WARWICK DISTRICT COUNCIL	Executive – 10th February 2016	Agenda Item No. **7**

Title:	Treasury Management Strategy Plan for 2016/2017
For further information about this report please contact	Roger Wyton 01926 456801 roger.wyton@warwickdc.gov.uk Karen Allison 01926 456334 karen.allison@warwickdc.gov.uk
Wards of the District directly affected	All
Is the report private and confidential and not for publication by virtue of a paragraph of schedule 12A of the Local Government Act 1972, following the Local Government (Access to Information) (Variation) Order 2006	No
Date and meeting when issue was last considered and relevant minute number	N/A
Background Papers	Treasury Management in the Public Services – A Code of Practice and associated guidance notes– CIPFA The Prudential Code for Capital Finance in Local Authorities - CIPFA Treasury Management file L1/9 Treasury Management information via External Advisors, Brokers etc.

Contrary to the policy framework:	No
Contrary to the budgetary framework:	No
Key Decision?	Yes
Included within the Forward Plan? (If yes include reference number)	Yes - 666
Equality & Sustainability Impact Assessment Undertaken	No – not relevant

Officer/Councillor Approval		
Officer Approval	**Date**	**Name**
Chief Executive/Deputy Chief Executive	18/01/2016	Andy Jones
Head of Service	18/01/2016	Mike Snow
CMT	18/01/2016	N/A
Section 151 Officer	18/01/2016	Mike Snow
Monitoring Officer	N/A	N/A

Finance	18/01/2016	Roger Wyton
Portfolio Holder(s)	21/01/2016	Cllr. Peter Whiting

Consultation & Community Engagement	
None	
Final Decision?	Yes
Suggested next steps (if not final decision please set out below) N/A	

1. SUMMARY

1.1 This report details the strategy for 2016/17 that the Council will follow in carrying out its Treasury Management activities including the Annual Investment Strategy and Minimum Revenue Provision (MRP)Policy Statement.

1.2 The report consists of a number of Appendices:-

Appendix A - Annual Treasury Management Strategy Plan 2016/17
Appendix B – 2016/17 Annual Investment Strategy Including Annex 1
Appendix C – Minimum Revenue Provision Policy Statement
Appendix D – An Explanation of Credit Rating Terms
Appendix E – Economic Background
Appendix F – Glossary of Terms

2. RECOMMENDATIONS

2.1 That the Executive notes:-

The changes to the various Treasury Management Practices as detailed in paragraph 3.2 below.

2.2 That the Executive recommends to Council:-

a) The Treasury Management Strategy for 2016/17 as outlined in paragraph 3.1 below and detailed in Appendix A,

b) The 2016/17 Annual Investment Strategy as outlined in paragraphs 3.3 and 3.4 below and detailed in Appendix B together with Annex 1 including the following changes:-

1. That as per paragraph 2.3 of Appendix B, for banks and category A and B Building Societies, the minimum long term rating be reduced from A+ to A and for banks rated A, a counterparty limit of £3m be introduced.

2. That as per paragraph 2.4 of Appendix B, the overall group limit of £6m for Variable Net Asset Value Money Market Funds be removed.

3. That as per paragraph 2.5 of Appendix B. the minimum credit rating for Category 1 & 3 Corporate and Covered Bonds and Floating Rate Notes be reduced from A+ to A.

4. That as per paragraph 2.7 of Appendix B. Repo's are added to the list of Specified investment vehicles and Corporate Equity Funds are added to the list of Non Specified investment vehicles that the Council can use.

5. That as per paragraph 2.9 of Appendix B, the relevant counterparty

limit is increased by £3m where that additional £3m is represented by Repo Collateral with a credit rating higher than that of the counterparty offering the Repo.

6. That as per paragraph 2.11 of Appendix B, in the case of Corporate Bond/Equity and Property Funds a volatility reserve be established if necessary in order to manage the impact of capital valuation changes on the General Fund.

7. That as per paragraph 2.12 of Appendix B the individual counterparty limit for Corporate Equity Funds be £3m, £2m and £1m for Low, Medium and High risk funds respectively. In each case the limit to be subject to a 10% allowance for capital growth.

8. That as per paragraph 2.16 of Appendix B the current long term investment limits of 60% of the core investments portfolio subject to a maximum of £15m be increased to 70% and £20m respectively and the current limit of £10m for Corporate Bond/Equity/Property Funds be increased to £15m to be included within the new proposed overall limit of £20m.

c) The Minimum Revenue Provision Policy Statement as outlined in paragraph 3.5 below and contained in paragraphs 4.1 to 4.4 of Appendix C.

d) The Prudential Indicators as outlined paragraph 3.6 below and contained in paragraphs 5.1 to 5.5 of Appendix A.

3. REASONS FOR RECOMMENDATIONS

3.1 The Council is required to have an approved Treasury Management Strategy, including an Annual Investment Strategy and Minimum Revenue Provision Policy within which its Treasury Management operations can be carried out. The Council will be investing approximately £11.72 million in new capital in 2016/17 and will have average investments of £57 million (2015/16 latest £62m). This level of investments arises from the Council's reserves and provisions, the General Fund and Housing Revenue Account balances, and accumulated capital receipts as well as cashflow.

3.2 The Council's treasury management operations are also governed by various Treasury Management Practices (TMP's), the production of which is a requirement of the CIPFA code and which must be explicitly followed by officers engaged in treasury management. These have previously been reported to the Executive and approved. There have been the following changes to various Treasury Management Practices (TMP's) and these changes are outlined overleaf

TMP 1 Risk Management.

Paragraph 2.1(a) – Reduction in Fitch minimum long term credit rating for Banks from A+ to A.

Paragraph 2.1(d) – Reduction in Fitch minimum long term credit rating for category A Building Societies from A+ to A.

Paragraph 2.1(e) - Reduction in Fitch minimum long term credit rating for category B Building Societies from A+ to A.

Paragraph 2.1(n) - Reduction in Fitch minimum long term credit rating for Corporate Bonds from A+ to A.

Paragraph 2.1(o) - Reduction in Fitch minimum long term credit rating for Floating Rate Notes from A+ to A.

Paragraph 2.1(s) - Reduction in Fitch minimum long term credit rating for Covered Bonds from A+ to A.

Paragraph 2.1(t) – inclusion of Corporate Equity Funds.

Paragraph 2.2 – setting of counterparty limits for new investment vehicles:-

i) Repo transactions with banks meeting the Council's minimum credit rating criteria, the counterparty limit is increased by £3m where the £3m represents Repo investments in which the credit quality of the collateral is greater than that of the counterparty.
ii) Repo transactions with category A and B building societies meeting the Council's minimum credit rating criteria, the counterparty limit is increased by £2m where the £2m represents Repo investments in which the credit quality of the collateral is greater than that of the counterparty.
iii) For Corporate Equity Funds, the counterparty limits will be Low Risk funds £3m, Medium Risk funds £2m and High Risk funds £1m with a 10% allowance for capital growth.
iv) The definition of what is low, medium or high risk will be based on the funds risk and reward profile as outlined in its Key Investor Information Document.

Paragraph 2.3 – Addition of Corporate Equity Funds to those vehicles with a maximum investment period of ten years. Also increase in amount of core investments that can be invested for more than 364 days from 60% of the value of the portfolio subject to a maximum of £15m to 70% and £20m respectively.

TMP2 Best value and Performance Management

Paragraph 1.4 – updating use of external investment agents to include Bond/Equity Fund managers.

Paragraph 2.1(n) - Reduction in Fitch minimum long term credit rating for Corporate Bonds from A+ to A.

TMP4 Approved Instruments, Methods and Techniques.

Paragraph 2.1(n) - Reduction in Fitch minimum long term credit rating for Corporate Bonds from A+ to A.

Paragraph 2.1(o) - Reduction in Fitch minimum long term credit rating for Floating Rate Notes from A+ to A.

Paragraph 2.1(s) - Reduction in Fitch minimum long term credit rating for Covered Bonds from A+ to A.

Paragraph 2.1(t) – introduction of Repo's up to a maximum of 364 days entered into with Financial Institutions with a minimum Fitch Long Term credit rating of A.

Paragraph 2.1(u) – introduction of Repo's up to a maximum of 364 days entered into with, subject to credit rating suitability, a building society.

Paragraph 2.1(v) – introduction of Corporate Equity Funds up to a maximum of 10 years.

TMP5 Organisation, Clarity and Segregation of Responsibilities and Dealing Arrangements.

Paragraph 1.3 – Limit on individual investments requiring approval of Head of Finance raised from £3m to £5m.

TMP 11 Use of External Service Providers

Paragraph 1.3(k) - Reduction in Fitch minimum long term credit rating for Corporate Bonds from A+ to A.

