Appendix B

2017/18 – 2019/20
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 demonstrate 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 2015/16 through to 2019/20 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 **£263m** for 2017/18, with an indicative programme for the subsequent two years totalling **£519m**, and funding the ongoing costs of earlier years' programmes and recurring items including highways and non schools maintenance. These planning levels represent a continued major investment in the infrastructure and economy of Essex.

Actual capital expenditure and financing sources for 2015/16, together with the original and updated plans for 2016/17, proposals for 2017/18 and the indicative guidelines for the subsequent two years are summarised in **Annex A**, with further detail presented within the Budget Book.

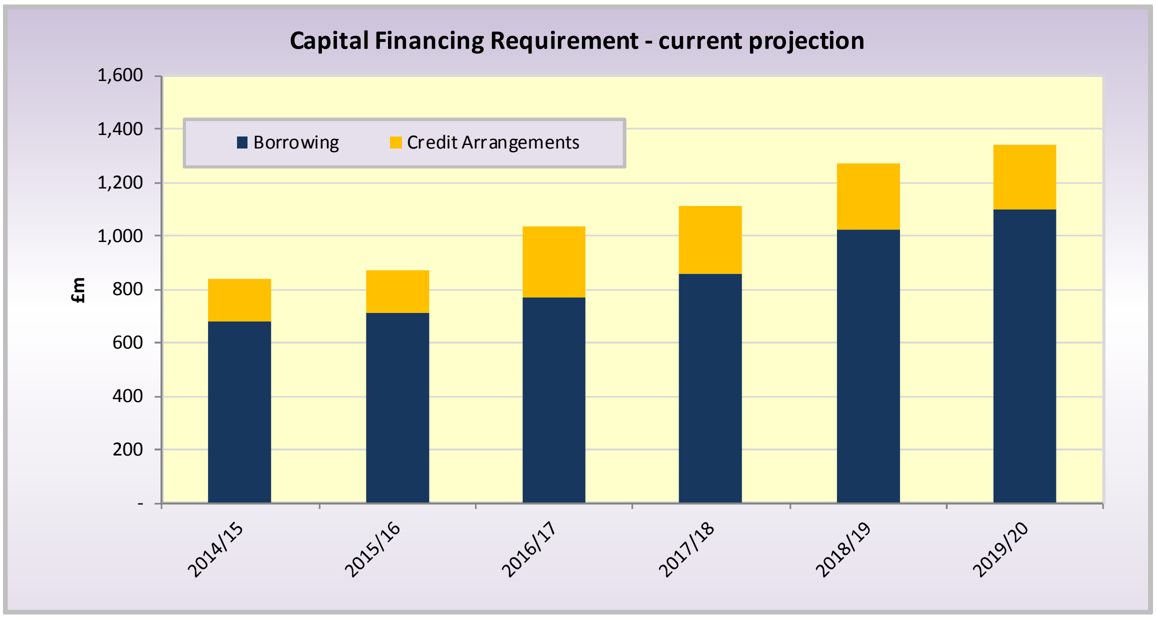
2.3 Capital Financing Requirement

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 2015/16 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 2015/16 and forward projections for the current and forthcoming 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 (including credit arrangements) exceeds the annual provision for the repayment of debt each year up to and including 2019/20.

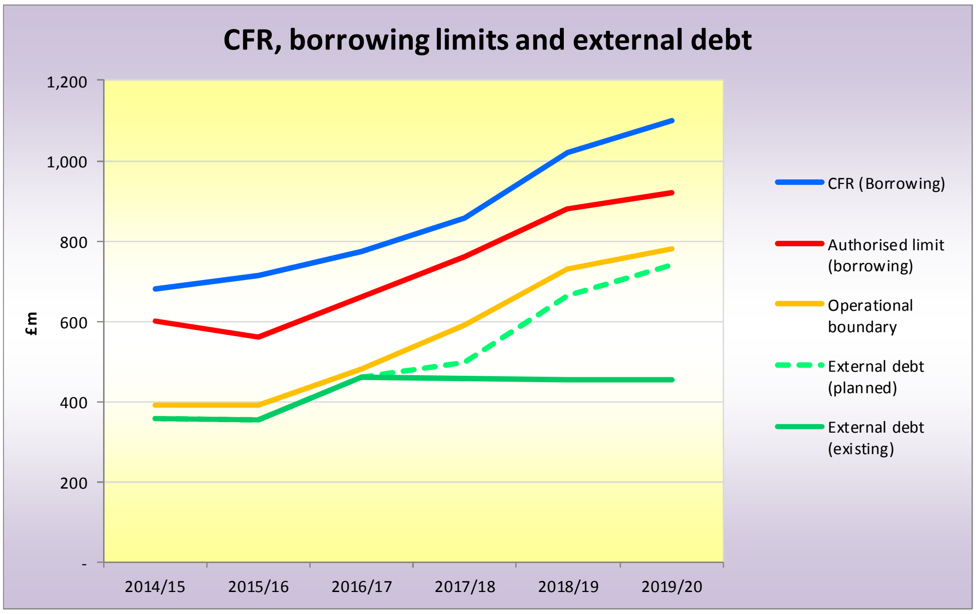
These estimates assume that the Government will continue to support local authorities' capital investment over the medium term via the provision of capital grant rather than by 'supported borrowing'. They also assume that the revised policy for the repayment of debt, which is explained later within this report, is adopted with effect from 2017/18.

