Appendix B

2016/17 Prudential Indicators, Treasury Management Strategy and MRP Policy

1. Introduction

This report is presented in compliance with statutory regulations and Codes of Practice that require the Council to compile:

- **Prudential indicators** that are intended to demonstrate that the borrowing the Council plans to undertake for capital financing purposes is at a prudent, affordable and sustainable level;
- A **treasury management strategy** that explains how the Council's cash flows, borrowing and investments will be managed;
- A policy that explains how the Council will discharge its duty to make prudent **revenue provision for the repayment of debt**.

Further details are provided in the following paragraphs.

2. Prudential indicators

2.1 Context

The Council is required by regulation to comply with the **CIPFA Prudential Code for Capital Finance in Local Authorities** (referred to as the '**Prudential Code**') when assessing the affordability, prudence and sustainability of its capital investment plans.

Fundamental to the prudential framework is a requirement to set a series of prudential indicators. These indicators are intended to collectively build a picture that demonstrates the impact over time of the Council's capital expenditure plans upon the revenue budget and upon borrowing and investment levels, and explain the overall controls that will ensure that the activity remains affordable, prudent and sustainable.

A summary of the Prudential Indicators for the period 2014/15 through to 2018/19 is provided in **Annex A**. Explanatory comments are provided in the following paragraphs.

2.2 Capital Expenditure Plans

The proposal is for capital investment of **£250m** for the 2016/17 programme, with an indicative programme for the subsequent two years totalling **£717m**. These planning levels represent a continued major investment in the infrastructure and economy of Essex.

Actual capital expenditure and financing sources for 2014/15, together with the original and updated plans for 2015/16, proposals for 2016/17 and the indicative guidelines for the subsequent two years, is summarised in **Annex A**, with detailed plans presented within the Budget Book.

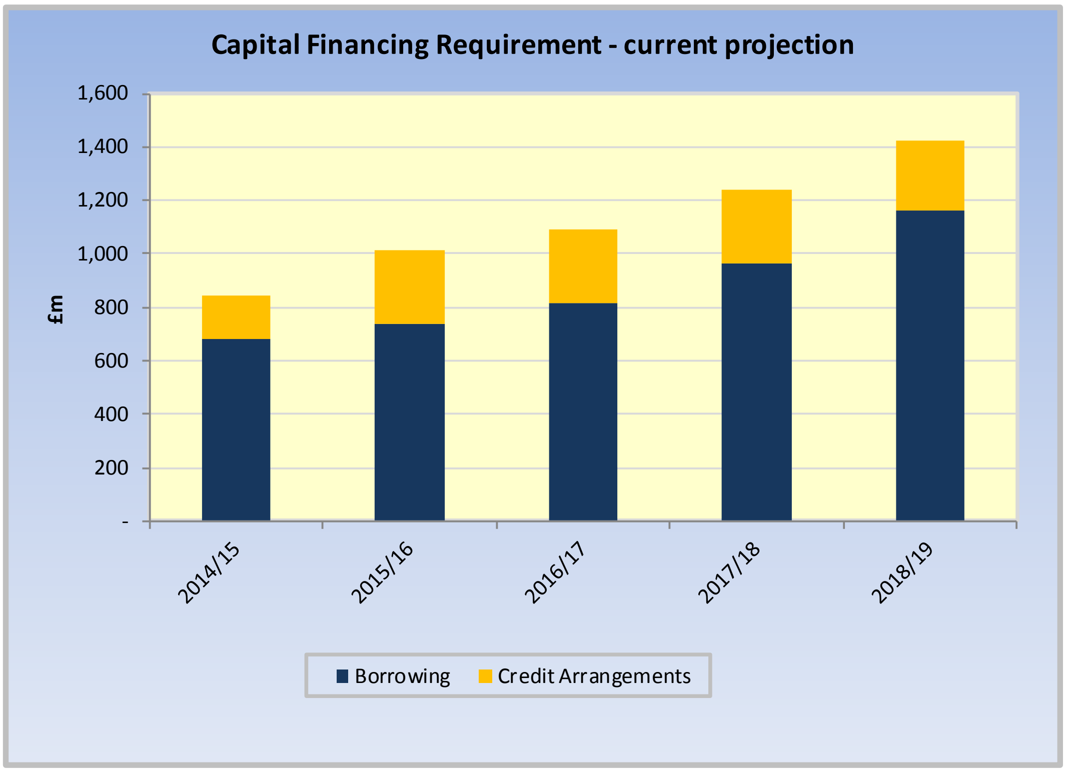
2.3 Capital Financing Requirement

One of the key ways that the Council has of financing capital expenditure is from 'borrowing'. This means that the Council is able to incur expenditure that it does not need to fund immediately from cash resources. Instead, the Council is able to charge the capital expenditure to the revenue budget over a number of years into the future. It does this in accordance with its policy for the repayment of debt, which is explained later within this report.

The **Capital Financing Requirement** (CFR) for 2014/15 provides a measure of the amount of capital expenditure that the Council has already spent that has yet to be funded from cash resources. That is, it provides a measure of the Council's indebtedness, and hence of its need to borrow for capital financing purposes.

Credit arrangements are also included in the calculation of the CFR because they have the same practical impact as borrowing; credit arrangements are those that enable the Council to acquire the use of assets on deferred payment terms – typical examples include finance leases and Private Finance Initiative (PFI) schemes.

The actual CFR for 2014/15 and forward projections for the current and forthcoming three years are as follows:



The year-on-year movements in the CFR are the net result of:

- The Council's intention to finance further capital expenditure from borrowing and to enter into further credit arrangements over this period (*these both result in **increases** to the CFR*); and

- Revenue budget provision being made for the repayment of debt (*which results in a **reduction** to the CFR*).

The estimates of the CFR therefore show that:

- The amount of capital expenditure that it is intended to finance from borrowing exceeds the annual provision for the repayment of debt each year up to and including 2018/19; and
- The element of the CFR related to credit arrangements will increase when a new Private Finance Initiative schemes became operational.

These estimates assume that:

- The Government will continue to support local authorities' capital investment over the medium term via the provision of capital grant rather than by 'supported borrowing'; and
- The Council will continue to repay debt on the basis followed in previous years.