Paragraph 1.3(l) - Reduction in Fitch minimum long term credit rating for Floating Rate Notes from A+ to A.

Paragraph 1.3(o) - Reduction in Fitch minimum long term credit rating for Covered Bonds from A+ to A.

Paragraph 1.3(p and q) – updated to allow use of repo's with Banks and Building Societies meeting the Council's minimum credit rating criteria.

Paragraph 1.4 – updated for addition of Repo's.

Paragraph 1.8 – updated to reflect that where appropriate, the Council will employ Corporate Bond/Equity Fund managers.

Paragraph 1.9 – new paragraph added re Corporate Bond/Equity Fund managers investment objectives and performance benchmarks.

3.3 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public. The Annual Investment Strategy for 2016/17 is contained within Appendix B and its Annex.

3.4 The current low interest rate environment is expected to continue for the foreseeable future as whilst interest rates are expected to start rising from the final quarter of 2016 it will be from a very low base and consequently investment returns will continue to be depressed for some time to come. The Council's requirement under the Fit For the Future agenda for an additional £50,000 investment income to be generated each year from 2016/17 for the General Fund and continuing high investment balances mean that it has become necessary once again to look at alternative investment vehicles in order to ensure that the Council can continue to invest its funds with the highest possible security whilst obtaining a reasonable rate of return. This means that the Council can diversify its risk rather than just increasing the limits for existing counterparties. The change being recommended is described in more detail in Appendix B but essentially involves the addition of Repo's and Corporate Equity Funds for longer term investments. In addition, various changes to counterparty credit ratings and limits are proposed and again these are described in more detail in Appendix B.

3.5 The Council has to make provision for the repayment of its outstanding long term debt and other forms of long term borrowing such as Finance Leases. Statutory guidance from the DCLG requires that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates and this is contained in Appendix C.

3.6 The Prudential Code for Capital Finance in local authorities which was revised in 2009 introduced new requirements for the manner in which capital spending plans are to be considered and approved, and in conjunction with this, the development of an integrated treasury management strategy. The Prudential Code requires the Council to set a number of Prudential Indicators and this report does therefore incorporate within section 5 of Appendix A the indicators to which regard should be given when determining the Council's treasury management strategy for the next 3 financial years.

4. POLICY FRAMEWORK

4.1 **Policy Framework** - This report is in accordance with the Council's established Treasury Management Policies, Code of Financial Practice and provides a framework within which it will conduct its Treasury Management Operations in 2016/17.

4.2 **Fit for the Future** – The Treasury Management function enables the Council to meet its vision of a great place to live, work and visit as set out in the Sustainable Community.

4.3 **Impact Assessments** – No impacts of new or significant policy changes proposed in respect of Equalities.

5. BUDGETARY FRAMEWORK

5.1 The Treasury Management Strategy has a potentially significant impact on the Council's budget through its ability to maximise its investment interest income whilst minimising the risk of the loss of the Council's funds and minimise its borrowing interest payable which is of particular importance to the HRA under the Self Financing regime and also the General Fund in respect of potential borrowing on projects such as leisure centre and multi-storey car parks refurbishments as well as the proposed new offices. This also helps to underpin the Council's Corporate Objectives and delivery of its Fit For the Future projects. The performance of the Treasury Management function is reported half-yearly to the Finance & Audit Scrutiny Committee which is the body charged by the Council with overseeing the treasury management activities of the council. Also an annual report for the Finance & Audit Scrutiny Committee is prepared at the end of the financial year on Treasury Management and compliance with the strategy and the Treasury Management Practices are reviewed as part of the annual Treasury Management audit.

5.2 Treasury Management is an evolving process and whilst it is not easy to compare investment returns from year to year due to complications arising from economic conditions, the previous year's performance together with feedback on our current performance from the Council's involvement in Capita Asset Services' Treasury Management Benchmarking Club is reviewed to see what lessons can be learnt that would help improve the current and future years investment returns and/or the security of the investments. For instance, this may take the form of new investment vehicles as is being recommended in this report.

6. **RISKS**

6.1 Treasury Management is essentially about the management of risk, e.g. the risk to the security of the Council's investments should a counterparty fail, liquidity risk in that there is a need to ensure that there is sufficient cash available to meet debts as and when they become due and interest rate risk in that the Council may be "locked" into low interest yielding investments at the time that interest rates are rising and therefore missing out on opportunities to maximise interest receipts. These risks are mitigated by the use of credit rating criteria and market intelligence in order to ensure the Council invests with only the best quality counterparties, good cash flow forecasting both short and long term and the use of interest rate forecasts published by the Council's treasury consultants.

6.2 The use of different investment vehicles also has its risks, for instance the introduction of Corporate Bonds in 2015/16 and in 2016/17, Corporate Equity Funds has potentially increased capital risk. This is through potential capital loss due to market price fluctuations, for instance if investments have to be withdrawn early. This is mitigated by good cash flow management ensuring that investments are available for the necessary length of time to ensure that there is no negative impact on the capital value of the fund. In addition, in the cases of Equity and Bond funds mitigation is achieved by having a spread of funds with differing risk appetites ranging from low through medium to high rather than concentrating all investments in one fund. The introduction of a "stop loss" limit in the case of Bond/Equity Funds whereby if the value in the fund(s) goes below a defined limit, the holdings in that fund will be sold thus limiting further losses will also reduce risk as will the use of a "volatility" reserve as a certain proportion of the annual return on the fund will be credited to the reserve and then when required released to revenue to either cover or at least mitigate the impact of any deficits. The risk of capital loss is not new to the Council, some years ago the Council had a cash fund managed by Invesco which incurred capital losses on the Gilt investments within the portfolio.

6.3 The risk involved in not adopting the recommendations are outlined in paragraph 7.2.

6.4 By engaging Treasury Management Consultants, the Council is able to mitigate the risks described in paragraphs 6.1 and 6.2. These Consultants provide regular briefings, alerts and advice in respect of the Council's portfolio. The contract also includes training both in-house and by way of seminars so officers responsible for the Council's Treasury Management Function are fully competent. Adequate cover (fully trained) is provided within the Finance Department should there be a risk of staff shortages and the updating of the procedure notes is nearing completion.

7. ALTERNATIVE OPTIONS CONSIDERED

7.1 The approval of an annual Treasury Management Strategy is a requirement of the CIPFA Treasury Management in the Public Services Code of Practice, the latest version of which was adopted by the Council in 2011/12.

7.2 An alternative to the strategy being proposed for 2016/17 would be to not introduce the new investment vehicles or alter the current counterparty limits and minimum credit ratings but this would not achieve the increase in investment interest required by the Council.

APPENDIX A ANNUAL TREASURY MANAGEMENT STRATEGY PLAN 2016/17

1. GENERAL

1.1 This part of the report outlines the strategy that the Council will follow during 2016/17. Its production and submission to the Council is a requirement of the CIPFA Code of Practice on Treasury Management in the Public Services.

1.2 The suggested strategy for 2016/17 in respect of the treasury management function is based upon the officers view on interest rates supplemented with forecasts provided by Capita Asset Services – Treasury Solutions who are the Council's treasury advisers.

1.3 It is also a statutory requirement under Section 33 of the Local Government Finance Act 1992, for the Council to produce a balanced budget. In particular, Section 32 requires a local authority to calculate its budget requirement for each financial year to include the revenue costs that flow from capital financing decisions. This, therefore, means that increases in capital expenditure must be limited to a level whereby increases in charges to revenue from a) increases in interest charges caused by increased borrowing to finance additional capital expenditure b) any increases in running costs from new capital projects and c) the loss of interest on balances or reserves arising from their use in financing the capital expenditure are limited to a level which is affordable within the projected income of the council for the foreseeable future. This is covered by the Prudential Indicator calculating the Incremental Impact on the Council Tax or Housing Rent in paragraph 5.3 below.

1.4 A Glossary of Terms is included as Appendix F in order to aid Member's understanding of technical terms used in the field of Treasury Management.

2 INTEREST RATE FORECASTS FOR 2016/17

2.1 The ability to forecast the movement of interest rates is fundamental to successful investment and borrowing strategies. The Council employs Capita Asset Services – Treasury Solutions to provide interest rate forecasts and their latest view on both short and long term rates is shown in 2.2 overleaf. Their view on Bank Rate has been used to formulate the investment interest estimates for 2016/17 and future years and the PWLB rates are of particular interest in respect of the £136.157m PWLB debt taken out in late 2011/12 to finance the HRA Self Financing debt settlement as they will form the basis for any debt restructuring decisions that may be taken during 2016/17 although none are currently planned. The PWLB rates are also germane to any take up of the £13.843m borrowing headroom that the HRA has under the Self Financing regime or any other schemes requiring the Council to borrow long term.