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.



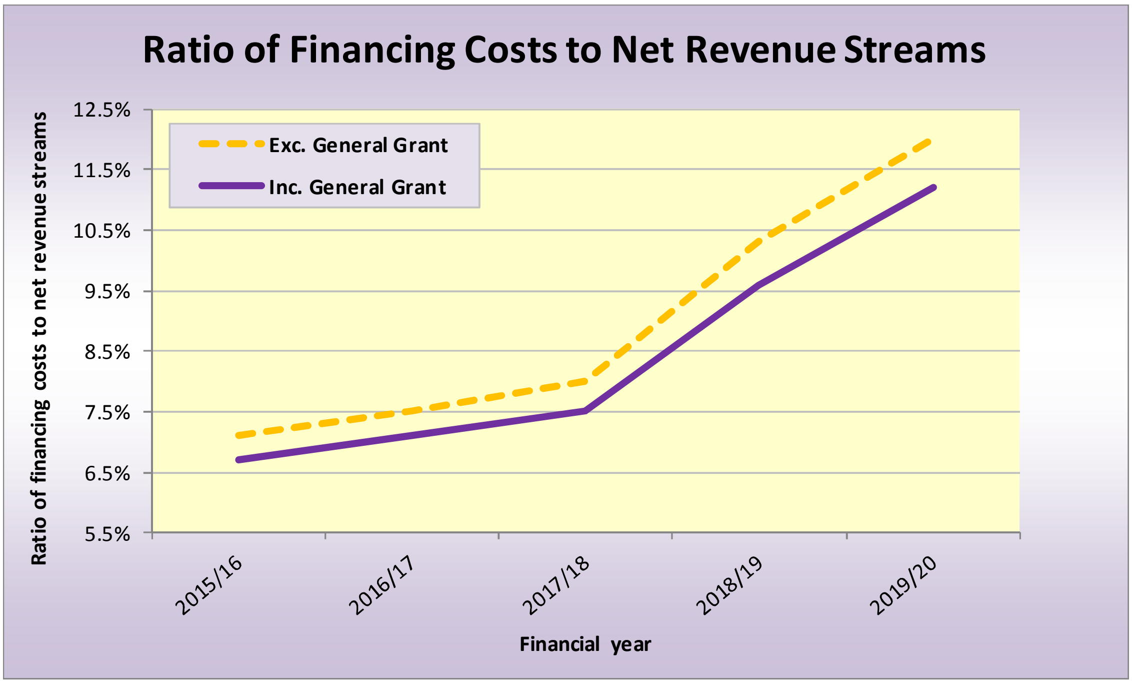
The authorised limit and operational boundary related to external borrowing are below the current estimates of the CFR for borrowing. This position is currently sustainable because the Council is able to temporarily utilise its cash balances as a short to medium term alternative to external borrowing. 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 2015/16, 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:



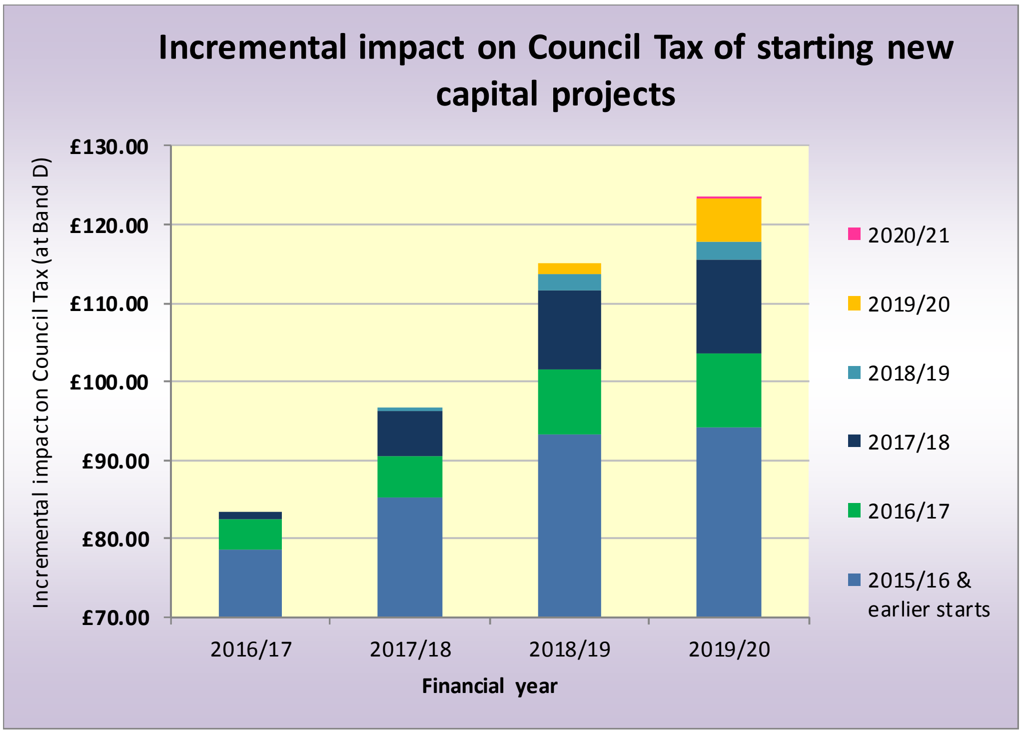
It is estimated that the proportion of the revenue budget that is required to fund borrowing costs will increase from **7.1%** in 2015/16 to **12%** by 2019/20. This increase partly reflects the impact of the Council's capital programme proposals over the forthcoming three years, but also a reduction 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, 2015/16 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 capital projects.

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 2017/18 and subsequent years, by providing commentary on the economic outlook:

- **UK economy**

  The referendum vote for Brexit in June 2016 delivered an immediate shock to the economy, pointing to a sharp downturn.

  The Monetary Policy Committee (MPC) cut the Bank Rate from **0.50%** to **0.25%**, and announced a renewal of quantitative easing, in August 2016 in order to counteract a slowdown. It also gave a strong steer that it was likely to cut Bank Rate again by the end of the year. However, economic data since August 2016 has indicated much stronger growth than that predicted, and inflation forecasts have risen substantially. Consequently, the Bank Rate has not been cut again. The latest MPC decision included a forward view that the Bank Rate could either go up or down, depending on how economic data evolves over the coming months.

  During the two year period 2017 – 2019, when the UK is negotiating the terms for withdrawal from the EU, it is unlikely that the MPC will do anything to dampen growth prospects (e.g. by raising Bank Rate). Accordingly, it is not anticipated that the Bank Rate will start to increase until the second quarter of 2019, when the Brexit negotiations are expected to be concluded. However, if strong domestically generated inflation (e.g. from wage increases within the UK) were to emerge, then the pace and timing of increases in Bank Rate could be brought forward.

  The number of external influences weighing down upon the UK mean that economic and interest rate forecasting remain difficult. The MPC decisions will be liable to further amendment depending on how economic data and developments in financial markets transpire over the next year.

  The overall balance of risks to economic recovery in the UK is to the downside, particularly in view of the current uncertainty over the final terms of Brexit and the timetable for its implementation.

- **Eurozone economy**

  In the Eurozone, the European Central Bank launched a €1.1 trillion programme of quantitative easing, initially intended to run until at least September 2016, but subsequently extended to March 2017. This programme has struggled to boost economic growth though, and forward indications are that economic growth in the EU is only likely to continue at moderate levels.

  There are also significant specific political and other risks within the Eurozone, including but not limited to:

  - Greece continuing to cause major stress due to its reluctance to implement the key reforms required by the EU.