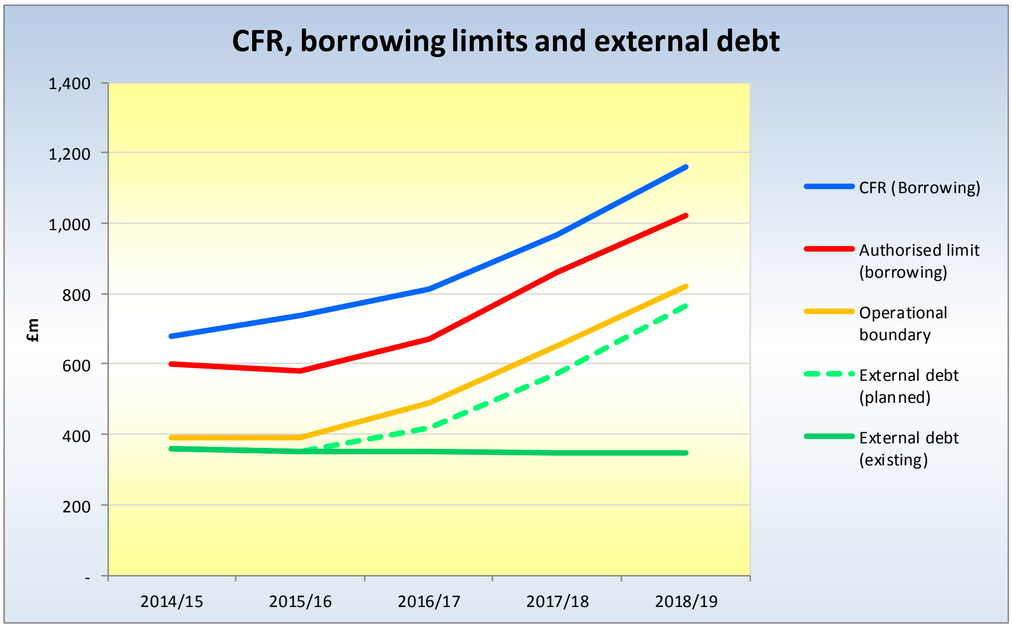
2.4 External borrowing limits

The Council is only permitted to borrow externally (*including via credit arrangements*) up to the level implied by its Capital Financing Requirement (CFR). To ensure that external borrowing does not exceed the CFR, other than in the short term, limits are established for external debt, as follows:

- **Authorised limit** – this defines the maximum amount of external debt permitted by the Council, and represents the statutory limit determined under section 3 (1) of the Local Government Act 2003.
- **Operational boundary** – this is an estimate of the probable level of the Council's external debt, and provides the means by which external debt is managed to ensure that the 'authorised limit' is not breached.

The proposed limits, which are set out in **Annex A**, make separate provision for external borrowing and other long-term liabilities, and are based upon an estimate of the most likely but not worst case scenarios. They allow sufficient headroom for fluctuations in the level of cash balances and in the level of the CFR.

The authorised limit and operational boundary related to external borrowing are below the current estimates of the CFR for borrowing. This position is currently sustainable because the Council is able to temporarily utilise its cash balances as a short to medium term alternative to external borrowing. This practice, which is referred to as 'internal borrowing', does not reduce the magnitude of funds held in reserves and balances; the funds are merely being borrowed until they are required for their intended purpose.

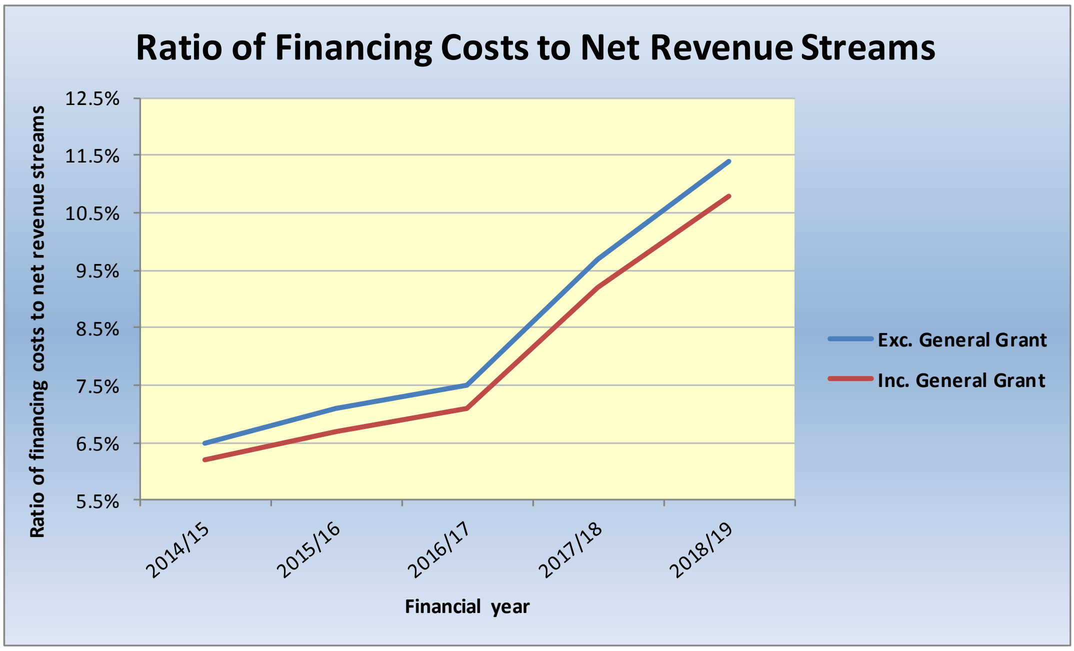


Further comments on these limits are set out within the Treasury Management Strategy, in paragraph 3.4.

2.5 Ratio of financing costs to net revenue streams

The trend in the 'cost of capital' is provided by the '**ratio of financing costs to net revenue streams**'. This ratio provides a key indicator of affordability, as it shows the proportion of the annual revenue budget that is being consumed year on year in order to finance the costs of borrowing (*i.e. interest and debt repayments, net of investment income*).

