Report

Audit Committee

Part 1

Date: 26th January 2017

Item No: Insert item number here

Subject **Treasury Management Strategy 2017/18**

Purpose This report considers the Council's 2017/18

- Treasury Management Strategy,
- Prudential Indicators,
- Investment Strategy; and
- Minimum Revenue Provision (MRP) policy

The Prudential Code requires these items to be reviewed and considered by the Audit Committee prior to their approval by full Council.

Author Assistant Head of Finance

Ward General

Summary Both the Prudential Code and the Welsh Government require the Audit Committee to have reviewed and considered the Council's Treasury Management Strategy and Prudential Indicators before they are approved by full Council.

The overarching recommended Treasury Strategy is unchanged from our current strategy, which, in summary:
- Limit the need to actually borrow cash by using the positive cash-flow the Council has to fund capital expenditure funded from borrowing, wherever possible
- Borrow and invest in the short-term to manage the shorter term cash-flow requirements of the Council.

In practice, the overarching strategy above limits the activities of long term borrowing and investments

The strategies within this report set the Council's approved borrowing and investment limits, based on planned capital spending. This report has been prepared in line with the Council's draft Medium Term Financial Plan, and will be presented to full Council as part of the overall budget report for approval in March 2017.

During 2016/17 the Council has repaid to date approximately £4million of borrowing, mainly relating to activities related to the Friars Walk Development, which are being kept on short-term periods and reviewed regularly – and therefore this does not represent any formal repayment but rather the management of the Council's cash-flow and limiting the external borrowing taken out at any point in time . New temporary borrowing of approximately £20 million is anticipated to be required before the end of the 2016/17 financial year.

In December 2013 the Council approved a loan of up to £89.1million to Queensbury Real Estates (Newport) Ltd (QRE) to fund the building of the Friars Walk Development. The Council's own borrowing to make the onward loan is kept separate from the Council's other borrowing requirements and is incurred, as needed, up to a maximum of £89.1million. Whilst kept separate, the actual borrowing is affected by the Council's overall cash-flow management. As previously reported, the loan is required to be paid off during 2016/17 via a capital receipt, which is likely to require surplus cash to be invested over a short period of time, before the Council's own loans for this purpose can be redeemed. If a sale is not successful, the Council will need to re-finance the scheme, which would require the current borrowing which is maturing up to the end of July 2017 to be re-financed.

Included within the report is a paragraph on the 'City Deal' project. While no formal decision has been made at this stage, any agreement to enter into the 'City Deal' would have a significant impact on capital expenditure and the minimum revenue provision. Figures for this have not been included in this report, and a further report would need to be brought to Committee when a decision has been made on the scheme.

Proposal

To recommend to Cabinet for approval the Prudential Indicators, Minimum Revenue Provision Policy, the Treasury Management Strategy and the Annual Investment Strategy as detailed in the report.

To note the potential change in calculation method of MRP policy from equal instalment method to annuity method.

Action by

Head of Finance – prepare budget papers for Cabinet in line with recommendations from this Committee

Timetable

Immediate

This report was prepared after consultation with:

- The Council's Treasury Advisors
- Accountancy Staff
- Heads of Law and Standards and HR/Policy

Signed

Background

Background

1. The Council is involved in two types of treasury activity:

   - Borrowing long-term for capital purposes and short term for temporary cash flow
   - Investment of surplus cash

   Within this, the overarching strategy is

   - Limit the need to actually borrow cash by using the positive cash-flow the Council has to fund capital expenditure funded from borrowing, wherever possible

   Borrow and invest in the short-term to manage the shorter term cash-flow requirements of the Council.

2. The borrowing and investment activities are controlled primarily via the Council's Treasury Management Strategy and various measures and limits set via its Prudential Indicators to regulate/control the implementation of that strategy.

3. CIPFA requires local authorities to determine their Treasury Management Strategy Statement (TMSS) and Prudential Indicators (PIs) on an annual basis. This requires approval by full Council following a recommendation from the Cabinet. The TMSS also includes the Annual Investment Strategy (AIS) that is a requirement of the Welsh Government's (WG's) Investment Guidance.

4. Our detailed Treasury strategies for 2017/18 are included at Appendix 1. In addition, planned strategies to 2020/21 are also included, in line with the Council's 5 year Medium Term Plan. Key points of interest are summarised below.

Treasury Management Strategy

5. The Council's overall Treasury Management Strategy takes into account the current outstanding borrowing that is has due to capital expenditure incurred in the past and links this into the future expectations for the Council around future capital expenditure to be incurred and future cash flows. As noted, the plan aims to limit new l/t borrowing, wherever possible by using internal cash resources.

6. This Treasury Management Strategy highlights that the Council has an inherent need to borrow and therefore the borrowing strategy discussed below is an important part of the overall Treasury Management Strategy.

7. Due to the revenue implications of undertaking capital expenditure and the need to charge a Minimum Revenue Provision (MRP) for capital expenditure funded by borrowing, the strategy of the Council, is where possible, to limit increases in the capital expenditure financing costs in the Medium Term Financial Plan. 2017/18 is the final year of our current capital programme and work is continuing over the next few months to complete the next four year programme. The prudential indicators for these are shown in the appendix to this report.

8. In summary the Council does not envisage taking out further long-term borrowing over the short-term, but in conjunction with advice from our Treasury Advisors, there will become a point where current borrowing will need to be re-financed, and a decision will need to be taken as to the appropriate timing of that borrowing. There are a lot of uncertainties on the level of borrowing or investment that will be required and this is dependent on the outcome of re-payment of any loans in relation to the Queensberry development.