- Spain having had two inconclusive general elections in 2015 and 2016.
- The under capitalisation of Italian and some German banks. National governments are forbidden by EU rules from providing state aid to bail out those banks that are at risk, but many of these banks are too big and too important to be allowed to fail.
- General elections in Holland, France and Germany during 2017.
- The core EU principle of free movement of people within the EU causing stress and tension between EU states.

Given the number and type of challenges the EU faces in the next eighteen months, there is an increasing risk that the EU will be called into fundamental question.

- **USA economy**

  The USA is probably the best positioned of the major world economies to make solid progress towards a combination of strong growth, full employment and rising inflation. The result of the recent presidential election is expected to lead to a strengthening of US growth, if the election promise of a major increase in expenditure on infrastructure is implemented.

  The Federal Reserve announced a **0.25%** hike in the federal fund rate in December 2016, and pledged a gradual pace of increases to more 'normal' levels. If the Trump package of policies is fully implemented, there is likely to be a significant increase in inflationary pressures which could, in turn, mean that the pace of further federal fund rate increases will be quicker and stronger than had previously been expected.

- **Other economies**

  Financial markets could be vulnerable to risks from emerging countries that are highly exposed to falls in commodity prices, and may have to liquidate substantial amounts of investments in order to cover national budget deficits over the next few years.

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 2017/18 has been determined in accordance with these forecasts.

3.4 Borrowing

<u>Borrowing strategy</u>

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 **£460m**, including **£110m** of external loans that were secured during April – June 2016. On the assumption that no further external loans are secured during the remainder of 2016/17, external borrowing will equate to around **61%** of the estimated CFR at **31 March 2017**. 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').

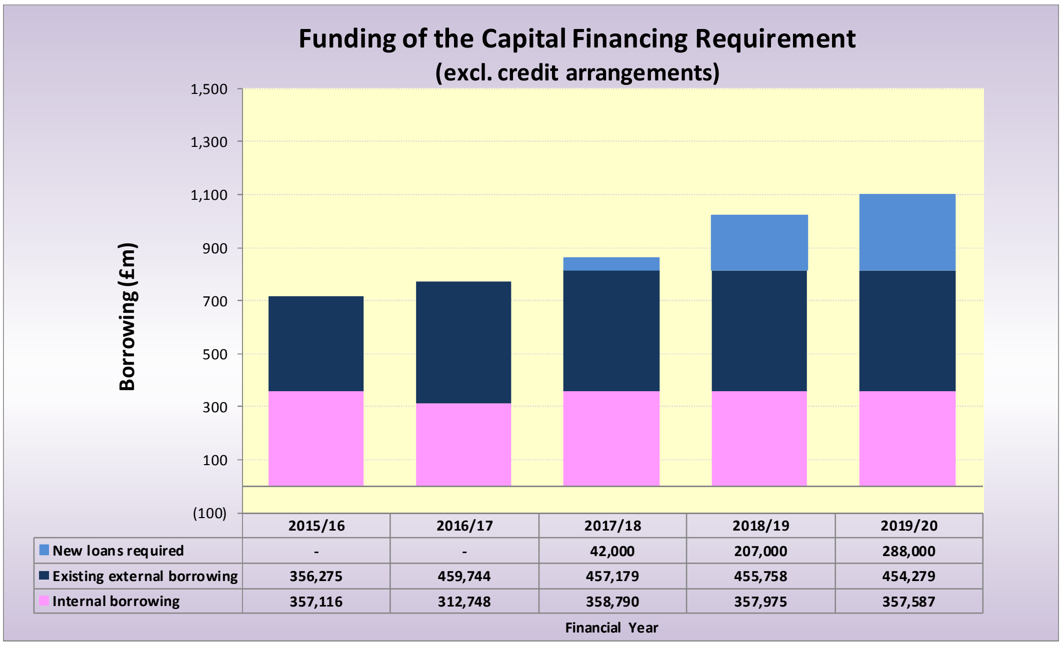
The use of internal borrowing is an effective treasury management strategy that enables the Council to:

- Avoid significant external borrowing costs (*i.e. making it possible to avoid net interest payments of around **£8.4m** in 2017/18 alone*); and
- Mitigate significantly the risks associated with investing cash in a volatile and challenging market.

The Council is likely to reach the limit of its capacity to 'internally borrow' (at around **£350m**) during 2017/18. Without undertaking new long term borrowing in 2017/18, and annually thereafter, the Council will cease to hold any cash for investment and will be borrowing short-term on a sustained basis.

