reduce the capital financing requirement instead.

Capital expenditure incurred during 2018/19 will not be subject to a MRP charge until 2019/20.

Based on the Authority's latest estimate of its Capital Financing Requirement on 31<sup>st</sup> March 2017, the budget for MRP has been set as follows:

	31.03.2018 Estimated CFR £m	2018/19 Estimated MRP £m
Supported capital expenditure	164	4
Unsupported capital expenditure	73	3
Finance leases and Private Finance Initiative	45	2
<b>Total General Fund</b>	<b>282</b>	<b>9</b>