Borrowing Strategy

9. The Council has significant long term borrowing requirements but in recent years, the strategy has been able to fund its capital expenditure from reducing investments rather than undertaking more expensive new borrowing i.e. using ‘surplus cash’. This is because the rates achievable on the Council’s investments are lower than the rates that would be payable on long-term borrowing and therefore this strategy is more cost effective.

10. In terms of the revenue budget, the Council must ensure it sets aside sums to repay capital expenditure funded from borrowing (irrespective of whether the borrowing itself is undertaken externally or through dis-investing). This is done via the ‘Minimum Revenue Provision’ (MRP). In addition, a budget is also needed to fund actual interest payable on loans taken out, which are based on predictions of actual external borrowing. Both are discrete budget lines in the Council’s overall revenue budget.

11. 2017/18 is the final year of the current four-year programme, and work has commenced on providing figures for the future programme from 2018/19 to 2021/22. Further work on this will be carried out on over the next 6-12 months to determine the priority schemes that will be emerging. . Appendix D shows the estimated capital expenditure for the Council over the medium term.

12. There are currently on-going discussions on the Council’s involvement in the ‘City Deal’ project which would involve the Council signing up to a significant capital investment over the next 20 years. There is still a significant amount of work required to finalise the full financial implications of the project, and an update will be brought to the committee on the treasury management impact of any approval to proceed with the scheme in the future. The figures for City Deal have not been included in any estimates on capital expenditure or CFR in Appendix D, but the borrowing limits for 2017/18 are deemed sufficient if and when the Council signs up to the scheme.

13. Local Authorities measure their underlying need for long-term borrowing through their ‘Capital Financing Requirement’ (CFR). This takes into account the amount of capital expenditure that needs to be funded through borrowing, (as opposed to external funding - from cash grants, capital receipts or S106 contributions for example) irrespective of whether the borrowing itself is undertaken externally or through dis-investing.

14. In addition to normal planned capital expenditure, in December 2013 the Council approved a loan of up to £89.1million to Queensbury Real Estates (Newport) Ltd (QRE) to fund the building of the Friars Walk Development. The Council’s own borrowings to make the onward loan are kept separate from the Council’s other borrowing requirements as these loans are relatively short term given the loan is to be paid off via a capital receipt upon sale of the development or re-financed if a sale does not conclude. Following any sale, the Council’s own borrowings for this will then be redeemed as soon as is possible. On this basis, the Council will not be required to make MRP charges to the revenue budget in relation to the Friars Walk Development loan as the borrowing will be paid off in full at the end of the scheme via the repayment of the loan by QRE (Newport) Ltd. Loans in relation to the Friars Walk development have been taken at various stages throughout the scheme, therefore have variable dates in which the loans are redeemable. £40 million of loans are redeemable in July 2017, with the balance being taken over shorter terms, currently up to the end of January 2017. This would mean if the loan by QRE (Newport) Ltd is repaid before July 2017, for a short period, the Council will have surplus funds to invest, unless we are able to redeem early at nil or minimal cost.

15. The table below shows the estimated Capital Financing Requirement / New Net Borrowing Requirement position for Newport City Council for 2016/17 to 2019/20:

Table 1: Newport City Council – CFR

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m
CFR	230.5	233.8	238.1	241.7	243.1
Less: External borrowing *	-223.3	-187.7	-146.3	-144.9	-103.4
Internal (over) borrowing	**7.2**	**46.1**	**91.8**	**96.8**	**139.7**
Less: Usable reserves	-101.3	-92.3	-89.4	-86.7	-83.8
Less: Working capital	90.7	7.7	7.7	7.7	7.7
Investments / (New Borrowing)	**3.4**	**38.5**	**-10.1**	**-17.8**	**-63.6**
Net Borrowing Requirement	**219.9**	**149.2**	**156.4**	**162.7**	**167.0**

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

16. As the table shows, the inherent 'need to borrow' as shown by the CFR is predicted to be £64 million. The significant reduction in the CFR between 2015/16 and 2016/17, and again to 2017/18 is due to the anticipated repayment of the loan in relation to the Friars Walk development. This borrowing would need to be refinanced if the sale did not proceed.

17. Given **current** borrowing levels no additional long term borrowing is likely to be required during 2017/18. However, the Authority will be required to be flexible to borrow up to the Authorised Limit, as there will be uncertainty over the timing of the repayment of the outstanding loan in relation to Queensberry.

18. The Authority will adopt a flexible approach to any borrowing necessary in consultation with its treasury management advisers, Arlingclose Ltd. The following issues will be considered prior to undertaking any external borrowing:

- Affordability
- Maturity profile of existing debt
- Interest rate and refinancing risk
- Borrowing source

Investment Strategy

19. The Authority holds minimal invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £0m and £25 million. In 2017/18, the investment balances could increase significantly dependent on the timing of the repayment of loans in relation to Queensberry, where a substantial receipt may be achieved in advance of borrowing required to be repaid.

20. **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.

21. Given the increasing risk and continued low returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding classes during 2017/18. This is especially the case for any surplus funds available for investment following the repayment of the Queensberry loan, before it is used to repay its own loans for this purpose.

22. **Approved Counterparties:** Whilst investment funds remain available and based on the treasury management advice from Arlingclose; 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 will invest in the following areas:

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				

23. Investment decisions are made 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. Whilst the credit ratings score drives the approved listing, the day-to-day operational counterparties are generally limited to named counterparty listing as documented in Appendix C. However, where it is prudent to do so the Authority may also use other approved investments based on the approved credit ratings as documented in the table above.

24. A more detailed explanation of the different approved counterparty types are included in Appendix 1 but for the sake of clarity, the Council's investment strategy will, as per the Welsh Governments Investment Guidance, give priority to security and liquidity and will aim to achieve a yield commensurate with these principles.