It is intended to undertake sufficient new external borrowing over the period 2017/18 to 2019/20 to maintain the Council's underlying cash balances at around **£100m**; this is considered to be the '**cash baseline**' below which our underlying balances ought not drop on a sustained basis.

Working on this principle, the funding of the CFR over the period 2017/18 to 2019/20 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**			
	2017 £000	**2018 £000**	**2019 £000**	**2020 £000**
Existing external loans	**459,744**	**457,179**	**455,758**	**454,279**
Requirement for further borrowing				
2017/18	-	**42,000**	42,000	42,000
2018/19	-	**-**	165,000	165,000
2019/20	-	**-**	-	81,000
Total new borrowing	**-**	**42,000**	**207,000**	**288,000**
Total external borrowing	**459,744**	**499,179**	**662,758**	**742,279**
Internal borrowing	*312,427*	***358,503***	*357,722*	*357,368*
Total borrowing	***772,171***	***857,682***	***1,020,480***	***1,099,647***

If it not be possible or desirable to sustain internal borrowing at around **£350m**, further long term external borrowing will be required beyond that indicated in the above table.

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.

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 (**7DLIBOR**) 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.

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 investments will be undertaken.

Liquidity

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.

Performance

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 **Capita Asset Services (Treasury Solutions)** throughout 2016/17.

The treasury advisory services provided include 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 Capita Asset Services (Treasury Solutions) 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'. Financing capital expenditure in this way means the Council is able to incur capital expenditure that it does not immediately fund from cash resources. Instead, the Council sets cash resources aside from the Revenue Budget each year to repay the borrowing. This practice is referred to as making **minimum revenue provision** (or MRP) for the repayment of debt.

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

4.2 Regulatory requirements

Statutory guidance requires MRP to be provided annually on a **prudent** basis, and interprets 'prudent' to mean that:

- MRP charges on government **supported** and **pre 1st April 2008** borrowing should (as a minimum) be made over a period commensurate with the period over which government support is provided towards the associated debt financing costs; and
- MRP charges on **unsupported** borrowing should be made over a period commensurate with the period the assets financed from borrowing continue to provide benefit.

In accordance with this statutory guidance, the Council has been determining annual MRP on its borrowing using the following methodology:

Borrowing	MRP repayment basis
Government supported and pre 1st April 2008 borrowing	**Regulatory method** (i.e. MRP equates to 4% of the opening Capital Financing Requirement for the year).

Borrowing	MRP repayment basis
Unsupported borrowing	**Asset life method** (i.e. MRP is repaid in equal instalments of principal over the periods that benefits accrue from the resulting assets).

The **regulatory method** for repaying government **supported** and **pre 1st April 2008** borrowing described above (i.e. 4% of the opening CFR each year) works on a diminishing balance basis, meaning that it will take in excess of 350 years to fully repay the debt. Although this basis for determining MRP was made available by statutory guidance, it is now hard to conclude that the resulting MRP charges are prudent (given the payback period), and it can no longer be evidenced that revenue support grant is being provided on this basis either. It is therefore intended to vary the basis on which MRP is provided on this element of the CFR with effect from 2017/18. The new methodology will change the repayment profile, but does not alter the overall liability. Further details are provided in paragraph **4.3** below.

The current **asset life** basis for determining MRP charges on **unsupported** borrowing (i.e. by repaying the principal sums in equal instalments over the periods that benefits directly or indirectly accrue from the assets) is consistent with current statutory requirement for prudence, and so no changes are proposed to this methodology.