The actual ratios for 2014/15, and the latest estimates for the current and forthcoming three years, are provided in **Annex A**. The trend in this ratio over this period is illustrated as follows:



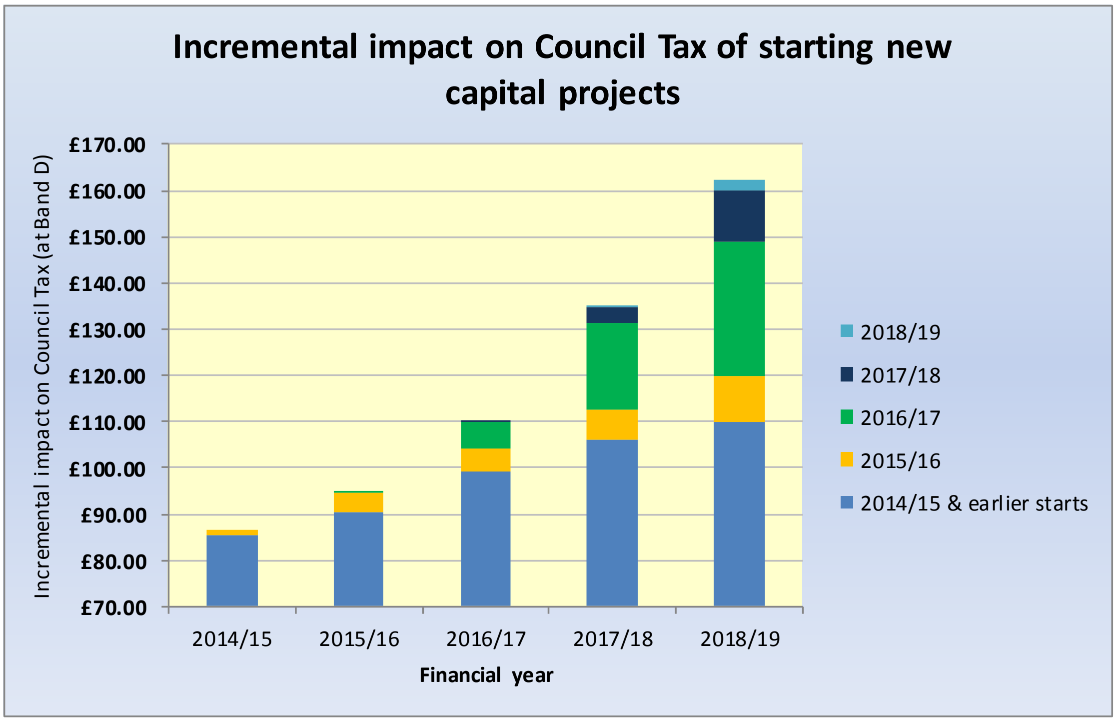
It is estimated that the proportion of the revenue budget that is required to fund borrowing costs will increase from **6.2%** in 2014/15 to **7.5%** by 2018/19. This increase partly reflects the impact of the Council's capital programme proposals over the forthcoming three years, but also a reduction in our net revenue streams.

2.6 Incremental impact on Council Tax

Another key measure of the affordability of the capital programme proposals is their impact upon council tax.

The prudential indicator for the **incremental impact upon council tax** shows the council tax at band D that results from continuing with capital schemes started in, and prior to, 2014/15 and the additional amounts that result from commencing new capital projects in the current and subsequent three years.

The indicators are set out in **Annex A** and are illustrated as follows:



The actual impact upon council tax may be lower than that implied by the indicators set out in **Annex A** because:

- The indicator is calculated on the basis that the revenue implications of borrowing decisions will be funded entirely from council tax; in reality, the Budget Requirement is funded from a combination of financing sources, including council tax, non-domestic rates and general government grants.
- No account has been taken of the savings that may accrue from invest to save / improve schemes.

2.7 Treasury Management

The Prudential Code requires the Council to confirm adherence to the principles of the CIPFA Treasury Management Code. This confirmation is provided within the Treasury Management Strategy, as detailed in section 3 below.

3. Treasury Management Strategy

3.1 Introduction

The Prudential Indicators consider the affordability and impact of the Council's capital expenditure proposals. The Treasury Management Strategy considers funding of these decisions.

The Council's treasury activities must be undertaken in compliance both with the **CIPFA Treasury Management in the Public Services Code of Practice** (referred to as the Treasury Management Code) and with statutory regulations. One of the key aspects of the Treasury Management Code, and the underlying regulations, is the requirement to produce an annual Treasury Management Strategy. The following paragraphs address this key requirement.

3.2 Economic outlook

The following paragraphs set the backdrop to the Council's treasury management activity in 2016/17 and subsequent years, by providing commentary on the economic outlook:

- **Global economy**

  In the Eurozone (EZ), the European Central Bank (ECB) launched a €1.1 trillion programme of quantitative easing to run until at least September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and economic growth. However, the ECB may need to boost its quantitative easing programme if it is to succeed in improving growth in the EZ and getting inflation up to its target of **2%**.

  During July 2015, Greece finally capitulated to EU demands to implement a major programme of austerity and is now cooperating fully with EU demands. However, previous resistance to EU demands damaged the Greek banking system and economy, and there are major doubts about whether the required programme of cuts and reforms can be achieved. Consequently, the latest bailout may only have delayed Greece's exit from the euro.

  With regard to the USA, the downbeat news in August – September 2015 about Chinese and Japanese growth, and the knock on impact on emerging countries that are major suppliers of commodities, was cited as the main reason for the Federal Reserve's decision at its September meeting to pull back from a first rate increase. However, there was strong growth in employment in October and this, together with a perception that concerns on the international scene have subsided, prompted the Federal Reserve to raise its interest rate in December 2015. The pace of future rises in the US however, may be impacted by the New Year uncertainty over the Chinese economy, oil concerns and the Middle East.

- **UK economy**

  UK GDP growth rates in 2013 and 2014 were the strongest growth rates of any G7 country, the 2014 growth rate being the strongest UK rate since 2006. For 2015, the growth rate is only likely to be bettered by the US. The Chancellor has raised the significant uncertainty and risks surrounding the international environment, which reflects the concerns over the future path of UK growth. Whilst growth was expected to moderate, a lower than expected future growth position would negatively impact on Government's austerity plans.