Minimum Revenue Provision (MRP) Policy

25. We are currently undertaking a review of how we charge MRP in relation to unsupported borrowing. Appendix E shows the MRP Policy, and there will be no change to this policy, however we, as with the majority of local authorities, use option 3 the asset life method as a basis to charge MRP on unsupported borrowing.

26. Currently this is charge through equal instalments over the life of an asset on a straight line basis. We are currently undertaking a review to move from this method, to using the annuity method. The annuity method still has asset life as its main basis, but takes into account the time value of money. Therefore the charge in year one will be less than the charge in say 25 years time, increasing year on year.

27. This method is prudent as it still keeps asset life as its main basis, and therefore the repayment will be the same over the life of the asset in both the equal instalment and annuity methods.

28. We will be liaising with our auditors to get assurance that our application of the method is correct and will look to implement in the near future. As previously highlighted, this is not a change to the MRP policy, it is a change to a method of calculation, therefore is to be noted by Audit Committee.

Prudential Indicators

29. The Council must establish certain ‘checks’ required by CIPFA to ensure that its Treasury Management Strategy is operating effectively. These are known as Prudential Indicators, and they will be reported to the Council on a 6 monthly basis.

30. Examples of our key indicators are noted below; again more detail is supplied at Appendix 1

Net Borrowing/Capital Financing Requirement
The Council’s net borrowing should not exceed its Capital Financing Requirements as outlined earlier. This ensures that borrowing is only used to finance capital over the long term. The Council does not note any difficulty in meeting this requirement.

Financing Costs to Net Revenue Stream
This ratio shows how much of the Council’s total revenue budget is used for capital financing costs, as a percentage. The ratio for 2017/18 is 8.4%.

31. We recommend that the Audit Committee scrutinise the 2017/18 Treasury Management Strategy and Prudential Indicators detailed in Appendix 1 and recommend to Cabinet for approval.

Risks

Risk	Impact of Risk if it occurs* (H/M/L)	Probability of risk occurring (H/M/L)	What is the Council doing or what has it done to avoid the risk or reduce its effect	Who is responsible for dealing with the risk?
Investment counterparty not repaying investments	High but depending on investment value	Low	The Council only invests with Institutions with very high credit scores. It employs advisors to monitor money market movements and changes to credit scores and acts immediately should things change adversely. The lower levels of funds/duration available for relatively higher risk investment as measured by ‘credit ratings’ will also alleviate the risk.	Members, Head of Finance, Treasury staff, based on advice from treasury advisors

Interest Rates moving adversely against expectations	Low	Low	Base and short-term Interest rates are expected to remain at current levels until the second half of 2016. The Treasury strategy approved allows for the use of short term borrowing once investment funds are exhausted to take advantage of these low rates.	Head of Finance, Treasury staff, treasury advisors

* Taking account of proposed mitigation measures

Links to Council Policies and Priorities

It is the Council's policy to ensure that the security of the capital sums invested is fully recognised and has absolute priority. The Council follows the advice of the Welsh Assembly Government that any investment decisions take account of security, liquidity and yield in that order.

Options Available and considered

The Prudential Code and statute requires that, during and at the end of each financial year, reports on these matters are presented to Cabinet/Council for approval. Best practice is for the reports to be scrutinised by the Audit committee prior to Council approval. Thus the only option available is to consider this report and provide comments prior to Council approval.

Preferred Option and Why

The preferred choice is to receive and scrutinise the contents of the report and provide feedback and comments prior to Council approval.

Comments of Chief Financial Officer

The treasury management strategy and the treasury management and prudential indicators included within this report are an important aspect of setting a prudent financial landscape for the Council. This includes ensuring a prudent and affordable capital programme, with a sight on the level of borrowing and risks associated with this.

Within the ever reducing medium term financial landscape this is as important as ever, and the on-going revenue impact of capital decisions needs to be at the forefront of any decisions that are made.

Comments of Monitoring Officer

There are no legal implications. The in year and annual treasury management report is consistent with relevant Chartered Institute of Public Finance and Accountancy Guidance, Treasury Management principles and the Council's Investment Strategy.

Comments of Head of People and Business Change

There are no human resources implications within the report

Comments of Cabinet Member

N/A

Local issues

N/A

Scrutiny Committees
N/A

Equalities Impact Assessment and the Equalities Act 2010
The Equality Act 2010 contains a Public Sector Equality Duty which came into force on 06 April 2011. The Act identifies a number of 'protected characteristics', namely age; disability; gender reassignment; pregnancy and maternity; race; religion or belief; sex; sexual orientation; marriage and civil partnership. The new single duty aims to integrate consideration of equality and good relations into the regular business of public authorities. Compliance with the duty is a legal obligation and is intended to result in better informed decision-making and policy development and services that are more effective for users. In exercising its functions, the Council must have due regard to the need to: eliminate unlawful discrimination, harassment, victimisation and other conduct that is prohibited by the Act; advance equality of opportunity between persons who share a protected characteristic and those who do not; and foster good relations between persons who share a protected characteristic and those who do not. The Act is not overly prescriptive about the approach a public authority should take to ensure due regard, although it does set out that due regard to advancing equality involves: removing or minimising disadvantages suffered by people due to their protected characteristics; taking steps to meet the needs of people from protected groups where these differ from the need of other people; and encouraging people from protected groups to participate in public life or in other activities where their participation is disproportionately low.

Children and Families (Wales) Measure
N/A.