4.3 Government supported and pre 1st April 2008 borrowing

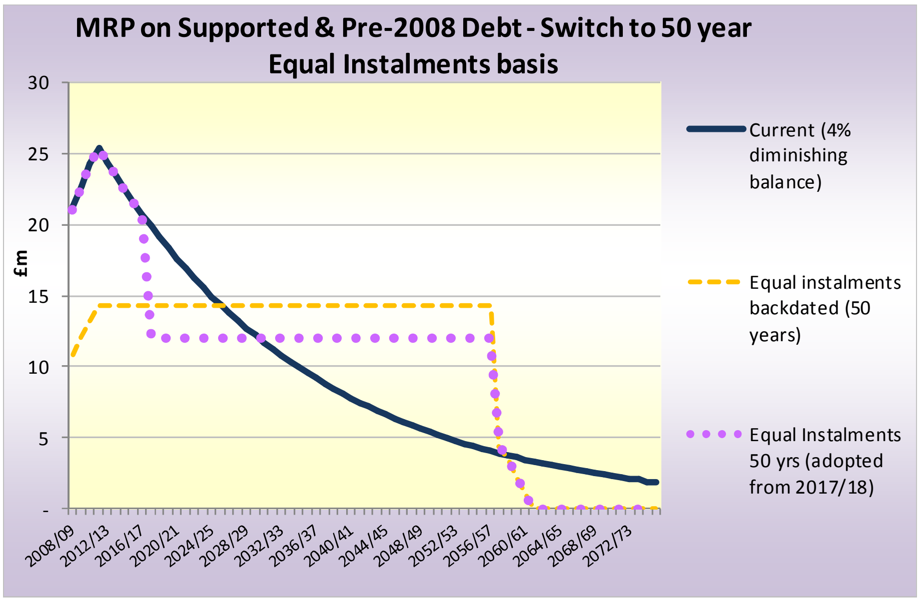
An ‘equal instalments’ basis for MRP on government supported and pre 1st April 2008 debt, that is aligned to the period the assets financed from borrowing continue to provide benefit, would be more ‘prudent’ than a continuation of the current **4%** diminishing balance basis described in the previous paragraph.

The difficulty comes in determining the period over which the assets financed from the government supported and pre 1st April 2008 borrowing continue to provide benefit. This is because, prior to 1st April 2008, it was not necessary to maintain records of the financing for individual assets, as all unfinanced expenditure was simply consolidated into the Capital Financing Requirement. However, statutory regulations state that, if no life can reasonably be attributed to an asset, the life should be taken to be a maximum of **50 years**.

The current statutory provisions for MRP took effect from **31st March 2008**, which means that they applied with effect from the 2007/08 financial year. It is therefore intended that a 50 year ‘equal instalments’ repayment term will be applied retrospectively with effect from 2007/08, with subsequent government supported borrowing being repayable over **50 years** from the year in which the expenditure was incurred.

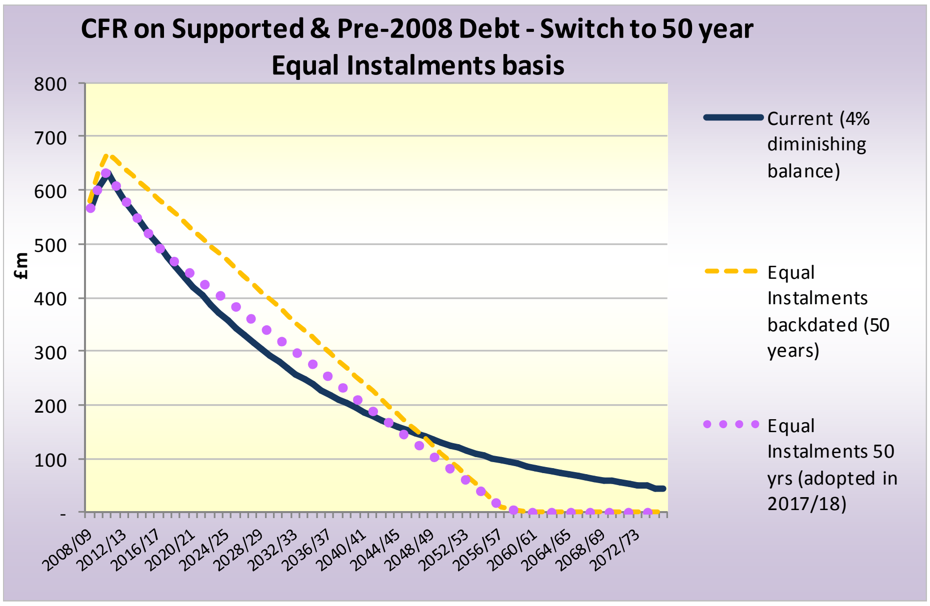
An implication of applying the 50 year ‘equal instalments’ methodology retrospectively is that the Council will have effectively over provided for MRP annually since 2007/08 (i.e. in aggregate, by a total of **£93.4m**). In accordance with guidance issued by the National Audit Office, this over provision will be released to reduce annual MRP charges over the remainder of the **50** year term (i.e. from 2017/18 onwards).