  The November Bank of England Inflation Report included a forecast for growth to remain around **2.5** – **2.7%** over the next three years, mainly due to strong consumer demand, a recovery in wage inflation and a fall in CPI inflation to near zero since February 2015 this year.

  The November Inflation Report expects inflation to get back up to the **2%** target within the 2-3 year time horizon. However, once the falls in oil, gas and food prices over recent months fall out of the 12-month calculation of CPI, there is likely to be a sharp increase to around **1%** in the second half of 2016.

  There is considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the Monetary Policy Committee (MPC) will decide to make a start on increasing Bank Rate.

3.3 Borrowing, investment and interest projections

The Council primarily undertakes external borrowing in order to manage the cash flow implications of incurring capital expenditure that it does not immediately fund from cash resources, and to manage fluctuations in its cash flows more generally too.

Separately, the Council has cash backed resources which it has set aside for longer term purposes (such as funds set aside in reserves and balances), and working capital balances, that can either be invested or temporarily utilised to defer the need for external borrowing.

Forecasts of the amount of external borrowing (*including existing long-term loans*) and investment balances for the forthcoming three years, and estimates for interest rates, are set out in **Annex B**. Revenue budget provision for interest payable and receivable in 2016/17 has been determined in accordance with these forecasts.

3.4 Borrowing

Borrowing strategy

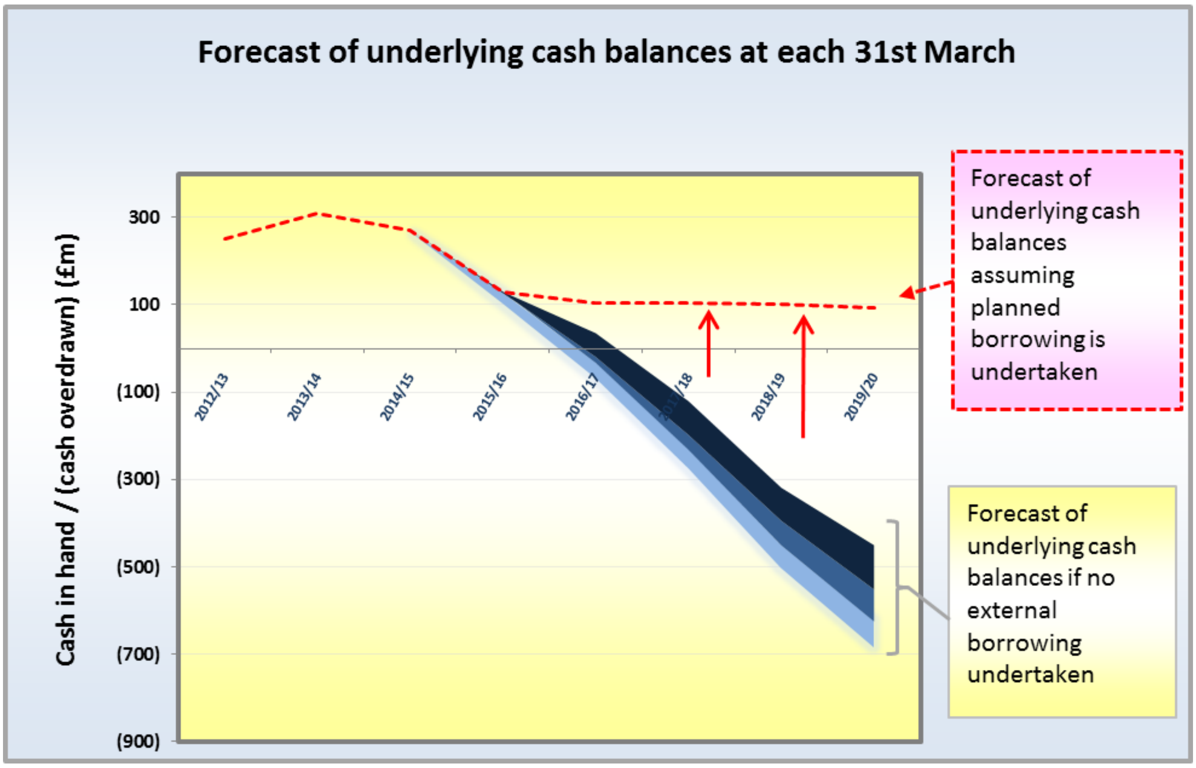
As explained in paragraph **2.4**, the **Capital Financing Requirement** (CFR) provides a measure of the Council's need to borrow in order to manage the cash flow implications of incurring capital expenditure that it does not immediately fund from cash resources. Currently, long-term external borrowing amounts to **£353m**, which equates to around **48%** of the estimated CFR at **31 March 2016**. The remainder of the CFR is currently funded from the cash the Council has set aside for other purposes (a practice referred to as 'internal borrowing').

The use of internal borrowing has been an effective strategy in recent years as:

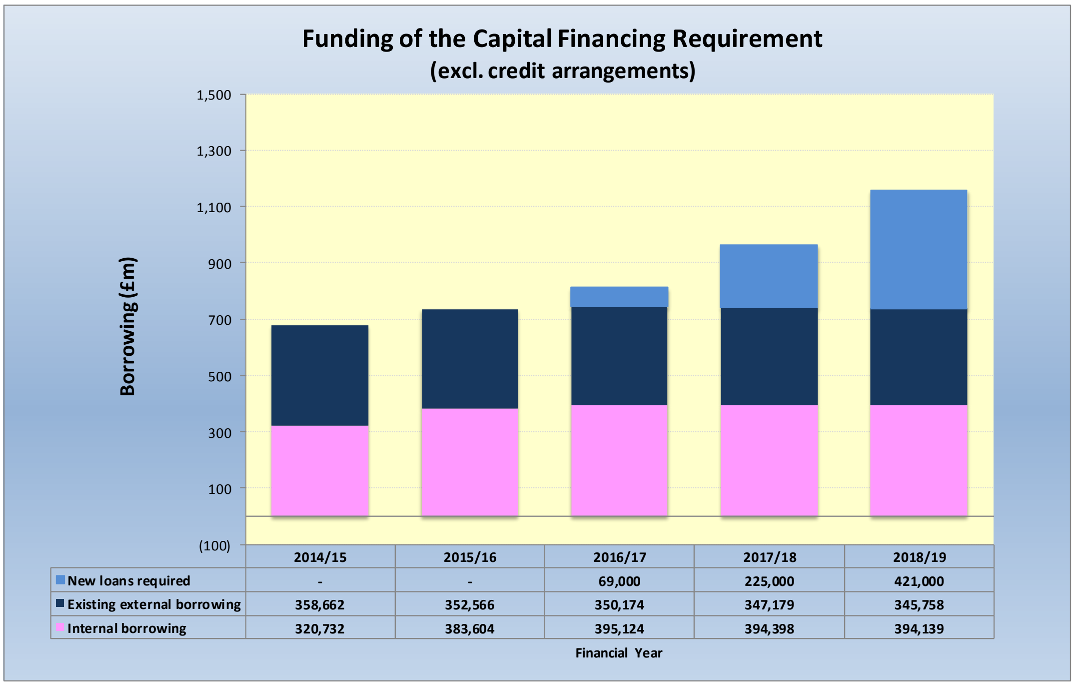
- It has enabled the Council to avoid significant external borrowing costs (*i.e. making it possible to avoid net interest payments of around* ***£11m*** *per annum*); and
- It has mitigated significantly the risks associated investing cash in what has often been a volatile and challenging market.

However, the Council is likely to reach the limit of its capacity to 'internally borrow' (at around **£390m**) by the end of 2015/16, or in the early part of 2016/17. Without undertaking new long term borrowing in 2016/17, and annually thereafter, in line with the forecast increases in the CFR, the Council will cease to hold any cash for investment and will be borrowing short-term on a sustained basis.

Long term external borrowing in line with the forecast increases in the CFR over the period 2016/17 to 2018/19 would maintain the Council's underlying cash balances at around **£100m**; this is considered to be the '**cash baseline**' below which our underlying balances should not drop on a sustained basis.



On the assumption that long-term borrowing is undertaken in line with the forecast increases in the CFR over the period 2016/17 to 2018/19, the funding of the CFR will be as follows:



This translates into the following levels of long-term external borrowing over the period covered by this strategy:

Current Forecast	**Total borrowing at 31st March**			
	2016	**2017**	**2018**	**2019**
	£000	**£000**	**£000**	**£000**
Existing external loans	**352,566**	**350,174**	**347,179**	**345,758**
Requirement for new borrowing				
2015/16	-	**-**	-	-
2016/17	-	**69,000**	69,000	69,000
2017/18	-	**-**	156,000	156,000
2018/19	-	**-**	-	196,000
Total new borrowing	**-**	**69,000**	**225,000**	**421,000**
Total external borrowing	**352,566**	**419,174**	**572,179**	**766,758**
Internal borrowing	*383,604*	***395,124***	*394,398*	*394,139*
Total borrowing	***736,170***	***814,298***	***966,577***	***1,160,897***

Should it not be possible or desirable to sustain internal borrowing at around **£390m**, further long term external borrowing will be required beyond that indicated.

The external borrowing requirement will be kept under review, and long term external loans will be secured within the parameters established by the **authorised limit** and **operational boundary** for external debt (as set out within **Annex A**).

Opportunities to generate savings by refinancing or prematurely repaying existing long term debt will also be kept under review. Potential savings will be considered in the light of the current treasury position and the costs associated with such actions.

Maturity structure of borrowing

Limits are proposed, in **Annex B**, for the maturity structure of borrowing. The purpose of these limits is to guide decisions about the period over which new borrowing will be secured, to ensure that the Council does not have:

- A large amount of debt maturing in any one year which it may need to refinance in that year alongside any new borrowing that may be required; and
- External loans in excess of its CFR, other than in the short term.

The Council has a number of Money Market (*Lender option, Borrower option*) loans within its existing portfolio of loans. These loans contain a series of option dates upon which the lender can propose a variation to the interest rate on the loans. Should the lender choose to exercise its option to vary the interest rate on any of these loans, the Council can repay the loans in full without penalty. Whilst it is not currently anticipated that the Council will repay any of these loans prematurely, the debt maturity limits proposed within this report assume that these loans will mature at their next option dates.

Interest rate exposure

In order to manage and minimise the impact of movements in interest rates, limits are proposed within **Annex B** that will establish the ranges within which fixed and variable rate borrowing will be undertaken.

Performance indicators

If long-term borrowing is undertaken, performance will be assessed against the average PWLB rate for the year for the applicable loan type and interest rate banding.

Short term borrowing will be assessed against the average 7 day London Inter Bank Offer Rate (**LIBOR**) for the year.

3.5 Investments

Investment strategy

When the Council has surplus cash balances, these are invested until they are next required. Usually, this means that funds are invested on a short-term basis (*i.e. up to a* *maximum period of 364 days*), but up to **£50m** may be invested for periods beyond 364 days.

In accordance with regulatory requirements, the primary objectives, when investing the Council's funds, are firstly to **safeguard** the principal sums invested; secondly, to ensure adequate **liquidity**; and lastly, to consider investment returns or **yield**.

The Council's funds will primarily be invested according to the Secretary of State's definition of **specified investments**. Specified investments are sterling deposits made for periods of less than one year and offering high security and high liquidity. Specified investments may include deposits with the UK Government, other local authorities, money market funds and bodies of high credit quality.

Funds may also be invested according to the Secretary of State's definition of **non-specified investments**. The inclusion of **non-specified investments** in the investment strategy is solely to allow funds (up to a maximum of **£50m**) to be invested for periods of in excess of one year.

A lending list will be compiled to include counterparties satisfying the criteria set out within **Annex C**. The lending limits that will be applied to counterparties satisfying these criteria are also set out within **Annex C**. Additional operational market information (*e.g. Credit Default Swaps, negative rating watches/outlooks etc.*) will also be considered before making any specific investment decisions.

The criteria for choosing counterparties (as set out within **Annex C**) provide a sound approach to investing in normal market circumstances. However, the Executive Director for Corporate and Customer Services will determine the extent to which the criteria set out within **Annex C** will be applied in practice.