2.2 The PWLB forecasts below, provided by Capita Asset Services, are based on the PWLB Certainty Rate.

Quarter	Bank Rate	5 yr PWLB Rate	10 yr PWLB Rate	25 yr PWLB Rate	50 yr PWLB Rate
Dec 2015	0.50%	1.92%	2.58%	3.36%	3.18%
Mar 2016	0.50%	2.00%	2.60%	3.40%	3.20%
Jun 2016	0.50%	2.10%	2.70%	3.40%	3.20%
Sep 2016	0.50%	2.20%	2.80%	3.50%	3.30%
Dec 2016	0.75%	2.30%	2.90%	3.60%	3.40%
Mar 2017	0.75%	2.40%	3.00%	3.70%	3.50%
Jun 2017	1.00%	2.50%	3.10%	3.70%	3.60%
Sep 2017	1.00%	2.60%	3.20%	3.80%	3.70%
Dec 2017	1.25%	2.70%	3.30%	3.90%	3.80%
Mar 2018	1.25%	2.80%	3.40%	4.00%	3.90%
Jun 2018	1.50%	2.90%	3.50%	4.00%	3.90%
Sep 2018	1.50%	3.00%	3.60%	4.10%	4.00%
Dec 2018	1.75%	3.10%	3.60%	4.10%	4.00%
Mar 2019	1.75%	3.20%	3.70%	4.10%	4.00%

2.3 The Monetary Policy Committee (MPC) utilises Bank Rate as one of its tools to control inflation in the economy and meet its target rate of 2% Consumer Prices Inflation (CPI).

2.4 Recent changes in market sentiment and outlook has led to Capita Asset Services revising their view of when Bank Rate might start to rise with the first rise now being predicted for the December quarter of 2016.The background to these changes is reflected in Appendix E which contains Capita's view of the economic background.

2.5 With regard to any potential long term borrowing, borrowing interest rates have been highly volatile during 2015 as alternating bouts of good and bad news have promoted optimism, and then pessimism, in financial markets. Gilt yields , on which long term borrowing rates are based, have continued to remain at historically very low levels during 2015. Although not utilised by the Council, the general policy of avoiding new borrowing by running down spare cash balances has served well over the last few years. However, this needs to be carefully reviewed to avoid incurring higher borrowing costs in later times, when authorities will not be able to avoid new borrowing to finance new capital expenditure and/or to refinance maturing debt. There will remain a cost of carry to any new borrowing which causes an increase in investments as this will incur a revenue loss between borrowing costs and investment returns.

3 CAPITAL BORROWING AND CAPITAL PROGRAMME FINANCING STRATEGY

3.1 The Council is able to finance its capital programmes in the following ways:-

a) By the use of Prudential Borrowing. Currently it is anticipated that there will be a need to borrow £50,000 in order to part finance the Council's General Fund 2016/17 capital programme. This relates to the Leisure Options expenditure required to reach RIBA stage 4. However, it is likely, given that investment interest rates are forecast to be below long term borrowing rates for the year, that any borrowing will be of an internal nature i.e. from the Council's cash balances.

b) From Usable capital receipts. With regard to the General Fund capital programme it is anticipated that it will be part funded by the balance of unused capital receipts carried forward to 2016/17 primarily arising from the sale of Wilton House in 2011/12. The Housing Investment Programme anticipates 22 council house sales during 2015/16 resulting in £700,000 being available to part finance current and future expenditure alongside receipts in hand from previous years.

c) From revenue or reserves.

d) From external contributions and grants. With regard to the General Fund capital programme, it is anticipated that external contributions will be used to part finance the 2016/17 expenditure on Green Farm Play Equipment and Jubilee House. With regard to the Housing Investment Programme it is expected that grants and contributions amounting to £423,100 will be utilised to finance General Fund Housing RSL projects and Improvement Grants.

e) From Leasing or other similar means of capital finance.

3.2 With the exception of dedicated external grants and contributions, before deciding which of the above means of capital financing will be utilised to finance capital expenditure, the Council will conduct an options appraisal exercise where appropriate.

3.3 The financing of the Council's proposed 2016/17 capital programmes (at January 2016) is shown in the table below:-

Financing Method	General Fund £	Housing Investment Programme £
Prudential/Internal Borrowing	50,000	0
Leasing	0	0
Capital Receipts	282,100	222,100
External Contributions	75,800	423,100
Revenue Contributions	93,000	219,500
Reserve Contributions	2,247,100	8,105,900
TOTAL	**2,748,000**	**8,970,600**

4. LONG TERM AND TEMPORARY BORROWING

4.1 The Council’s current long term borrowing portfolio consists of £136.157m PWLB debt. These loans were taken out to finance the HRA Self Financing settlement and the interest paid on this debt is entirely borne by the Housing Revenue Account and is provided for as part of the HRA Business Plan.
The first of these loans is scheduled to be repaid on 28th March 2053 with the final loan being repaid on 28th March 2062.

4.2 As part of their ongoing services, Capita Asset Services will monitor the debt portfolio during 2016/17 identifying, where appropriate, any opportunities for debt restructuring although these are expected to be minimal, if at all.

4.3 Should the Council engage in any long term borrowing during 2016/17, if deemed to be advantageous due to the expected path of interest rates, the Council may borrow in advance of need subject to prior appraisal of the risk and the borrowing must not take place in excess of 18 months before the anticipated need.

4.4 The major source of long term borrowing for local authorities is the Public Works Loans Board (PWLB) which is part of HM Treasury. However, the Local Government Association is in the process of creating an alternative called the Municipal Bond Agency. It is likely that this agency will be offering loans to local authorities in the near future. It is also hoped that the borrowing rates will be lower than those offered by the Public Works Loan Board (PWLB). Should this Council consider long term borrowing in the future then it will make use of this new source of borrowing as and when appropriate.

4.5 The Council will continue to engage in short term borrowing (up to 364 days) when necessary in order to finance temporary cash deficits, however by managing our cash flow effectively these will be kept to a minimum. In each case, wherever possible, the loan will be taken out for periods of less than 7 days in order to minimise the interest payable. To date in 2015/16 the Council has not incurred any short term borrowing and is not expected to do so in 2016/17 either.

5. TREASURY LIMITS AND PRUDENTIAL INDICATORS FOR 2016/17 TO 2018/19

5.1 It is a statutory duty under Section 3 of the Local Government Act 2003 and supporting regulations, for the Council to determine and keep under review how much it can afford to borrow. The amount so determined is termed the "Authorised Limit". The Council must have regard to the Prudential Code when setting its Authorised Limit, which essentially requires it to ensure that total capital investment remains within sustainable limits and, in particular, that the impact upon its future council tax / rent levels is acceptable. Whilst termed an Authorised Limit, the capital plans to be considered for inclusion incorporate those planned to be financed by both external borrowing and other forms of liability, such as credit arrangements e.g. finance leases. The Authorised Limit is to be set, on a rolling basis, for the forthcoming financial year and two successive financial years. The limits shown in the table in paragraph 5.2 include the impact of the HRA Self Financing debt settlement which took place on the 28th March 2012. It also includes the HRA "Headroom" which is the amount that the HRA can borrow between the debt settlement and the Debt Cap set under the Self Financing regime and also an allowance for potential new capital projects such as the leisure centre refurbishments, multi-storey car parks refurbishments and the proposed new offices.

5.2 The Authorised Limits to be recommended to Council by the Executive were included in the Budget report presented to the Executive on 10th February and need to be ratified by the Council at its meeting on 24th February. They are also displayed in the table below :-

Authorised Limit	**2015/16 (For Comparison) £,000**	**2016/17 Estimate £'000**	**2017/18 Estimate £'000**	**2018/19 Estimate £'000**
Debt	10,050	56,050	66,050	66,050
Add HRA Settlement	136,157	136,157	136,157	136,157
HRA Head Room	13,843	13,843	13,843	13,843
Other Long Term Liabilities	1,077	1,045	1,012	1,009
Total	161,127	207,095	217,062	217,059

5.3 The Prudential Indicators required by the code are explained in more detail in the report on the budget and those relevant to an integrated treasury management strategy are reproduced below:-

That the Council has adopted the revised CIPFA Treasury Management Code of Practice which it did in February 2011.

Capital Financing Requirement

Year	General Fund (inc. GF HIP element)	HRA	Overall
2015/16 (for comparison)	-£999,510	£135,786,796	£134,787,286
2016/17	-£949,510	£135,786,796	£134,837,286
2017/18	-£949,510	£135,786,796	£134,837,286
2018/19	-£949,510	£135,786,796	£134,837,286

The Capital Financing Requirement (CFR) as shown in the table above is a measure of the Council's underlying need to borrow in order to meet past capital expenditure. It will be noted that the negativity of the 2016/17 General Fund CFR has decreased when compared to the 2015/16 figure and also the 2014/15 actual which was -£1,326,896. This is due to the internal borrowing required to finance the Leisure Options project capital expenditure in the current General Fund capital programme. The CFR would normally be reduced by any provision for the repayment of debt each year. As the GF CFR is negative this is not required and in the case of the HRA debt redemption is not scheduled to start until year 41 (2052/53) of the current Business Plan.