The following graph compares the MRP charges on government supported and pre 1st April 2008 debt that would result from a continuation of the 4% diminishing balance basis and those that result from adopting an 'equal instalments' basis retrospectively from 2007/08 and with effect from 2017/18:



The change in the methodology for determining MRP will not alter the totality of the MRP liability, but will change the incidence of annual charges against the Revenue Budget. That is, MRP charges will initially be lower (i.e. in each year until 2030/31), and higher annually thereafter until the CFR on government supported and pre 1 April 2008 debt is fully extinguished.

The MRP payback period will be shortened too. That is, by adopting a 50 year 'equal instalments' basis, the CFR will be fully repaid by 2060/61 – in comparison, if the diminishing balance methodology were to be continued, the CFR outstanding at 1 April 2061 would still be **£79m**:



4.4 Revenue Provision for Debt Repayment Policy 2017/18

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 commensurate with the period over which the capital expenditure provides benefit.

This is achieved by applying the following methodology:

Borrowing	MRP repayment basis
Pre 1st April 2008 debt	This element of the Capital Financing Requirement is being repaid on a 50 year '**Equal instalments**' basis, with commencement of the 50 year term in 2007/08. ***Note****: as this is a change to the approach adopted in previous years, the actual CFR at 1 April 2017 will be repaid in equal instalments over the remainder of the 50 year term.*
Government supported debt – 2008/09 onwards	This element of the CFR is being repaid on a 50 year '**Equal Instalments**' basis, with commencement of the 50 year term in the financial year following the capital expenditure. ***Note****: as this is a change to the approach adopted in previous years, the actual CFR at 1 April 2017 will be repaid in equal instalments over the remainder of the relevant 50 year term.*
Unsupported borrowing	This element of the CFR is being repaid using the **Asset Life** method. This spreads the unsupported borrowing over the useful life estimated at the start of the relevant asset lives (or over a shorter period where use of the standard useful life would not be supportable as prudent).
Loans awarded for capital purposes	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).
Credit arrangements	MRP is met by a charge equal to the element of rent/charge that goes to write down the balance sheet liability.

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

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.

The revenue budget provision for MRP charges in 2017/18 has been compiled on a basis consistent with this policy.

Prudential Indicators

Summary of prudential indicators		2015-16 Actual	2016-17 Original Estimate	2016-17 Updated Estimate	2017-18 Estimate	2018-19 Forecast	2019-20 Forecast
Capital expenditure & financing							
Capital Expenditure	£m	227	252	224	**263**	308	211
Capital Financing							
Borrowing (unsupported)	£m	57	114	87	**107**	188	110
Grants and contributions	£m	143	111	114	**121**	102	83
Capital receipts and earmarked reserves	£m	27	27	23	**35**	18	18
Total capital financing	£m	**227**	**252**	**224**	**263**	**308**	**211**
Capital financing requirement							
Capital financing requirement (CFR)							
Opening CFR	£m	841	996	868	**1,038**	1,115	1,268
Add							
Additional borrowing	£m	57	114	87	**107**	188	110
Additional credit liabilities (PFI / Finance leases)	£m	4	10	120	**-**	-	-
		902	1,120	1,075	**1,145**	1,303	1,378
Less							
Revenue provision for debt repayment	£m	(34)	(34)	(37)	**(30)**	(35)	(40)
Capital Financing Requirement	£m	**868**	**1,086**	**1,038**	**1,115**	**1,268**	**1,338**
Analysis of the Capital Financing Requirement							
Supported borrowing and pre 2008/09 unsupported borrowing	£m	511	489	490	**478**	466	454
Unsupported borrowing (2008/09 and later)	£m	202	317	282	**380**	555	646
Sub total - borrowing	£m	**713**	**806**	**772**	**858**	**1,021**	**1,100**
Credit arrangements (PFI / Finance leases)	£m	155	280	266	**257**	247	238
Total	£m	**868**	**1,086**	**1,038**	**1,115**	**1,268**	**1,338**
Gross borrowing and the CFR							
Medium term forecast of CFR	£m	1,115	1,419	1,268	**1,338**	1,317	1,288
Forecast external debt (long term) and credit arrangements	£m	546	629	729	**824**	997	996
Headroom	£m	**569**	**790**	**539**	**514**	**320**	**292**
External debt							
Authorised limit							
Borrowing	£m	620	660	660	**760**	880	920
Other long term liabilities	£m	284	279	266	**257**	247	238
Total authorised limit	£m	**904**	**939**	**926**	**1,017**	**1,127**	**1,158**
Operational boundary							
Borrowing	£m	520	480	480	**590**	730	780
Other long term liabilities	£m	265	259	256	**237**	228	219
Total operational boundary	£m	**785**	**739**	**736**	**827**	**958**	**999**
Actual external debt (incl. credit arrangements)	£m	**511**	**N/A**	**N/A**	**N/A**	**N/A**	**N/A**
Financing & net revenue streams							
Net revenue streams excl. gen. govnt grants	%	7.1%	7.5%	7.5%	**8.0%**	10.3%	12.0%
Net revenue streams incl. gen. govnt grants	%	6.7%	7.1%	7.1%	**7.5%**	9.6%	11.2%
Incremental impact on Council Tax							
Effect of capital schemes starting in:							
2015/16 and earlier years	£	£85.81	£97.87	£90.21	**£78.66**	£85.33	£93.17
2016/17	£		£3.60	£0.73	**£3.70**	£5.13	£8.25
2017/18	£		-	-	**£0.96**	£5.69	£10.24
2018/19	£		-	-	**-**	£0.46	£2.01
2019/20	£		-	-	**-**	-	£1.29
Total	£	**£85.81**	**£101.47**	**£90.94**	**£83.32**	**£96.61**	**£114.96**