Wellbeing of Future Generations (Wales) Act 2015
The Wellbeing of Future Generations (Wales) Act 2015 is taken into account when looking at the long-term impact of treasury management and capital decisions. The Council has a prudent Minimum Revenue Provision Policy and abides by the treasury management and prudential indicators detailed in the report.

Crime and Disorder Act 1998
Section 17(1) of the Crime and Disorder Act 1998 imposes a duty on the Local Authority to exercise its various functions with due regard to the likely effect of the exercise of those functions on, and the need to do all that it reasonably can to prevent, crime and disorder in its area.

Consultation
N/A

Background Papers
Report on Treasury Management for the period to 30 September 2016 – Audit Committee 01/12/2016

Dated:

Appendix 1

Prudential Code Indicators, Minimum Revenue Policy, Treasury Management and Investment Strategy Statements 2017/18

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.

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 borrows/invests 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, or 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 2017/18 will be the UK's progress in negotiating a smooth exit from the European Union. Financial markets, wrong-footed by the referendum outcome, have since been weighed down by uncertainty over whether leaving the Union also means leaving the single market. Negotiations are expected to start once the UK formally triggers exit in early 2017 and last for at least two years. Uncertainty over future economic prospects will therefore remain throughout 2017/18.

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

Initial post-referendum economic data showed that the feared collapse in business and consumer confidence had not immediately led to lower GDP growth. However, the prospect of a leaving the single market has dented business confidence and resulted in a delay in new business investment and, unless counteracted by higher public spending or retail sales, will weaken economic growth in 2017/18.

Looking overseas, with the US economy and its labour market showing steady improvement, the market has priced in a high probability of the Federal Reserve increasing interest rates in December 2016. The Eurozone meanwhile has continued to struggle with very low inflation and lack of momentum in growth, and the European Central Bank has left the door open for further quantitative easing.

The impact of political risk on financial markets remains significant over the next year. With challenges such as immigration, the rise of populist, anti-establishment parties and negative interest rates resulting in savers being paid nothing for their frugal efforts or even penalised for them, the outcomes of Italy's referendum on its constitution (December 2016), the French presidential and general elections (April – June 2017) and the German federal elections (August – October 2017) have the potential for upsets.

Credit outlook:

Markets have expressed concern over the financial viability of a number of European banks recently. Sluggish economies and continuing fines for pre-crisis behaviour have weighed on bank profits, and any future slowdown will exacerbate concerns in this regard.

Bail-in legislation, which ensures that large investors including local authorities will rescue failing banks instead of taxpayers in the future, has now been fully implemented in the European Union, Switzerland and USA, while Australia and Canada are progressing with their own plans. The credit risk associated with making unsecured bank deposits has therefore increased relative to the risk of other investment options available to the Authority; returns from cash deposits however continue to fall.

Interest rate forecast:

The Authority's treasury adviser Arlingclose's central case is for UK Bank Rate to remain at 0.25% during 2017/18**.** The Bank of England has, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further falls in the Bank Rate look less likely. Negative Bank Rate is currently perceived by some policymakers to be counterproductive but, although a low probability, cannot be entirely ruled out in the medium term, particularly if the UK enters recession as a result of concerns over leaving the European Union.

Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50. Long-term economic fundamentals remain weak, and the quantitative easing (QE) stimulus provided by central banks globally has only delayed the fallout from the build-up of public and private sector debt. The Bank of England has defended QE as a monetary policy tool, and further QE in support of the UK economy in 2017/18 remains a possibility, to keep long-term interest rates low.

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

Local Context

On 31 December 2016, the Authority held £215.9 million of borrowing and £8.2 million 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

	31.3.16 Actual £m	31.3.17 Estimate £m	31.3.18 Estimate £m	31.3.19 Estimate £m	31.3.20 Estimate £m
CFR	230.5	233.8	238.1	241.7	243.1
Less: External borrowing *	-223.3	-187.7	-146.3	-144.9	-103.4
Internal (over) borrowing	**7.2**	**46.1**	**91.8**	**96.8**	**139.7**
Less: Usable reserves	-101.3	-92.3	-89.4	-86.7	-83.8
Less: Working capital	90.7	7.7	7.7	7.7	7.7
Investments / (New Borrowing)	**3.4**	**38.5**	**-10.1**	**-17.8**	**-63.6**

Net Borrowing Requirement	**219.9**	**149.2**	**156.4**	**162.7**	**167.0**

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

Capital Financing Requirement

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 during 2015/16 due to the capital programme and the on-going loan to Queensbury Real Estates (Newport) Ltd, but holds minimal investments and will therefore be required to borrow up to £50m during 2015/16. However, during 2016/17 the sale of the development will reduce the CFR significantly and dependent on timing of loan re-payments and capital receipts, significant investments are likely to be required over the forecast period.

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 2017/18.

Borrowing Strategy

The Authority currently holds £215.9 million of loans as part of its strategy for funding previous years' capital programmes. The balance sheet forecast in table 1 shows that the Authority does not expect to need to borrow in 2017/18, but this is dependent on the outcome of the repayment or refinancing of the Queensberry loan. The Authority may however borrow to pre-fund future years' requirements, providing this does not exceed the recommended authorised limit for borrowing of £354 million.

The Authority's chief objective when borrowing money is to strike an appropriately low risk balance between securing low interest costs and achieving cost certainty 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.

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 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 2016/17 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 2016/17, 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 (normally for up to one month) to cover unexpected cash flow shortages.

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

- Public Works Loan Board and any successor body
- UK local authorities
- any institution approved for investments (see below)

- any other bank or building society authorised by the Prudential Regulation Authority to operate in the UK
- UK public and private sector pension funds
- capital market bond investors
- Special purpose companies created to enable joint local authority bond issues.