Incremental Impact on Council Tax / Housing Rents

Year	Council Tax	Housing Rent
2015/16 (for comparison)	£1.35	£0.29
2016/17	£3.61	£0.45
2017/18	£2.86	£0.73
2018/19	£4.44	£1.01

Operational Boundary for External Debt

Operational Boundary	2015/16 (For Comparison) £,000	2016/17 Estimate £,000	2017/18 Estimate £,000	2018/19 Estimate £,000
Debt	1,050	13,050	13,050	13,050
Add HRA Settlement	136,157	136,157	136,157	136,157
HRA Head Room	13,843	13,843	13,843	13,843
Other Long Term Liabilities	77	45	12	9
Total	151,127	163,095	163,062	163,059

As a result of HRA Self Financing, the Council is also limited to a maximum HRA CFR. This limit is currently:-

HRA Debt Limit	2015/16 (for comparison)	2016/17 Estimate £m	2017/18 Estimate £m	2018/19 Estimate £m
Total	150.00	150.00	150.00	150.00

5.4 In addition certain indicators that used to be part of the Prudential Code are now part of the Treasury Management Code of Practice and are shown below :-

Upper limits to fixed interest rate and variable interest rate exposures on borrowing

Year	Upper Limit - Fixed Rate	Upper Limit - Variable Rate
2016/17	100%	30%
2017/18	100%	30%
2018/19	100%	30%

Upper and Lower Limits respectively for the Maturity Structure of Fixed Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	4%	0%
12 months and within 24 months	20%	0%
24 months and within 5 years	20%	0%
5 years and within 10 years	20%	0%
10 years and above	96%	0%

Upper and Lower Limits respectively for the Maturity Structure of Variable Interest Rate Borrowing

Period	Upper	Lower
Under 12 months	100%	0%
12 months and within 24 months	100%	0%
24 months and within 5 years	100%	0%
5 years and within 10 years	100%	0%

5.5 **Principal sums invested for periods longer than 364 days**

The total maximum sum that can be invested for more than 364 days is 70% of the core investment portfolio subject to a maximum of £20 million at any one time. However, where investments which originally were for periods of more than 364 days have 364 days or less to maturity at the 1st April each year they shall be classed from that date as short term i.e. less than 364 day investments and will not count against the 70% or £20 million limit.

6. BEST VALUE

6.1 The Council participates in Capita Asset Services' investment risk management benchmarking service in order to provide benchmarks against which the in house function could monitor its performance. The Council is part of a local group comprising both District and County Councils and our investment rate of return is benchmarked on a weighted average basis against the Capita Asset Services Model Portfolio and the returns experienced by the other club members. In 2016/17, the Council will seek to achieve a weighted average rate of return in line with the Capita Asset Services Model Portfolio which is based upon the best possible return whilst providing the maximum security for the capital invested.

6.2 The internal treasury function will also seek to achieve an average rate of return on its Money Market investments of 0.0625% over the LIBID (London Inter Bank Bid Rate) average for comparable investment periods (e.g. up to 7 day, 1 to 3 months, 3 to 6 months and over 6 months).

6.3 Should the Council employ external cash fund investment agents during 2016/17 suitable performance indicators will be agreed with the agents similar to that which operated under the previous Invesco agreement e.g. the fund will be required to outperform the Financial Times 7 day LIBID rate compounded weekly with a target return of 110% of the benchmark over a 3 year rolling period. Suitable benchmarks will also be agreed with Corporate Bond/Equity Fund managers in respect of any such funds opened with them.

6.4 The Council's performance is reported half-yearly to the Finance and Audit Scrutiny Committee.

7. EXTERNAL TREASURY MANAGEMENT ADVISERS

7.1 The Council employs Capita Asset Services – Treasury Solutions as its Treasury Management advisers. Following a procurement exercise they have been re-appointed for another three years with effect from 5th January 2015 with an option to extend the contract for a further two years.

8. BANKING SERVICES

8.1 The Council currently employs HSBC Bank to provide its banking services and. the current contract runs for 5 years from 1st March 2015 with the option to extend the contract for a further 5 years.

9. TRAINING

9.1 The CIPFA Code requires that members with responsibility for treasury management receive adequate training in treasury management. This especially applies to members responsible for scrutiny. Following the 2015 Council elections, our treasury consultants delivered in house training on 29th October 2015 to a number of Members.

9.2 Those officers currently involved in treasury management have received training from the Council's treasury consultants and this has been and will be kept up to date by regular attendance at seminars held by our consultants and also through other sources such as CIPFA publications and market intelligence.

10. OTHER

10.1 Although though not currently included in the Council's General Fund capital programme there are potential schemes in future years which may require the Council to significantly increase its external long term borrowing. These include the Leisure Centre refurbishments, refurbishing multi-storey car parks and new offices for the Council. These will have a significant on both the Council's treasury management operations and also its revenue budgets and the Treasury Management function will advise on the implications accordingly.

APPENDIX B 2016/17 ANNUAL INVESTMENT STRATEGY

1. BACKGROUND

1.1 This Council has regard to the Governments Guidance on Local Government Investments and CIPFA's updated Treasury Management in Public Services Code of Practice. Section 15(1) of the 2003 Local Government Act requires councils to have regard to such guidance as the Secretary of State may issue. Guidance was issued in 2004 and has subsequently been updated with the last major change being that Local Authorities who invest in Corporate Bonds no longer need to account for these as capital transactions i.e. capital expenditure. The general policy objective is that local authorities should invest prudently the temporarily surplus funds held on behalf of their communities. The borrowing of monies purely to invest or on-lend and make a return is unlawful and this Council will not engage in such activity. The guidance states that an Annual Investment Strategy must be produced in advance of the year to which it relates and must be approved by the full Council. The Strategy can be amended at any time and it must be made available to the public.

2. INVESTMENT VEHICLES AND CREDITWORTHINESS POLICY

2.1 In line with the guidance, this Annual Investment Strategy states which investments the Council may use for the prudent management of its treasury balances during the financial year under the headings of Specified and Non Specified Investments. These are listed in paragraph 2.12 and detailed in Annex 1.

2.2 Specified investments are defined as those with a high credit rating, as outlined in the table below for each type of investment institution or vehicle. Currently for deposits with Banks this is a Fitch (or Moody's and Standard & Poor's equivalents) sovereign rating at least equal to that of the United Kingdom at the point at which the investment was taken out, at least F1 short term and A+ long term (except in the case of a part or fully nationalised UK bank where the debts are guaranteed by the UK Government in which case the minimum long term rating is A). However, mindful of the need to maximise investment interest in the current low interest rate environment without significantly weakening the security of the investments a number of changes are proposed to both counterparty ratings and limits.

2.3 For banks, it is proposed to reduce the long term rating from A+ to A. This will give the Council additional counterparties such as Barclays and Santander, both of whom are active in the markets in terms of fixed term deposits and CD's. A is still an investment grade rating and it is considered unlikely that A rated institutions will experience financial difficulties threatening the security of the Council's deposits. As an additional precaution, investments with A rated counterparties will be limited to £3m per counterparty. In line with the change for Banks, it is recommended that the long term credit rating for Category A and B Building Societies also be lowered from A+ to A. An explanation of credit rating terms appears in Appendix D.

2.4 There has been an increase in the number of Variable Net Asset Value (VNAV) Money Market Funds (also known as Enhanced Cash Funds) in the market. Currently such investments are limited to a maximum of £6m per fund with a maximum of £6m in total over all funds. It is proposed to remove the overall limit so that it will be possible to have a maximum of £6m in any one VNAV MMF at any one time but an unlimited number of VNAV MMF's. It is anticipated that this will produce a useful increase in yield without compromising security as these funds are AAA rated and no fund has ever defaulted.

2.5 With regard to Corporate, Covered Bonds and Floating Rate Notes, it is proposed to reduce the minimum credit rating for categories 1 and 3 from Fitch A+ to Fitch A (or equivalent rating from Standard & Poors or Moody's). Over the past year, a number of corporate institutions e.g. Volkswagen and Heathrow Airport have offered bonds on the market at attractive rates but the Council has not been able to purchase these bonds due to the credit rating of the corporate being below the minimum required. The bonds were comparatively short dated (up to 364 days to maturity) so there was little likelihood of the corporate folding before the bond matured and therefore little risk to the security of the investment. The ability to access these bonds will provide additional yield with little additional risk especially in the case of covered bonds as these are backed by securities which can be sold in the case of difficulty in order to repay the investment.