Annex B

Treasury Management Summary

Treasury Management Summary		2015-16 Actual	2016-17 Original Estimate	2016-17 Latest Estimate	2017-18 Estimate	2018-19 Forecast	2019-20 Forecast
Estimated debt and investments							
Investments (estimated balance at each 31st March)	£m	218	106	218	**225**	162	150
External debt (operational boundary for borrowing)	£m	520	480	480	**590**	730	780
Expected movement in interest rates							
Bank Rate (at each 31st March)	%		0.75%	0.25%	**0.25%**	0.25%	0.50%
PWLB (borrowing) rates							
5 year	%		2.40%	1.60%	**1.60%**	1.75%	1.95%
10 year	%		3.00%	2.30%	**2.30%**	2.40%	2.60%
25 year	%		3.70%	2.90%	**2.95%**	3.10%	3.30%
50 year	%		3.50%	2.70%	**2.75%**	2.90%	3.10%
Source: *Capita Asset Services (Treasury Solutions) (December 2016)*							
Effect of 1% increase in interest rates							
Interest on borrowing	£000		-	-	**210**	1,245	2,475
Interest on investments	£000		(1,045)	(2,234)	**(1,603)**	(1,478)	(1,442)
Interest attributed to reserves & balances	£000		2,282	2,229	**2,292**	2,355	2,419
Interest attributed to other bodies	£000		325	304	**304**	304	304
Net total	£000		**1,562**	**299**	**1,203**	**2,426**	3,756
Borrowing requirement (external borrowing)	£m	**35**	62	63	**42**	165	81
Interest rate exposures							
Upper limits for exposure to fixed rates							
Net exposure	£m	620	660	660	**760**	880	920
Debt	%	100%	100%	100%	**100%**	100%	100%
Investments	%	100%	100%	100%	**100%**	100%	100%
Upper limits for exposure to variable rates							
Net exposure	£m	186	198	198	**228**	264	276
Debt	%	30%	30%	30%	**30%**	30%	30%
Investments	%	100%	100%	100%	**100%**	100%	100%
Maturity structure of borrowing (upper limit)							
Under 12 months	%	5.60%	40%	40%	**40%**	40%	40%
12 months and within 24 months	%	7.80%	40%	40%	**40%**	40%	40%
24 months and within 5 years	%	13.50%	60%	40%	**40%**	40%	40%
5 years and within 10 years	%	11.30%	60%	40%	**40%**	40%	40%
10 years and within 25 years	%	11.80%	65%	60%	**60%**	60%	60%
25 years and within 40 years	%	30.00%	70%	40%	**40%**	40%	40%
40 years and within 50 years	%	23.00%	50%	20%	**20%**	20%	20%
50 years and above	%	0.00%	22%	20%	**20%**	20%	20%
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	4	50	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. 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.

3. 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).

4. 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.

5. 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.

6. 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).

7. 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.

8. 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 determine the use of these alternative investment products, taking into account the acceptability or otherwise of the risks associated with their use.

9. 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.

Annex C