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

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

The Authority has previously raised the majority of its long-term borrowing from the Public Works Loan Board, 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.

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 automatic option to either accept the new rate or to repay the loan at no additional cost. £25m of these LOBOS have options during 2017/18, and although the Authority understands that lenders are extremely unlikely to exercise their options in the current low interest rate environment, there remains a remote 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.

Short-term and variable rate 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. Some bank 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 saving or reduction in risk.

Investment Strategy

The Authority holds invested funds, representing income received in advance of expenditure plus balances and reserves held. In the past 12 months, the Authority's investment balance has ranged between £0 million and £25 million. In 2017/18, the investment balances could, for a short period, increase significantly dependent on the timing of the repayment of loans in relation to Queensberry, where a substantial receipt may be achieved in advance of borrowing required to be repaid. As per the strategy, balances could first be used to reduce levels of borrowing required before the Authority invests funds, this is in relation to long term loans which become redeemable.

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 receiving unsuitably low investment income. Where balances are expected to be invested for more than a 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 sums invested.

Given the increasing risk and falling returns from short-term unsecured bank investments, the Authority aims to diversify into more secure and/or higher yielding classes during 2017/18. This is especially the case for any surplus funds available for investment following the repayment of the Queensberry loan.

- **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 level 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 designated 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.

- **Banks Secured:** Covered bonds, reverse repurchase agreements and other collateralised arrangements with banks and designated building societies. These investments are secured on the bank's assets, which limits the potential losses in the unlikely event of insolvency, and means that they are exempt from bail-in. Where there is no investment specific credit rating, but the collateral upon which the investment is secured has a credit rating, the highest of the collateral credit rating and the counterparty credit rating will be *u*sed 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 UK government, regional and local authorities. These investments are not subject to bail-in, and there is an insignificant risk of insolvency. Investments with the UK Government may be made in unlimited amounts for up to 50 years.

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

- **Registered Providers:** Loans and bonds issued by, guaranteed by or secured on the assets of Registered Providers of Social Housing, formerly known as Housing Associations. These bodies are tightly regulated by the Homes and Communities Agency and, as providers of public services they retain the likelihood of receiving government support if needed. The Authority will consider investing with unrated Registered Providers with adequate credit safeguards, subject to receiving independent advice.

- **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.

- **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 the Treasury advisor provides advice relating to a specific named counterparty then the Authority will act upon that advice relating to the duration of exposure and amount. 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; those that are defined as capital expenditure by legislation, such as shares in money market funds and other pooled fund; and investments with bodies and schemes not meeting the definition on high credit quality. Appendix C sets out the investment limits/ maximum maturity periods for Non-specified investments.

- **Approved Instruments:** The Authority may lend or invest money using any of the following instruments:
  - interest-bearing bank accounts,
  - fixed term deposits and loans,
  - callable deposits and loans where the Authority may demand repayment at any time (with or without notice),
  - certificates of deposit,
  - bonds, notes, bills, commercial paper and other marketable instruments, and
  - shares in money market funds and other pooled funds.

- Investments may be made at either a fixed rate of interest, or at a variable rate linked to a market interest rate, such as LIBOR, subject to the limits on interest rate exposures below.

- **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, with receipts under-estimated and payments over-estimated 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.

Monitoring & reporting on the Treasury Management and capital Prudential Indicators

The Head of Finance will report to the Audit committee/ Cabinet/ Council on treasury management activity, performance and Treasury/Capital Prudential Indicators (set out in Appendix D) as follows:

- Half Yearly and then annually against the strategy approved for the year. The annual report will be produced normally by July of the following year but in any event no later than 30th September.
- The Audit Committee will be responsible for the scrutiny of treasury management activity and practices.

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 Use of Financial Derivatives:** In the absence of any 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 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 annually as part of the staff appraisal process, and additionally when the responsibilities of individual members of staff change.

  Staff members regularly attend training courses, seminars and conferences provided by Arlingclose and other organisations.

- **Investment Advisers:** The Authority has appointed Arlingclose Limited as treasury management advisers and receives specific advice on investment, debt and capital finance issues. The service provided by Arlingclose continues to meet all expectations and the advice given especially in relation to investment counterparties and credit ratings has allowed the Council to action the changes needed, especially in removing counterparties from the approved list, in a prompt and timely manner.

Financial Implications

- The approximate debt interest of £8.6 million and principal of £1.3 million is expected to be paid in 2017/18. In addition to this, principal of c£69m in relation to Queensberry loans (as detailed in Appendix B) will be paid or re-financed in 2017/18 depending on the status of the sale. If actual levels of investments and borrowing 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 Head of Finance 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.

Alternative	Impact on income and expenditure	Impact on risk management
Invest in a narrower range of counterparties and/or for shorter times	Interest income will be lower	Reduced risk of losses from credit related defaults, but any such losses will 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 will 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 will 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 will 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 will be less certain

Appendix A – Arlingclose Economic & Interest Rate Forecast November 2016

Underlying assumptions:

- The medium term outlook for the UK economy is dominated by the negotiations to leave the EU. The long-term position of the UK economy will be largely dependent on the agreements the government is able to secure with the EU and other countries.

- The global environment is also riddled with uncertainty, with repercussions for financial market volatility and long-term interest rates. Donald Trump's victory in the US general election and Brexit are symptomatic of the popular disaffection with globalisation trends. The potential rise in protectionism could dampen global growth prospects and therefore inflation. Financial market volatility will remain the norm for some time.

- However, following significant global fiscal and monetary stimulus, the short term outlook for the global economy is somewhat brighter than earlier in the year. US fiscal stimulus is also a possibility following Trump's victory.