2.6 In addition to credit ratings themselves, the Council will also have regard to any ratings watch notices issued by the 3 agencies as well as articles in the Financial press and market data. In addition to credit ratings the Council will also use Credit Default Swap data as supplied by Capita Asset Services – Treasury Solutions to determine the suitability of investing with counterparties. Credit Default Swaps (CDS) are a form of "insurance premium" against defaulting taken out by investors when making investments and if the Market perceives problems with the counterparty then the margin on the CDS will widen (i.e. the insurance premium will increase) thus providing warnings for future investors with that counterparty that it might have problems repaying their investment. The Council will monitor the CDS's on the counterparties within its lending list and if there are significant movements on a counterparty such as it moves out of a pre-determined range which will be determined with the aid of the Councils Treasury Consultants then that counterparty will be removed from the list until such time as it moves back within range.

2.7 For 2016/17, it is proposed to add two new investment vehicles, Repo's and Corporate Equity Funds to the list of Specified and Non Specified Investments respectively.

2.8 A re-purchase agreement (known as a Repo) is an agreement to sell securities and then buy them back at a later date at a specified price. The difference between the sale price and re-purchase price is known as the repo interest and represents the interest that the purchaser of the securities would receive when selling them back to the counterparty from whom they were purchased in the first place. Government bonds are the most common form of collateral but other forms of collateral exist although the use of these attracts a higher interest or Repo rate. Should the Council purchase any Repo's in 2016/17 these will be through its custodian, King & Shaxson who will monitor the current value of the collateral received by the Council and should that value dip below the purchase price paid by the council, request additional collateral from the counterparty to make up the difference. Should for any reason, the counterparty not be in a position to purchase back the collateral on the agreed date, the Council will be able to sell the collateral in its possession to make good its original investment thus avoiding any loss of capital.

2.9 It is intended that Repo's will sit alongside the other investment vehicles such as fixed term deposits, CD's and corporate bonds and form part of the overall limit per counterparty as outlined in Appendix B Annex 1. However, where the credit quality of the collateral e.g. Government Bonds offered by the counterparty exceeds that of the counterparty itself then the overall limit for the counterparty will be increased as stated in Appendix B Annex 1 with the increase being accounted for by the Repo investments. Repo interest rates are not significantly different from CD and fixed term investment interest rates but the ability to use Repo's will help manage the still historically high levels of investments expected during 2016/17 by giving access to additional counterparties and being able to invest more with selected counterparties.

2.10 The interest rate environment is expected to remain benign for the foreseeable future with the anticipated increases in Bank Rate being modest. As Bank Rate largely determines the interest rates received on the current portfolio, in order to significantly increase the Council's investment returns without overly compromising the security of the Council's investments, it has become necessary to look again at longer term investment vehicles and it is proposed to add Corporate Equity Funds to the Council's investment vehicles in 2016/17. The objective of a Corporate Equity Fund is long term growth through capital gains although dividends have also been an important source of total return. The value of the Council's investments in such funds will fluctuate over time as the prices of the equities in the fund change in relation to stock market movements so in order to gain the long term growth in capital it will be necessary for the Council to invest for a period of at least three years and probably nearer five. In order to do so it will need to identify how much of its core investments will not be needed for that length of time and can therefore be locked away in the fund without needing to be withdrawn early and therefore risking capital loss due to price fluctuations within the fund. The Council's Medium Term Financial Strategy, GF and HIP capital programmes and the Housing Revenue Account Business Plan are either being currently revised or are due to be revised in the near future and these exercises will provide the information required in order to determine just how much of the Council's core investments, which derive from its reserves and balances, can be locked away in longer term investment vehicles.

2.11 It should be noted that it will be necessary to "mark to market" the value of any equity funds at 31st March each year. This may result in the value of the fund at 31st March being either greater or less than the amount originally invested. Currently, accounting standards allow this fluctuation in value to be "reversed out" to the Financial Instruments Available For Sale reserve thus not impacting on the General Fund. However, this is under review and it is likely that the accounting standard will be changed so that any surplus or deficit in the value of the fund is charged to the General Fund and not reversed out. Should the fund be in deficit this would result in a real "hit" upon the Council's resources. Conversely, if the fund is in surplus then the surplus would be credited to the General Fund and increase resources. Should the Council invest in either Corporate Bond or Corporate Equity Funds, in order to manage the issue of deficits being charged to the General Fund it is proposed to utilise a "volatility" reserve whereby a certain proportion of the annual return on the fund is credited to the reserve and then when required released to revenue to either cover or at least mitigate the impact of any deficits.

2.12 In order to obtain the best possible return whilst protecting the investment capital it will be necessary to follow a balanced strategy which is best achieved through a spread of low, medium and high risk funds with a maximum investment limit per Corporate Equity Fund. It is necessary to set limits for each type of fund and in order to allow for capital growth it is proposed to set the following limits:-

Low Risk - £3m plus 10%
Medium Risk - £2m plus 10%
High Risk – £1m plus 10%

Once the capital growth in the fund reaches 110% of the original investment value i.e. in the case of a Low Risk fund £3,300,000 then the capital growth will be realised in order to bring the capital value of the fund back down to £3m, £2m or £1m respectively.

The limits above are in any case subject to the new proposed overall limit of £15m for Corporate Bond, Corporate Equity and Property Funds.

2.13 In relation to Corporate Equity Funds, the definition of what is low, medium or high risk will be based on a particular funds risk and reward profile as outlined in its Key Investor Information Document or KIID. The profile ranges from 1 (low risk) to 7(high risk) with 1 to 3 being low risk, 4 to 5 being medium risk and 6 to 7 high risk.

2.14 There are a large number of equity funds in existence so should such funds be approved for use in 2016/17 and once the Council has determined how much it can afford to invest and for how long, it will be necessary to formulate a policy governing the use of these funds including the timing of buying or selling holdings within these funds in agreement with the Head of Finance and then select suitable fund managers which match the Council's requirements in relation to returns, capital security and other aspirations such as ethical investment. This will be done in conjunction with our Treasury Advisors, Capita and will cover a range of criteria such as fund size, past performance, scale of fees, style of management (active or passive), minimum investment levels, performance targets, reporting arrangements and portfolio composition in terms of institutions agreeable to the Council. This list is not exhaustive and in all likelihood will also include presentations from each of the Funds ultimately short listed. The appointment of the fund managers will be managed in accordance with the Council's procurement practices but will be exempt from the requirements of the Public Contracts Directive. The Head of Finance has delegated authority to take all executive decisions in respect of Treasury Management therefore any decision to appoint fund managers will be taken by him. It will also be necessary to agree arrangements for monitoring performance of the funds whether this is done in house or by external advisers such as Capita.

2.15 The types of investment that the council can use are listed below and described in more detail in Annex 1. These are split under the headings of specified and non-specified in accordance with statutory guidance.

Specified Instruments (maximum period 364 Days)

Deposits with banks and building societies
Deposits with UK Government, Nationalised Industries, Public Corporations, UK Housing Associations and UK Local Authorities
UK Government Gilts with less than one year to maturity
Debt Management Agency Deposit Facility (DMADF)
Constant Net Asset Value Money Market Funds (AAA rated)
Variable Net Asset Value Money Market Funds (AAAf rated)
Certificates of deposits issued by banks and building societies
Corporate Bonds issued by private sector financial institutions
Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government
Corporate Bonds issued by corporates
Covered Bonds issued by private sector financial institutions
Covered Bonds issued by financial institutions partly or wholly owned by the UK Government
Covered Bonds issued by corporates
Supranational Bonds issued by Supranational Institutions or Multi Lateral Development Banks
Floating Rate Notes issued by private sector financial institutions
Floating Rate Notes issued by financial institutions partly or wholly owned by the UK Government
Floating Rate Notes issued by corporates
Eligible Bank Bills
Sterling Securities guaranteed by HM Government
Repo's

Non Specified Investments

Deposits with unrated building societies
Deposits with banks and building societies greater than 364 days
Deposits with UK Housing Associations and UK Local Authorities greater than 364 days
Certificates of deposits issued by banks and building societies greater than 364 days
Corporate Bonds issued by private sector financial institutions greater than 364 days

Corporate Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
Corporate Bonds issued by corporates greater than 364 days
Covered Bonds issued by private sector financial institutions greater than 364 days
Covered Bonds issued by financial institutions partly or wholly owned by the UK Government greater than 364 days
Covered Bonds issued by corporates greater than 364 days
Corporate Bond Funds
Regulated Property Funds including Real Estate Investment Trusts
CCLA Property Fund
Day to Day balances where Council's bankers do not meet the minimum bank credit rating criteria
UK Government Gilts with over 364 days to maturity
Supranational Bonds issued by Supranational Institutions or Multi Lateral Development with over 364 days to maturity
Corporate Equity Funds

2.16 It is necessary to outline the reasons why the Council would use non specified investments and also the risks involved. The use of unrated building societies alongside Business Reserve and Call Accounts and Money Market Funds forms a useful tool for investing relatively small amounts of money for short periods of time (up to 3 months) and obtaining a decent return on the investment. There is of course a risk that the Building Society may fail during the maximum 3 month duration of an investment but this is not considered likely. As an additional safeguard, the Council will only invest in Category C i.e. unrated Building Societies with an asset value of £500m and over. In addition, investments in category C building societies are restricted to a group limit of £8m. With regard to deposits for more than one year, the advantage from a treasury management point of view is that there is a known rate of return over the period that the monies are invested which aids forward planning. There is however the increased risk due to the longer time span that a) the institution fails or b) interest rates rise in the meantime. The current limit for investments longer than 364 days is 60% of the core investment portfolio subject to a maximum of £15 million at any one time and the maximum duration is 10 years for Property, Corporate Bond and Corporate Equity Funds,5 years for investments with other Local Authorities and 2 years for all other counterparties. In order to accommodate Corporate Equity Funds, it is proposed to increase the current limits to 70% and £20m respectively with a maximum of £15m invested in Corporate Bond/Equity/Property Funds.