<u>Interest rate exposure</u>

In order to manage and minimise the impact of movements in interest rates, limits are proposed within **Annex B** that will establish the ranges within which fixed and variable rate investments will be undertaken.

<u>Liquidity</u>

Liquidity is defined as having adequate, but not excessive cash resources, borrowing arrangements and overdraft or standby facilities to ensure that funds are available, at all times, for the achievement of the Council's objectives. In this respect, the Council will seek to maintain liquid short-term deposits of at least **£20m** available with a week's notice.

<u>Performance</u>

Performance on cash invested short term, in order to maintain liquidity of funds, will be benchmarked against the Seven Day London Inter Bank Bid Rate (LIBID) rate; the aim being to achieve investment returns that are equivalent to, or greater than, the average 7 day LIBID rate for the year.

3.6 Treasury management advisors

The Council has received treasury management advisory services from **Arlingclose** and **Capita Asset Services (Treasury Solutions)** during 2015/16 financial year, the latter advising on the strategy for 2016/17.

Both advisors provide a range of services, including advice on treasury matters and capital finance issues, economic and interest rate analysis and creditworthiness information. Notwithstanding this, the final decision on all treasury matters remains vested with the Council.

The services received from the Treasury Management Advisors are subject to regular review.

3.7 Other matters

The Council currently provides treasury management support to its local trading companies (principally Essex Cares Ltd).

As part of the agreement to provide treasury management support to these organisations, the Council may borrow their surplus funds, or lend to them to cover temporary shortfalls of cash.

Any amounts borrowed from, or lent to, these organisations are consolidated with the Council's own cash balances on a daily basis, and the Council invests or borrows on the net position. The Council charges interest on amounts lent to these organisations, or pays interest on amounts borrowed, in accordance with the terms of a formal agreement between the respective parties.

4. Revenue Provision for the Repayment of Debt Policy

4.1 Introduction

As noted elsewhere within this report, one of the key ways that the Council has of financing capital expenditure is from 'borrowing'. 'Borrowing' means that the Council is able to incur capital expenditure that it does not fund immediately from cash resources. However, implicit in the permission to defer the funding of the capital expenditure is a regulatory requirement to set cash resources aside from the Revenue Budget annually to repay this borrowing on a prudent basis. This practice is referred to as making a prudent level of '**revenue provision for the repayment of debt**'.

The Capital Financing Requirement (CFR) provides a measure of the capital expenditure that has yet to be funded from cash resources.

4.2 Revenue Provision for Debt Repayment Policy 2016/17

In accordance with the requirement to make a prudent ‘revenue provision for the repayment of debt’, the Council ensures that debt is repaid over a period that is either commensurate with:

- The period over which the capital expenditure provides benefit; or
- In the case of borrowing supported by the Government, the period implicit in the determination of that support.

This is achieved by:

- Applying the ‘**Regulatory Method**’ to determine the ‘revenue provision’ in relation to borrowing undertaken prior to 1 April 2008 and government-supported borrowing undertaken since this date.
- Applying the ‘**Asset Life Method**’ to determine the ‘revenue provision’ in relation to ‘unsupported borrowing’ undertaken since 1 April 2008. This method spreads capital expenditure financed from unsupported borrowing over the useful life estimated at the start of the relevant assets’ lives (or over a shorter period where use of the standard useful life would not be supportable as prudent).

Revenue provision is chargeable in the first financial year after the relevant capital expenditure is incurred.

Where expenditure does not meet the accounting classification of capital expenditure but the Council is nevertheless permitted to fund it from capital financing resources, the Capital Financing Requirement (CFR) will increase by the amount expended. Where the Council will subsequently recoup the amount expended (e.g. via the sale of an asset or repayment of an amount loaned), the income will be classified as a capital receipt. Where the capital receipts will be applied to reduce the CFR, there will be no revenue provision made for the repayment of the debt liability (i.e. unless the eventual receipt is expected to fall short of the amount expended).

Where it is practical or appropriate to do so, the Council may make voluntary revenue provision, or apply capital receipts, to reduce debt over a shorter period.

In the case of finance leases and on balance sheet PFI contracts, the ‘revenue provision’ requirement is met by a charge equal to the element of the rent/charge that goes to write down the balance sheet liability.

The revenue budget provision for ‘revenue provision’ charges in 2016/17 has been compiled on a basis consistent with this policy.

Annex A

Prudential Indicators

Summary of prudential indicators		2014-15 Actual	2015-16 Original Estimate	2015-16 Updated Estimate	2016-17 Estimate	2017-18 Forecast	2018-19 Forecast
Capital expenditure & financing							
Capital Expenditure	£m	**197**	**272**	**238**	**250**	**348**	**369**
Capital Financing							
Borrowing (unsupported)	£m	35	110	83	**106**	183	230
Grants and contributions	£m	109	141	131	**117**	133	131
Capital receipts and earmarked reserves	£m	53	21	24	**27**	32	8
Total capital financing	£m	**197**	**272**	**238**	**250**	**348**	**369**
Capital financing requirement							
Capital financing requirement (CFR)							
Opening CFR	£m	835	880	841	**1,011**	1,093	1,239
Add							
Additional borrowing	£m	35	110	83	**106**	183	230
Additional credit liabilities (PFI / Finance leases)	£m	4	120	120	**10**	-	-
		874	1,110	1,044	**1,127**	1,276	1,469
Less							
Revenue provision for debt repayment	£m	(33)	(34)	(33)	**(34)**	(37)	(41)
Capital Financing Requirement	£m	**841**	**1,076**	**1,011**	**1,093**	**1,239**	**1,428**
Analysis of the Capital Financing Requirement							
Supported borrowing and pre 2008/09 unsupported borrowing	£m	531	509	509	**489**	468	450
Unsupported borrowing (2008/09 and later)	£m	148	283	227	**325**	498	711
Sub total - borrowing	£m	**679**	**792**	**736**	**814**	**966**	**1,161**
Credit arrangements (PFI / Finance leases)	£m	162	284	275	**279**	273	267
Total	£m	**841**	**1,076**	**1,011**	**1,093**	**1,239**	**1,428**
Gross borrowing and the CFR							
Medium term forecast of CFR	£m	1,093	1,197	1,239	**1,428**	1,541	1,609
Forecast external debt (long term) and credit arrangements	£m	520	562	628	**629**	620	619
Headroom	£m	**573**	**635**	**611**	**799**	**921**	**990**
External debt							
Authorised limit							
Borrowing	£m	520	620	580	**670**	860	1,020
Other long term liabilities	£m	171	284	275	**279**	273	267
Total authorised limit	£m	**691**	**904**	**855**	**949**	**1,133**	**1,287**
Operational boundary							
Borrowing	£m	**390**	520	390	**490**	650	820
Other long term liabilities	£m	**161**	265	265	**259**	253	247
Total operational boundary	£m	**551**	**785**	**655**	**749**	**903**	**1,067**
Actual external debt (incl. credit arrangements)	£m	**520**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Financing & net revenue streams							
Net revenue streams excl. gen. govnt grants	%	6.5%	6.9%	6.7%	**7.5%**	9.7%	11.4%
Net revenue streams incl. gen. govnt grants	%	6.2%	6.6%	6.4%	**7.1%**	9.2%	10.8%
Incremental impact on Council Tax							
Effect of capital schemes starting in:							
2014/15 and earlier years	£	£86.53	£88.59	£85.54	**£90.38**	£99.16	£105.91
2015/16	£		£0.26	£1.04	**£4.13**	£5.00	£6.76
2016/17	£		-	-	**£0.53**	£5.61	£18.55
2017/18	£		-	-	**-**	£0.45	£3.61
2018/19	£		-	-	**-**	-	£0.39
2019/20	£		-	-	**-**	-	-
2020/21	£		-	-	**-**	-	-
Total	£	**£86.53**	**£88.85**	**£86.58**	**£95.04**	**£110.22**	**£135.22**