- Recent data present a more positive picture for the post-Referendum UK economy than predicted due to continued strong household spending.

- Over the medium term, economic and political uncertainty will likely dampen investment intentions and tighten credit availability, prompting lower activity levels and potentially a rise in unemployment.

- The currency-led rise in CPI inflation (currently 1.0% year/year) will continue, breaching the target in 2017, which will act to slow real growth in household spending due to a sharp decline in real wage growth.

- The depreciation in sterling will, however, assist the economy to rebalance away from spending. The negative contribution from net trade to GDP growth is likely to diminish, largely due to weaker domestic demand. Export volumes will increase marginally.

- Given the pressure on household spending and business investment, the rise in inflation is highly unlikely to prompt monetary tightening by the Bank of England, with policymakers looking through import-led CPI spikes to the negative effects of Brexit on economic activity and, ultimately, inflation.

- Bank of England policymakers have, however, highlighted that excessive levels of inflation will not be tolerated for sustained periods. Given this view and the current inflation outlook, further monetary loosening looks less likely

Forecast:

- Globally, the outlook is uncertain and risks remain weighted to the downside. The UK domestic outlook is uncertain, but likely to be weaker in the short term than previously expected.

- The likely path for Bank Rate is weighted to the downside. The Arlingclose central case is for Bank Rate to remain at 0.25%, but there is a 25% possibility of a drop to close to zero, with a very small chance of a reduction below zero.

- Gilt yields have risen sharply, but remain at low levels. The Arlingclose central case is for yields to decline when the government triggers Article 50.

	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	Average
Official Bank Rate														
Upside risk	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.25	0.25	0.25	0.25	0.25	0.25	**0.12**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**	**0.25**
Downside risk	0.25	0.25	0.25	0.25	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.40**
3-month LIBID rate														
Upside risk	0.05	0.05	0.10	0.10	0.10	0.15	0.25	0.25	0.25	0.25	0.25	0.25	0.25	**0.18**
Arlingclose Central Case	**0.25**	**0.25**	**0.25**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.30**	**0.29**
Downside risk	0.20	0.25	0.25	0.25	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.34**
1-yr LIBID rate														
Upside risk	0.10	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.23**
Arlingclose Central Case	**0.60**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.50**	**0.60**	**0.70**	**0.85**	**0.90**	**0.90**	**0.90**	**0.65**
Downside risk	0.10	0.15	0.15	0.15	0.20	0.30	0.30	0.30	0.30	0.30	0.30	0.30	0.30	**0.24**
5-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**0.50**	**0.40**	**0.35**	**0.35**	**0.35**	**0.40**	**0.40**	**0.40**	**0.45**	**0.50**	**0.55**	**0.60**	**0.65**	**0.45**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
10-yr gilt yield														
Upside risk	0.30	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.15**	**0.95**	**0.85**	**0.85**	**0.85**	**0.85**	**0.85**	**0.90**	**0.95**	**1.00**	**1.05**	**1.10**	**1.15**	**0.96**
Downside risk	0.30	0.45	0.45	0.45	0.45	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	**0.47**
20-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.70**	**1.50**	**1.40**	**1.40**	**1.40**	**1.40**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.65**	**1.70**	**1.75**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**
50-yr gilt yield														
Upside risk	0.25	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	0.40	**0.39**
Arlingclose Central Case	**1.60**	**1.40**	**1.30**	**1.30**	**1.30**	**1.30**	**1.30**	**1.35**	**1.40**	**1.45**	**1.50**	**1.55**	**1.60**	**1.41**
Downside risk	0.40	0.55	0.55	0.55	0.55	0.60	0.60	0.60	0.60	0.60	0.60	0.60	0.60	**0.57**

Appendix B – Existing Investment & Debt Portfolio Position

	31/12/16 Actual Portfolio £m
External Borrowing:	
PWLB – Fixed Rate	71.79
Market Loans	35.00
Stock Issue	40.00
Temporary loans - Queensberry	69.08
Other Soft Loans	0.00
Total External Borrowing	**215.87**
Other Long Term Liabilities:	
PFI	49.51
Finance Leases and other	0.13
Total Gross External Debt	**265.51**
Investments:	
Short-term investments	8.20
Long-term investments	0.00
Total Investments	**8.20**
Net Debt	**257.31**

Appendix C – Operational Investment Counterparties List

COUNTERPARTY LIMITS FOR BANKING – UK INSTITUTIONS

	Unsecured Investments		Secured Investments	
Counterparty - Banking UK Institutions	**Maximum Counterparty Limit and Group Limit (if applicable)**	**Maximum Lending Period**	**Maximum Counterparty Limit and Group Limit (if applicable)**	**Maximum Lending Period**
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	£10,000,0000	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

*** based on advice from Arlingclose**

Appendix D

Prudential Indicators 2017/18 – 2019/20

1. **Background:**
   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.

2. **Gross Borrowing and the Capital Financing Requirement:**
   This is a key indicator of prudence. In order to ensure that over the medium term net borrowing will only be for a capital purpose, the local authority should ensure that the net external borrowing does not, except in the short term, exceed the total of the capital financing requirement in the preceding year plus the estimates of any additional increases to the capital financing requirement for the current and next two financial years.

   If in any of these years there is a reduction in the capital financing requirement, this reduction is ignored in estimating the cumulative increase in the capital financing requirement, which is used for comparison with gross external debt.

   The Head of Finance reports that the authority will have no difficulty meeting this requirement in 2017/18, nor are there any difficulties envisaged for future years. This view takes into account current commitments, existing plans and the proposals in the approved budget.