2.17 No investments for more than 364 days excluding any forward deal periods will be made without the advice of our Treasury Consultants on the likely movement of interest rates over the period of the proposed investment and any investments over 364 days with building societies will be limited to £1m per counterparty**.** In the case of Property, Corporate Bond and Corporate Equity Funds, decisions to invest will be taken in conjunction with our Treasury Consultants and the respective Fund Managers.

2.18 As a means of further diversifying risk whilst obtaining a reasonable return for cash flow derived investments, the Council uses the SunGard Money Market Funds Portal which will enable it to open further Money Market Funds as necessary and to be able to see on a daily basis before deciding with whom to invest, which funds are offering the best rates.

3. INVESTMENT OBJECTIVES

3.1 All investments will be in sterling. The Council's investment priorities are the security and liquidity of its investments. The Council's objective will be to maximise the return whilst safeguarding as much as possible the capital sum and avoiding cash flow problems. The Council will not engage in borrowing for purely investment purposes.

4. SECURITY OF CAPITAL

4.1 The Council relies on credit ratings published by the three main Credit Rating agencies , Fitch Ratings, Moody's Investor Services and Standard & Poor's which are supplied to it by its Treasury Advisers., These ratings are used to establish the credit quality of counterparties and investment schemes. These institutions also issue regular ratings watch bulletins and where these are negative and affect one of our counterparties this will be taken into account when deciding whether or not to place future investments with them. The Council has also determined the minimum long term (365 days or more), short term (364 days or less) and other credit ratings it deems to be high for each category of investment and these are as shown in paragraph 2.2 above.

4.2 Individual credit ratings will be revised as and when changes are notified to the Council by its Treasury Advisers. If a counterparty's or investment scheme's rating is downgraded with the result that it no longer meets the Council's minimum criteria then the counterparty / investment vehicle will no longer be used with immediate effect. This also applies to investments placed by fund managers. Similarly if a counterparty is upgraded so that it meets the Council's minimum credit rating requirements then it will be added to the Council's counterparty list.

4.3 The Council will also use the Credit Default Swap (CDS) information supplied by its Treasury Consultants to determine levels of investments with its counterparties once they have been selected using the criteria set out in 2.2 above. Counterparties with an in range CDS (as determined by our consultants) will be invested in as per the limits defined for that particular category of counterparty . Those counterparties with either a monitoring or an out of range status will not be invested in until their CDS returns to within range.

5. INVESTMENT BALANCES / LIQUIDITY OF INVESTMENTS

5.1 Based on its cash flow forecasts, the Council anticipates that its investments in 2016/17 on average will be in the region of £57m of which £29m will be "core" investments i.e. made up of reserves and balances which are not required in the short term**.**

5.2 Subject to approval, the maximum percentage of its core investments that the Council will hold in long term investments (365 days or over) is 70%. It follows therefore that the minimum percentage of its overall investments that the Council will hold in short term investments (364 days or less) is 30%. Having regard to the Council's likely cash flows and levels of funds available for investment the amount available for long term investment will be a maximum of 70% of the core investment portfolio subject to a total of £20 million at any one time in line with the proposed Prudential Indicator covering this issue. These limits will apply jointly to the in house team and any fund managers so that the overall ceilings of 70% and £20 million are not breached.

6. INVESTMENT STRATEGY

6.1 The Council will continue to make use of MoneyMarket Funds (MMF's) and the Money Markets to invest cash flow driven money to known dates where large debts such as precepts, NNDR etc. have to be paid out. Based on the cash flow experienced to date in 2015/16 it is unlikely that this will result in the average length of a cash flow investment being more than 3 months in 2016/17 and probably considerably less. Core investments (i.e. investments not needed for payment of debts) will continue to be invested in the best part of the market based on the advice issued by our Treasury Advisers.

6.2 The 2016/17 interest rate outlook is for Bank Rate to rise to 0.75% by the end of 2016/17.Whilst this is welcome, in order to try and maximise the return on our investments whilst fully protecting the security of the capital, the Treasury Function has considered various ideas and it is proposed that Corporate Equity Funds and Repo's are added to the types of investment vehicles in which the Council is permitted to invest and any such investments will count against the overall limit for each type of counterparty as defined in the table in Annex 1.

6.3 Based on current investment policies and interest rate projections, it is currently estimated that the overall portfolio will achieve a 0.85% return for 2016/17.

7. EXTERNAL FUND MANAGERS

7.1 The performance of fund managers will be kept under review using the Council's Treasury Consultants and should it be felt appropriate to do so then the Council may engage fund managers in order to manage its investments in such vehicles as Cash Management, Corporate Bond and Corporate Equity Funds. The appointment process will be subject to the Council's procurement rules and handled in conjunction with our Treasury Consultants in order to ensure that the Council secures best value.

8. END OF YEAR INVESTMENT REPORT

8.1 In accordance with the requirements of the Treasury Management Code of Practice, the Treasury Management function reports on its in year activities to the Finance & Audit Scrutiny Committee twice a year i.e. at mid year and at the end of the year.

APPENDIX C

MINIMUM REVENUE PROVISION POLICY STATEMENT

1. BACKGROUND

1.1 Capital expenditure can be financed in a number of ways, not least of which is through borrowing and credit arrangements such as finance leases. The use of these 2 methods involves the Council in setting aside resources each year in order to eventually pay off the liability for example a maturing PWLB loan. Until recently, this set aside was prescribed nationally through Statutory regulations and was set at 4% per annum of the General Fund Capital Financing requirement (CFR). There was no similar requirement within the Housing Revenue Account although Council's could make voluntary provision if they so wished. The statutory regulations were superseded by statutory guidance issued under Statutory Instrument 2008 no.414 which says that " A local authority shall determine for the current financial year an amount of minimum revenue provision (MRP) that it considers prudent" .Where a Council's CFR at the end of the preceding year is nil or negative there is no requirement to charge MRP.

1.2 It is a requirement of the statutory guidance that a statement on the Council's policy for its annual MRP should be submitted to the full Council for approval before the start of the financial year to which it relates. The guidance offers four main options under which MRP could be made, with an overriding recommendation that the Council should make prudent provision to redeem its debt liability over a period which is reasonably commensurate with that over which the capital expenditure is estimated to provide benefits. Although four main options are recommended in the guidance, there is no intention to be prescriptive by making these the only methods of charge under which a local authority may consider its MRP to be prudent.

2. THE FOUR MAIN OPTIONS

Option 1 – Regulatory Method

2.1 This option is the old statutory method of 4% of the CFR and which has to be used in order to calculate MRP on all debt still outstanding at 1/4/08 and it can also be used to calculate MRP on debt incurred under the new system but which is supported through the annual SCE (Supported Capital Expenditure) allocation from DCLG.

Option 2 – Capital Financing Requirement Method.

2.2 This is a variation of option 1 and is based upon 4% of the CFR with certain changes and is appropriate where the borrowing is not linked to a particular asset.

Option 3 – Asset Life Method.

2.3 Under this option, it is intended that MRP should be spread over the useful life of the asset financed by the borrowing or credit arrangement. In future, where borrowing is utilised to finance specific assets it is likely that the period of the loan will match the expected life of the asset and therefore, under this method the annual charge to the Council's accounts is directly related to building up the provision required to pay off the loan when it matures which under options 1 and 2 is not possible.

2.4 There are 2 methods of calculating the annual charge under this option a) equal annual instalments or b) by the annuity method where annual payments gradually increase during the life of the asset.

Option 4 – Depreciation Method.