Annex B

Treasury Management Summary

Treasury Management Summary		2014-15 Actual	2015-16 Original Estimate	2015-16 Latest Estimate	2016-17 Estimate	2017-18 Forecast	2018-19 Forecast
Estimated debt and investments							
Investments (estimated balance at each 31st March)	**£m**	272		272	**105**	106	110
External debt (operational boundary for borrowing)	**£m**	390		390	**490**	650	820
Expected movement in interest rates							
Bank Rate (at each 31st March)	**%**	0.50%	1.00%	0.50%	**1.00%**	1.75%	2.00%
PWLB (borrowing) rates							
5 year	**%**		3.00%	2.40%	**2.80%**	3.30%	3.60%
10 year	**%**		3.80%	3.00%	**3.40%**	3.80%	4.10%
25 year	**%**		4.50%	3.70%	**4.10%**	4.30%	4.50%
50 year	**%**		4.50%	3.60%	**4.00%**	4.20%	4.40%
Source: *Capita Asset Services (Treasury Solutions) (November 2015)*							
Effect of 1% increase in interest rates							
Interest on borrowing	**£000**				**-**		
Interest on investments	**£000**				**(1,042)**		
Interest attributed to reserves & balances	**£000**				**2,282**		
Interest attributed to other bodies	**£000**				**325**		
Net total	**£000**				**1,565**		
Borrowing requirement (external borrowing)	**£m**	**35**	**84**	-	**69**	156	196
Interest rate exposures							
Upper limits for exposure to fixed rates							
Net exposure	**£m**	520	620	580	**670**	860	1,020
Debt	**%**	100%	100%	100%	**100%**	100%	100%
Investments	**%**	100%	100%	100%	**100%**	100%	100%
Upper limits for exposure to variable rates							
Net exposure	**£m**	156	186	174	**201**	258	306
Debt	**%**	30%	30%	30%	**30%**	30%	30%
Investments	**%**	100%	100%	100%	**100%**	100%	100%
Maturity structure of borrowing (upper limit)							
Under 12 months	**%**	**3.71%**	40%	40%	**40%**	40%	40%
12 months and within 24 months	**%**	**8.31%**	40%	40%	**40%**	40%	40%
24 months and within 5 years	**%**	**14.14%**	60%	60%	**60%**	60%	60%
5 years and within 10 years	**%**	**10.97%**	60%	60%	**60%**	60%	60%
10 years and within 25 years	**%**	**1.57%**	67%	60%	**67%**	60%	60%
25 years and within 40 years	**%**	**4.33%**	51%	70%	**70%**	70%	70%
40 years and within 50 years	**%**	**30.87%**	50%	50%	**50%**	50%	50%
50 years and above	**%**	**0.00%**	22%	20%	**22%**	19%	13%
Maturity structure of borrowing (lower limit)							
All maturity periods	**%**	0%	0%	0%	**0%**	0%	0%
Total sums invested for more than 364 days							
Upper limit for sums invested for more than 364 days	**£m**	**6**	**100**	50	**50**	50	50

Counterparty Criteria for Investments

1. Context

In order to minimise the risk to investments, the Council stipulates the minimum acceptable credit quality of counterparties for inclusion on its lending list. Where applicable, it does this by reference to the credit ratings, watches and outlooks published by all three ratings agencies (i.e. Fitch, Standard and Poor and Moody's). Definitions of the credit ratings of the three main rating agencies are available upon request.

2. Credit rating methodology

The main credit rating agencies (Fitch, Moody's and Standard and Poor's) had, through much of the financial crisis, provided some institutions with a ratings 'uplift' due to implied levels of sovereign support. Commencing in 2015, in response to the evolving regulatory regime, all three agencies began removing these 'uplifts'. In addition, other factors, such as regulatory capital levels, are now being taken into consideration. These new methodologies have lessened the importance of the (Fitch) **Support** and **Viability** ratings and have seen the (Moody's) **Financial Strength** rating withdrawn.

Although the implied sovereign government support has effectively now been withdrawn from banks, they are expected to have sufficiently strong balance sheets to be able to withstand foreseeable adverse financial circumstances without government support. In fact, the balance sheets of many banks are now much more robust than they were before the 2008 financial crisis when they had higher ratings than now. However, this is not universally applicable, leaving some entities with modestly lower ratings than they had through much of the 'support' phase of the financial crisis.

In keeping with the agencies' new methodologies, the credit rating criteria applied by the Council focuses solely on the **Short** and **Long Term** ratings of an institution.