3. **Estimates of Capital Expenditure:**

3.1 This indicator is set to ensure that the level of proposed capital expenditure remains within sustainable limits and, in particular, to consider the impact on Council Tax.

Capital Expenditure	***2016/17 Estimate £m***	***2017/18 Estimate £m***	**2018/19 Estimate* £m**	**2019/20 Estimate* £m**	**2020/21 Estimate* £m**
Total	***37.3***	***33.1***	***12.9***	**12.0**	**11.9**

* *The Capital Programme for 2018/19 to 2021/22 is currently being assessed and compiled. The estimated capital expenditure included in the figures above, give an indication of the level of capital expenditure that could be allowed in the financial year which will keep the revenue costs within the current MRP headroom. The estimated capital expenditure does not currently include, as shown in the table 3.2 below, any estimates for specific grants (which could be significant) or any revenue contributions, which would have no impact on the CFR or borrowing.*

3.2 Capital expenditure will be financed or funded as follows:

Capital Financing	***2016/17 Estimate £m***	***2017/18 Estimate £m***	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Capital receipts	3.0	7.3	0.0	0.7	0.6
Government Grants	2.5	2.5	2.2	2.0	2.0
Other Specific Grants	16.1	12.7	0.0	0.0	0.0
S106 Contributions	2.6	0.1	0.0	0.0	0.0
Revenue contributions	1.8	0.0	0.0	0.0	0.0
Total Financing	**26.0**	**22.6**	**2.2**	**2.7**	**2.6**
Supported borrowing	4.1	4.0	4.0	3.2	3.2

Unsupported borrowing	7.2	6.3	6.7	6.1	6.1
Finance Leases	0.0	0.2	0.0	0.0	0.0
Total Funding	**11.3**	**10.5**	**10.7**	**9.3**	**9.3**
Total Financing and Funding	**37.3**	**33.1**	**12.9**	**12.0**	**11.9**

4. Ratio of Financing Costs to Net Revenue Stream:

4.1 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. The definition of financing costs is set out in the Prudential Code.

4.2 The ratio is based on costs net of investment income.

Ratio of Financing Costs to Net Revenue Stream	2016/17 Estimate %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Total	8.6%	8.4%	8.4%	7.8	7.8%

5. Capital Financing Requirements:

5.1 The Capital Financing Requirement (CFR) measures the Council's underlying need to borrow for a capital purpose. The calculation of the CFR is taken from the amounts held in the Balance Sheet relating to capital expenditure and it's financing.

Capital Financing Requirement	2015/16 Actual £m	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m	2019/20 Estimate £m
Total CFR	230.5	233.8	238.1	241.7	243.1

6. Actual External Debt:

6.1 This indicator is obtained directly from the Council's balance sheet. It is the closing balance for actual gross borrowing plus other long-term liabilities. This Indicator is measured in a manner consistent for comparison with the Operational Boundary and Authorised Limit.

Actual External Debt as at 31/03/2016	£000
Borrowing	230,008
Other Long-term Liabilities	49,656
Total	**279,664**

7. Incremental Impact of Capital Investment Decisions:

7.1 This is an indicator of affordability that shows the impact of capital investment decisions on Council Tax and Housing Rent levels. The incremental impact is calculated by comparing the total revenue budget requirement of the current approved capital programme with an equivalent calculation of the revenue budget requirement arising from the proposed capital programme.

Incremental Impact of Capital Investment Decisions	2017/18 Estimate £	2018/19 Estimate £	2019/20 Estimate £	2020/21 Estimate £
Increase in Band D Council Tax*	1.93	3.18	-2.78	3.43

*Assumes a 4% increase in Council Tax although no decision has been taken to this effect. The Friars Walk Loan have been excluded from these calculation as it is not part of the capital programme.

8. Authorised Limit and Operational Boundary for External Debt:

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

8.2 The **Authorised Limit** sets the maximum level of external borrowing on a gross basis (i.e. not net of investments) for the Council. It is measured on a daily basis against all external-borrowing items on the Balance Sheet (i.e. long and short term borrowing, overdrawn bank balances and long term liabilities). This Prudential Indicator separately identifies borrowing from other long-term liabilities such as finance leases. It is consistent with the Council's existing commitments, its proposals for capital expenditure and financing and its approved treasury management policy statement and practices.

8.3 The Authorised Limit has been set on the estimate of the most likely, prudent but not worst case scenario with sufficient headroom over and above this to allow for unusual cash movements.

8.4 The Authorised Limit is the statutory limit determined under Section 3(1) of the Local Government Act 2003 (referred to in the legislation as the Affordable Limit).

Authorised Limit for External Debt	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Borrowing	308	276	283	287
Other Long-term Liabilities	46	44	43	42
Total	**354**	**320**	**326**	**329**

8.5 The Operational Boundary links directly to the Council's estimates of the CFR and estimates of other cashflow requirements. This indicator is based on the same estimates as the Authorised Limit reflecting the most likely, prudent but not worst case scenario but without the additional headroom included within the Authorised Limit.

8.6 The Head of Finance has delegated authority, within the total limit for any individual year, to effect movement between the separately agreed limits for borrowing and other long-term liabilities. Decisions will be based on the outcome of financial option appraisals and best value considerations. Any movement between these separate limits will be reported in the next regular capital/treasury monitoring report to be submitted to Cabinet/Council.

Operational Boundary for External Debt	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
Borrowing	288	256	263	267
Other Long-term Liabilities	46	44	43	42
Total	**334**	**300**	**306**	**309**

9. Adoption of the CIPFA Treasury Management Code:

9.1 This indicator demonstrates that the Council has adopted the principles of best practice.

Adoption of the CIPFA Code of Practice in Treasury Management
The Council approved the adoption of the CIPFA Treasury Management Code at its Council meeting on 29th June 2009.