2.5 This is a variation on option 4 using the method of depreciation attached to the asset e.g. straight line where depreciation is charged in equal instalments over the estimated life and the reducing balance method where depreciation is greater in the early years of an assets life and which is most appropriate for short lived assets e.g. vehicles. In this Council's case assets are depreciated using the straight line method and so option 4 is not materially different from option 3.

3. HRA MINIMUM REVENUE PROVISION.

3.1 Under the Self Financing regime, the HRA Business Plan has to provide resources for the repayment of the £136.157m borrowed from the PWLB on the 28th March 2012. Repayment of this debt is currently provided for commencing in year 41 (2052/53) and continuing through to year 50 year of the Business Plan. Provision will also have to be made for any use made of the £13.843m "headroom" between the Self Financing debt settlement i.e. the PWLB borrowing and the "Debt Cap" imposed by the Government.

4. RECOMMENDATION FOR 2016/2017.

4.1 It is recommended that for any long term borrowing on the General Fund which is incurred in 2016/2017, the following methods of Minimum Revenue Provision be adopted:-

For borrowing which cannot be linked to a particular asset – Option 2.
For borrowing linked to a particular asset – Option 3 based on the annuity method.

4.2 For any borrowing incurred through Finance Leases, the annual principal repayments in the lease are regarded as MRP.

4.3 Although not strictly part of Minimum Revenue Provision requirements, it is also recommended that for internal borrowing (i.e. capital expenditure financed from reserves) , where appropriate, Option 3 based on the annuity method be adopted as a means of replenishing those reserves which financed the capital expenditure.

4.4 With regard to the HRA, annual MRP to be equal to any amounts set aside for debt repayment within the Business Plan which currently is nil for 2016/17.

APPENDIX D

AN EXPLANATION OF CREDIT RATING TERMS

1. Sovereign Credit Rating

1.1 Fitch assigns a long term credit rating to the country in which the financial institution being rated is domiciled. This credit rating assesses the economic health of the country including its ability to service its debt and also its capacity to support the banking system in that country should financial support be required. The assessment follows the normal long term rating scale, the highest rating being AAA with anything below BBB being non investment grade i.e. "junk bond status". The UK has a AA+ Fitch rating and the Council's policy is to invest only in institutions where the state in which they are domiciled has at least the same sovereign rating as the UK at the point in time when the investment was placed.

2. International Long - Term Credit Ratings

2.1 Long - term credit ratings are an attempt to assess the ongoing stability of an institutions prospective financial condition given such factors as sensitivity to fluctuations in market conditions and the capacity for maintaining profitability or absorbing losses in a difficult operating environment. Traditionally they look beyond a 12 month horizon. Investment grade ratings range from BBB to AAA.

2.2 Subject to approval, the minimum rating that WDC will use is A which is mid range in the ratings referred to above. A ratings denote a low expectation of credit risk. The capacity for timely payment of financial commitments is considered strong.

3. International Short - Term Credit Ratings

3.1 A short - term rating has a timescale of less than 12 months for most obligations and thus places greater emphasis on the liquidity necessary to meet financial commitments in a timely manner.

3.2 The minimum rating that WDC will use is F1. This indicates the strongest capacity for timely payment of financial commitments. It may have a + added to it to denote any exceptionally strong credit feature.

APPENDIX E

Capita Asset Services' View of the Economic Background

1. United Kingdom.

1.1 UK GDP growth rates in of 2.2% in 2013 and 2.9% in 2014 were the strongest growth rates of any G7 country; the 2014 growth rate was also the strongest UK rate since 2006 and the 2015 growth rate is likely to be a leading rate in the G7 again. However, quarter 1 of 2015 was weak at +0.4%, although there was a short lived rebound in quarter 2 to +0.7% before it subsided again to +0.5% (+2.3% y/y) in quarter 3. The Bank of England's November Inflation Report included a forecast for growth to remain around 2.5% – 2.7% over the next three years. For this recovery, however, to become more balanced and sustainable in the longer term, it still needs to move away from dependence on consumer expenditure and the housing market to manufacturing and investment expenditure. The strong growth since 2012 has resulted in unemployment falling quickly to a current level of 5.3%.

1.2 The MPC has been particularly concerned that the squeeze on the disposable incomes of consumers should be reversed by wage inflation rising back above the level of CPI inflation in order to underpin a sustainable recovery. It has, therefore, been encouraging in 2015 to see wage inflation rising significantly above CPI inflation which has been around zero since February. The Inflation Report was notably subdued in respect of the forecasts for CPI inflation; this was expected to barely 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 will be a sharp tick up from the current zero rate to around 1% in the second half of 2016. Indeed, the increase in the forecast for inflation at the three year horizon was the biggest in a decade and at the two year horizon it was the biggest since February 2013. Nevertheless, despite average weekly earnings ticking up to 3.0% y/y in the three months ending in September, this is unlikely to provide ammunition for the MPC to take action to raise Bank Rate in the near future as labour productivity growth has meant that net labour unit costs appear to be rising by about only 1% y/y. Having said that, at the start of October, data came out that indicated annual labour cost growth had jumped sharply in quarter 2 from +0.3% to +2.2%: time will tell if this is just a blip or the start of a trend.

1.3 There is, therefore, considerable uncertainty around how quickly inflation will rise in the next few years and this makes it difficult to forecast when the MPC will decide to make a start on increasing Bank Rate. There are also concerns around the fact that the central banks of the UK and US currently have few monetary policy options left to them given that central rates are near to zero and huge QE is already in place. There are, therefore, arguments that they need to raise rates sooner, rather than later, so as to have some options available for use if there was another major financial crisis in the near future. But it is unlikely that either would raise rates until they are sure that growth was securely embedded and 'noflation' was not a significant threat.

1.4 The forecast for the first increase in Bank Rate has, therefore, been pushed back progressively during 2015 from Q4 2015/16 to Q3 2016/17 and increases after that will be at a much slower pace, and to much lower levels than prevailed before 2008, as increases in Bank Rate will have a much bigger effect on heavily indebted consumers than they did before 2008.

1.5 The Government's revised Budget in July eased the pace of cut backs from achieving a budget surplus in 2018/19 to achieving that in 2019/20 and this timetable was maintained in the November Budget.

2. USA.

2.1 GDP growth in 2014 of 2.4% was followed by Q1 2015 growth, which was depressed by exceptionally bad winter weather, at only +0.6% (annualised). However, growth rebounded very strongly in Q2 to 3.9% (annualised) before dipping again in Q3 to 2.1%.

2.2 Until the turmoil in financial markets in August, caused by fears about the slowdown in Chinese growth, it had been strongly expected that the Fed. may start to increase rates in September. However, the Fed pulled back from that first increase due to global risks which might depress US growth and put downward pressure on inflation, as well as a 20% appreciation of the dollar which has caused the Fed. to lower its growth forecasts. Although the non-farm payrolls figures for growth in employment in August and September were disappointingly weak, the October figure was stunningly strong and, together with a likely perception by the Fed. that concerns on the international scene have subsided since August led to a first rate rise in December.

3. Eurozone.

3.1 The ECB fired its big bazooka in January 2015 in unleashing a massive €1.1 trillion programme of quantitative easing to buy up high credit quality government and other debt of selected EZ countries. This programme of €60bn of monthly purchases started in March 2015 and it is intended to run initially to September 2016. This appears to have had a positive effect in helping a recovery in consumer and business confidence and a start to a significant improvement in economic growth. GDP growth rose to 0.5% in Q1 2015 (1.0% y/y) but came in at +0.4% (+1.5% y/y) in Q2 and +0.3% in Q3. However, the recent downbeat Chinese and Japanese news has raised questions as to whether the ECB will need to boost its QE programme if it is to succeed in significantly improving growth in the EZ and getting inflation up from the current level of around zero to its target of 2%.

3.2 During July, Greece finally capitulated to EU demands to implement a major programme of austerity. An €86bn third bailout package has since been agreed although it did nothing to address the unsupportable size of total debt compared to GDP. However, huge damage has been done to the Greek banking system and economy by the initial resistance of the Syriza Government, elected in January, to EU demands. The surprise general election in September gave the Syriza government a mandate to stay in power to implement austerity measures. However, there are major doubts as to whether the size of cuts and degree of reforms required can be fully implemented and so a Greek exit from the euro may only have been delayed by this latest bailout.

4. China and Japan.

4.1 Japan is causing considerable concern as the increase in sales tax in April 2014 suppressed consumer expenditure and growth. In Q2 2015 quarterly growth shrank by -0.7% after a short burst of strong growth of 1.0% during Q1. Growth in Q3 was -0.8% so Japan is now back into recession for the fourth time in five years. It has been hit hard by the downturn in China during 2015. This does not bode well for Japan as the Abe government has already fired its first two arrows to try to stimulate recovery and a rise in inflation from near zero, but has dithered about firing the third, deregulation of protected and inefficient areas of the economy.