3. Banks and building societies

The Council will invest funds with UK banks and building societies, and non UK banks domiciled in a country with a minimum sovereign rating of **AA,** that have credit ratings equivalent to, or better than, the following:

Rating category	**Credit rating agencies**		
	Fitch	**Standard & Poor's**	**Moody's**
Short term rating	**F1**	**A-1**	**P-1**
Long term rating	**A**	**A**	**A2**

These ratings will be used to determine the pool of counterparties with whom the Council can transact for **term/call deposits** and **certificates of deposit**. This will ensure that funds are invested with high quality counterparties.

Where counterparties are rated by more than one credit rating agency, the lowest ratings will be used to determine whether they are included on the counterparty list.

The short and long-term ratings will be further applied to determine the maximum amount that will be invested with each of the counterparties in the ‘pool’, and for what duration.

Credit ratings will be kept under review. Counterparties will be removed from the Council’s lending list in the event that they receive a downgrading to their credit rating below the minimum criteria outlined above.

Counterparties placed on ‘negative ratings watch’ will remain on the Council’s lending list at the discretion of the Executive Director for Corporate and Customer Services, in consultation with the Cabinet Member for Finance.

Although non-UK banks domiciled in a country with a minimum sovereign rating of **AA** may be included on the lending list, due regard will be given to the country exposure of the Council’s investments.

In the event that the Council’s own banker falls below the minimum credit rating criteria outlined above, and is not nationalised or part nationalised, the bank will be used for transactional purposes only, and not as an active outlet for investments.

4. Financial institutions nationalised (or part nationalised) by the UK Government

UK banks that do not fully meet the credit rating criteria outlined in the previous paragraph, but which have been nationalised or part nationalised, will remain on the counterparty list whilst they continue to be nationalised (or part nationalised).

5. Money Market Funds

Money Market Funds (MMFs) are short term, pooled, investments that are placed, by a manager, in a wide range of money market instruments. The size of the investment pool of a MMF enables the manager to not only offer the flexibility of overnight and call money, but also the stability and returns of longer dated deposits.

Strict rules and criteria are set down by the official rating agencies, covering the types of investment counterparties used, the maturity distribution of the funds and investment concentrations.

The Council will only use MMFs with an **AAA** credit rating that are denominated in sterling and regulated within the EU.

6. Enhanced Money Market Funds

Enhanced Money Market Funds (EMMFs) are designed to produce enhanced returns, and this typically requires the manager to take more risk than the traditional money market funds referred to above. This does not mean there is necessarily a reduction in credit quality though.

The Council will only use EMMF's with an **AAA** credit rating and a minimum credit score of **1.25** that are denominated in sterling and regulated within the UK.

7. UK Government

No restrictions are placed on the amounts that can be invested with the UK Government (i.e. with the Debt Management Office or via UK Treasury bills or Gilts with less than 1 year to maturity).

8. Other local authorities

Other local authorities are included within the counterparty 'pool'. However, the amount that can be invested will be determined with regard to their size. For this purpose, top tier local authorities will include county councils, unitary and metropolitan authorities and London Boroughs and lower tier local authorities will include district / borough councils and police and fire authorities.

9. Other products

A range of other investment products may be used for investing the Council's underlying / core cash balances, including:

- **Property Funds -** this is a long term, and relatively illiquid investment, which is expected to yield both rental income and capital gains.
- **Corporate bonds** – bonds issued by companies to raise long term funding other than via issuing equity. Investing in corporate bonds offers a fixed stream of income, paid at half yearly intervals, in exchange for an initial investment of capital.
- **Corporate bond funds** – these are pooled funds investing in a diversified portfolio of corporate bonds, so provide an alternative to investing directly in individual corporate bonds.
- **UK Government Gilts / Gilt Funds** – with greater than 1 year maturity
- **UK Government Treasury bills** – with greater than 1 year maturity

The risks associated with the use of any combination of these investment products may include:

- **Liquidity risk** - Ability to realise assets in a timely manner, at an appropriate price.
- **Security or credit risk** - Capital preservation (principal is returned at contractual maturity); Payments of interest or principal not being made, or not being made in full.
- **Valuation or 'mark to market' risk** - Paper losses may be reported in year-end accounts; liquidating assets prior to maturity could lead to losses being crystalised.

The investment instrument listed above will each demonstrate some combination of these risks – they therefore all need to be weighed against potential rewards of higher returns.

The Executive Director for Corporate and Customer Services will work with the Council's treasury advisors to determine the use of these alternative investment products, taking into account the acceptability or otherwise of the risks associated with their use.

10. Time and monetary limits applying to investments

The time and monetary limits for counterparties satisfying the criteria outlined in the previous paragraphs will be determined with reference to the counterparties' short and long term credit ratings (or to other criteria where applicable), as outlined in the table overleaf. Notwithstanding these limits, the Executive Director for Corporate and Customer Services will ensure appropriate operational boundaries are in place to avoid over exposure in any particular country, sector or group.

Time and monetary limits

Counterparty type	Short and long term credit rating criteria						Investment Limit £m	Maximum duration (No. years)
	Fitch		Standard & Poor's		Moody's			
	Short term	Long term	Short term	Long term	Short term	Long term		
UK Banks & building societies	F1+	AA-	A-1+	AA-	P-1	Aa3	**70**	3 years
	F1	A	A-1	A	P-1	A2	**60**	1 year
UK banks & building societies (nationalised)							**60**	1 year
Non UK financial institutions	F1	A	A-1	A	P-1	A2	**35**	1 year
'AAA' rated Money Market Funds							**50**	Not fixed
'AAA' rated Enhanced Money Market Funds							**25**	Not fixed
UK Government							**No limit**	1 year
Local authorities - upper tier							**50**	3 years
Local authorities - lower tier							**35**	3 years
Property Funds							**20**	Not fixed
'AAA' rated Corporate Bonds							**20**	3 years
Corporate Bond Funds							**20**	3 years
UK Government Gilts / Gilt Funds							**20**	3 years
UK Government Treasury Bills							**20**	3 years

Notes:

Property Funds – these do not have a defined maturity date and the Property Fund may need to sell its underlying assets in order to repay the funds invested by the Council, so this is an illiquid form of investment.