The Council has incorporated the changes from the revised CIPFA Code of Practice into its treasury policies and procedures and will update its treasury management practice documentation in due course.

10. Upper Limits for Fixed Interest Rate Exposure and Variable Interest Rate Exposure:

10.1 These indicators allow the Council to manage the extent to which it is exposed to changes in interest rates. This Council calculates these limits on net principal outstanding sums, (i.e. fixed rate debt net of fixed rate investments)

10.2 The upper limit for variable rate exposure has been set to ensure that the Council is not exposed to interest rate rises that could adversely impact on the revenue budget. The limit allows for the use of variable rate debt to offset exposure to changes in short-term rates on investments.

	Existing limit at 31/03/16 %	2017/18 Estimate %	2018/19 Estimate %	2019/20 Estimate %	2020/21 Estimate %
Upper Limit for Fixed Interest Rate Exposure	100%	100%	100%	100%	100%
Upper Limit for Variable Interest Rate Exposure	50%	50%	50%	50%	50%

10.3 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.

11. Maturity Structure of Fixed Rate borrowing:

11.1 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 in the course of the next ten years.

11.2 It is calculated as the amount of projected borrowing that is fixed rate maturing in each period as a percentage of total projected borrowing that is fixed rate. The maturity of borrowing is determined by reference to the earliest date on which the lender can require payment.

11.3 LOBO's are classified as maturing on the next call date i.e. the earliest date that the lender can require repayment and as most of these loans are on six monthly notice period, then they increase the under 12 months percentage accordingly, though it is considered unlikely all will be called within one financial year.

11.4 The greatest concentration of debt is in the financial year 2019/20 when the stock issue (£40m) matures. A strategy to deal with the repayment will be prepared closer to the maturity date.

Maturity structure of fixed rate borrowing (Newport CC debt)	Existing level at 31/12/16 %	Lower Limit for 2017/18 %	Upper Limit for 2017/18 %
under 12 months	46%	0%	80%
12 months and within 24 months	0%	0%	70%
24 months and within 5 years	21%	0%	70%
5 years and within 10 years	17%	0%	50%
10 years and within 20 years	6%	0%	30%
20 years and within 30 years	0%	0%	20%
30 years and within 40 years	6%	0%	20%

40 years and within 50 years	2%	0%	20%
50 years and above	2%	0%	20%

12. Credit Risk:

12.1 The Council considers security, liquidity and yield, in that order, when making investment decisions.

12.2 Credit ratings remain an important element of assessing credit risk, but they are not a sole feature in the Council's assessment of counterparty credit risk.

12.3 The Council also considers alternative assessments of credit strength, and information on corporate developments of and market sentiment towards counterparties. The following key tools are used to assess credit risk:

- Published credit ratings of the financial institution (minimum A- or equivalent) and its sovereign (minimum AA+ or equivalent for non-UK sovereigns);
- Sovereign support mechanisms;
- Credit default swaps (where quoted);
- Share prices (where available);
- Economic fundamentals, such as a country's net debt as a percentage of its GDP;
- Corporate developments, news, articles, markets sentiment and momentum;
- Subjective overlay.

12.4 The only indicators with prescriptive values remain to be credit ratings. Other indicators of creditworthiness are considered in relative rather than absolute terms.

13. Upper Limit for total principal sums invested over 364 days:

13.1 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.

Upper Limit for total principal sums invested over 364 days	**2017/18 Estimate £m**	**2018/19 Estimate £m**	**2019/20 Estimate £m**	**2020/21 Estimate £m**
	5	**5**	**5**	**5**

Appendix E – Minimum Revenue Provision (MRP) Statement 2017/18

1. The Welsh Government's Guidance on Minimum Revenue Provision (issued in 2010) places a duty on local authorities to make a prudent provision for debt redemption. Guidance on Minimum Revenue Provision has been issued by the Welsh Ministers and local authorities are required to "have regard" to such Guidance under section 21(1A) of the Local Government Act 2003.

2. The four MRP options available are:
   - Option 1: Regulatory Method
   - Option 2: CFR Method
   - Option 3: Asset Life Method
   - Option 4: Depreciation Method

3. MRP in 2016/17: Options 1 and 2 may be used only for supported (i.e. financing costs deemed to be supported through Revenue Support Grant from Central Government) Non-HRA capital expenditure funded from borrowing. Methods of making prudent provision for unsupported Non-HRA capital expenditure include Options 3 and 4 (which may also be used for supported Non-HRA capital expenditure if the Authority chooses). There is no requirement to charge MRP in respect of HRA capital expenditure funded from borrowing.

4. The MRP Statement will be submitted to Council before the start of the 2016/17 financial year. If it is ever proposed to vary the terms of the original MRP Statement during the year, a revised statement should be put to Authority at that time.

5. The Authority will apply Option 1/Option 2 in respect of supported Non-HRA capital expenditure funded from borrowing and Option 3/Option 4 in respect of unsupported Non-HRA capital expenditure funded from borrowing.

6. MRP in respect of leases and Private Finance Initiative schemes brought on Balance Sheet under the International Financial Reporting Standards (IFRS) based Accounting Code of Practice will match the annual principal repayment for the associated deferred liability.

7. In December 2013 the Council approved a loan of up to £89.1million to Queensbury Real Estates (Newport) Ltd (QRE) to fund the building of the Friars Walk Development. The loan is anticipated to be paid off in full via a capital receipt at the end of the three-year period. On this basis, the Council will not be required to make MRP charges to the revenue budget in relation to the Friars Walk Development loan as the borrowing will be paid off in full at the end of the scheme.