4.2 As for China, the Government has been very active during 2015 in implementing several stimulus measures to try to ensure the economy hits the growth target of 7% for the current year and to bring some stability after the major fall in the onshore Chinese stock market during the summer. Many commentators are concerned that recent growth figures could have been massaged to hide a downturn to a lower growth figure. There are also major concerns as to the creditworthiness of much of the bank lending to corporates and local government during the post 2008 credit expansion period. Overall, China is still expected to achieve a growth figure that the EU would be envious of. Nevertheless, concerns about whether the Chinese economy could be heading for a hard landing, and the volatility of the Chinese stock market, which was the precursor to falls in world financial markets in August and September, remain a concern.

5. Emerging countries.

5.1 There are also considerable concerns about the vulnerability of some emerging countries and their corporates which are getting caught in a perfect storm. Having borrowed massively in dollar denominated debt since the financial crisis (as investors searched for yield by channelling investment cash away from western economies with dismal growth, depressed bond yields and near zero interest rates into emerging countries) there is now a strong flow back to those western economies with strong growth and an imminent rise in interest rates and bond yields.

5.2 This change in investors' strategy, and the massive reverse cash flow, has depressed emerging country currencies and, together with a rise in expectations of a start to central interest rate increases in the US, has helped to cause the dollar to appreciate significantly. In turn, this has made it much more costly for emerging countries to service their dollar denominated debt at a time when their earnings from commodities are depressed. There are also likely to be major issues when previously borrowed debt comes to maturity and requires refinancing at much more expensive rates.

5.3 Corporates (worldwide) heavily involved in mineral extraction and / or the commodities market may also be at risk and this could also cause volatility in equities and safe haven flows to bonds. Financial markets may also be buffeted by the sovereign wealth funds of those countries that are highly exposed to falls in commodity prices and which, therefore, may have to liquidate investments in order to cover national budget deficits.

6. CAPITA ASSET SERVICES FORWARD VIEW

6.1 Economic forecasting remains difficult with so many external influences weighing on the UK. Our Bank Rate forecasts, (and also MPC decisions), will be liable to further amendment depending on how economic data evolves over time. Capita Asset Services undertook its last review of interest rate forecasts on 20 January 2016. There is much volatility in rates and bond yields as news ebbs and flows in negative or positive ways. This latest forecast includes a first increase in Bank Rate in quarter 3 of 2016/17.

6.2 The overall trend in the longer term will be for gilt yields and PWLB rates to rise when economic recovery is firmly established accompanied by rising inflation and consequent increases in Bank Rate, and the eventual unwinding of QE. Increasing investor confidence in eventual world economic recovery is also likely to compound this effect as recovery will encourage investors to switch from bonds to equities.

6.3 The overall balance of risks to economic recovery in the UK is currently evenly balanced. Only time will tell just how long this current period of strong economic growth will last; it also remains exposed to vulnerabilities in a number of key areas.

6.4 However, the overall balance of risks to our Bank Rate forecast is probably to the downside, i.e. the first increase, and subsequent increases, may be delayed further if recovery in GDP growth, and forecasts for inflation increases, are lower than currently expected.

6.5 Downside risks to current forecasts for UK gilt yields and PWLB rates currently include:

- Geopolitical risks in Eastern Europe, the Middle East and Asia, increasing safe haven flows.
- UK economic growth turns significantly weaker than we currently anticipate.
- Weak growth or recession in the UK's main trading partners - the EU, US and China.
- A resurgence of the Eurozone sovereign debt crisis.
- Recapitalisation of European banks requiring more government financial support.
- Emerging country economies, currencies and corporates destabilised by falling commodity prices and / or the start of Fed. rate increases, causing a flight to safe havens

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

- Uncertainty around the risk of a UK exit from the EU.
- The commencement by the US Federal Reserve of increases in the Fed. funds rate causing a fundamental reassessment by investors of the relative risks of holding bonds as opposed to equities and leading to a major flight from bonds to equities.
- UK inflation returning to significantly higher levels than in the wider EU and US, causing an increase in the inflation premium inherent to gilt yields.

APPENDIX F

GLOSSARY OF TERMS

Basis Point (BP)	1/100th of 1%, i.e. 0.01%
Bank Rate	Minimum lending rate of a bank or financial institution in the UK.
Benchmark	A measure against which the investment policy or performance of a fund manager can be compared.
Bill of Exchange	A financial instrument financing trade.
Callable Deposit	A deposit placed with a bank or building society at a set rate for a set amount of time. However, the borrower has the right to repay the funds on pre agreed dates, before maturity. This decision is based on how market rates have moved since the deal was agreed. If rates have fallen the likelihood of the deposit being repaid rises, as cheaper money can be found by the borrower.
Cash Fund Management	Fund management is the management of an investment portfolio of cash on behalf of a private client or an institution, the receipts and distribution of dividends and interest, and all other administrative work in connection with the portfolio.
Certificate of Deposit (CD)	Evidence of a deposit with a specified bank or building society repayable on a fixed date. They are negotiable instruments and have a secondary market; therefore the holder of a CD is able to sell it to a third party before the maturity of the CD.
Commercial Paper	Short-term obligations with maturities ranging from 2 to 270 days issued by banks, corporations and other borrowers. Such instruments are unsecured and usually discounted, although some may be interest bearing.
Corporate Bond	Strictly speaking, corporate bonds are those issued by companies. However, the term is used to cover all bonds other than those issued by governments in their own currencies and includes issues by companies, supranational organisations and government agencies.

Corporate Equity Fund	A managed fund that invests in stocks, also called equities securities. The fund's assets are typically mainly in stock, with some amounts of cash and bonds. The objective is long term growth through capital gains as well as dividends on the stocks held within the fund.
Counterparty	Another (or the other) party to an agreement or other market contract (e.g. lender/borrower/writer of a swap/etc.)
CDS	Credit Default Swap – a swap designed to transfer the credit exposure of fixed income products between parties. The buyer of a credit swap receives credit protection, whereas the seller of the swap guarantees the credit worthiness of the product. By doing this, the risk of default is transferred from the holder of the fixed income security to the seller of the swap.
CFR	Capital Financing Requirement.
CIPFA	Chartered Institute of Public Finance and Accountancy.
CLG	Department for Communities and Local Government.
Derivative	A contract whose value is based on the performance of an underlying financial asset, index or other investment, e.g. an option is a derivative because its value changes in relation to the performance of an underlying stock.
DMADF	Deposit Account offered by the Debt Management Office, guaranteed by the UK government.
ECB	European Central Bank – sets the central interest rates in the EMU area. The ECB determines the targets itself for its interest rate setting policy; this is the keep inflation within a band of 0 to 2%. It does not accept that monetary policy is to be used to manage fluctuations in unemployment and growth caused by the business cycle.
Equity	A share in a company with limited liability. It generally enables the holder to share in the profitability of the company through dividend payments and capital gain.
Forward Deal	The act of agreeing today to deposit funds with an institution for an agreed time limit, on an agreed future date, at an agreed rate.

Forward Deposits	Same as forward dealing (above).
Fiscal Policy	The government policy on taxation and welfare payments.
GDP	Gross Domestic Product.
Gilt	Registered British government securities giving the investor an absolute commitment from the government to honour the debt that those securities represent.
Money Market Fund	A well rated, highly diversified pooled investment vehicle whose assets mainly comprise of short-term instruments. It is very similar to a unit trust.
Monetary Policy Committee (MPC)	Government body that sets the bank rate (commonly referred to as being base rate). Their primary target is to keep inflation within plus or minus 1% of a central target of 2.5% in two years time from the date of the monthly meeting of the committee. Their secondary target is to support the government in maintaining high and stable levels of growth and employment.
Other Bond Funds	Pooled funds investing in a wide range of bonds.
PWLB	Public Works Loan Board.
QE	Quantitative Easing.
Repo's	Re-purchase agreement (Repo) to sell securities and buy them back at a later date at a specified price. The difference between the sale price and the re-purchase price represents the interest on the transaction.
Retail Price Index	Measurement of the monthly change in the average level of prices at the retail level weighted by the average expenditure pattern of the average person.
Sovereign Issues (Ex UK Gilts)	Bonds issued or guaranteed by nation states, but excluding UK government bonds.

Supranational Bonds	Bonds issued by supranational bodies, e.g. European Investment Bank. The bonds – also known as Multilateral Development Bank bonds – are generally AAA rated and behave similarly to gilts, but pay a higher yield ("spread") given their relative illiquidity when compared with gilts.
Treasury Bill	Treasury bills are short-term debt instruments issued by the UK or other governments. They provide a return to the investor by virtue of being issued at a discount to their final redemption value.